Report No. 48652-PK

June 2009

Pakistan

Public Expenditure and Financial Accountability Assessment of Federal Government

Government of Pakistan and Development Partners

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The World Bank Group

The European Commission

UK's Department for International Development

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GOVERNMENT FISCAL YEAR
July 1 – June 30

CURRENCY EQUIVALENTS

Currency Unit = Pakistan Rupee (PKR)
US$1 = PKR 80.56 (March 12, 2009 Floating Inter Bank Rate)

ACRONYMS AND ABBREVIATIONS

ABS	Annual Budget Statement
ADB	Asian Development Bank
ADR	Alternate Dispute Resolution (Tax)
AG	Accountant General
AGA	Autonomous Government Agencies
AGP	Auditor General of Pakistan
AGPR	Accountant General Pakistan Revenue
BER	Budget Execution Report
CARP	Customs Automated Reform Project
CFAA	Country Financial Accountability Assessment
CFAO	Chief Finance and Accounts Officer
CGA	Controller General of Accounts
CoA	Chart of Accounts
CRR	Cash Reserve Requirements
DAC	Departmental Accounts Committee
DAO	District Accounts Office
DDO	Drawing and Disbursement Officer
DfID	Department for International Development (UK)
DPCO	Debt Policy Coordination Office
DSSP	Devolved Social Services Program
EAD	Economic Affairs Department
EC	European Commission
FAM	Financial Audit Manual
FBR	Federal Board of Revenue
FD	Finance Division
FIFO	First In First Out
FMC	Fiscal Monitoring Committee
FRDL	Fiscal Responsibility and Debt Limitation (Act)
FY	Fiscal Year
GFMIS	Government Financial Management Information System
GFSM 2001	Government Finance Statistics Manual 2001
GoP	Government of Pakistan
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
LTU	Large Taxpayer Unit
LIFO	Last in First Out
MDA	Ministries, Departments and Agencies
MoF	Ministry of Finance
MTBF	Medium Term Budget Framework
MTDF	Medium Term Development Framework
NAM	New Accounting Model
NBP	National Bank of Pakistan
N/A	Not Applicable
NFC	National Finance Commission
PAAS	Pakistan Audit and Accounts Service
PAC	Public Accounts Committee
PAO	Principal Accounting Officer
PD	Project director
PE	Public Enterprises
PI	Performance Indicator
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PIFRA	Project to Improve Financial Reporting and Auditing
PLA	Personal Ledger Account
PPRA	Public Procurement Regularly Authority
PSDP	Public Sector Development Program
PRSP	Poverty Reduction Strategy Paper
RA	Revenue Administration
SBA	Stand-by Arrangement (IMF)
SAE	Self-Accounting Entity
SBP	State Bank of Pakistan
SN	Sub-National
SNE	Statement of New Expenditures
TARP	Tax Administration Reform Project
TMA	Tehsil Municipal Administration
USAS	Universal Self-Assessment Scheme (tax)
USAID	US Agency for International Development

PAKISTAN
PUBLIC EXPENDITURE AND FINANCIAL ACCOUNTABILITY ASSESSMENT OF FEDERAL GOVERNMENT

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Summary Overview of the PEFA Assessment

1. This Public Expenditure and Financial Accountability (PEFA) Assessment was undertaken by major development partners (the World Bank, Asian Development Bank, UK Department for International Development, and the European Commission) in conjunction with the Government of Pakistan (GoP). A Steering Committee, chaired by the Additional Finance Secretary, External Finance & Policy Wing, coordinated the PEFA Assessment. Its primary purpose is to establish an evidence-based assessment of the current status of Pakistan's Public Financial Management (PFM) system at the federal level The Assessment identifies PFM system strengths and weaknesses and provides a basis for further development of a reform strategy by the GoP that can be supported by all development partners. While the views expressed in the report were the subject of discussions at the stakeholders' workshop, they do not necessarily represent the views of the Government of Pakistan.

2. Chapter 3 of this report gives a detailed assessment of the federal PFM system against the 31 PEFA performance indicators (PIs). The indicators cover most PFM operations and identify areas of strength and weakness. The findings point toward both opportunities and risks that need to be addressed in developing a sustainable PFM strategy. Key conclusions, including relationships among PIs and their likely impact on aggregate fiscal discipline, strategic resource allocation, and efficient service delivery, are highlighted in this Summary Overview. While reviewing the key findings in the Overview, it is also important to look beyond the current ratings and identify those dimensions that appear to be on an improvement trajectory. The current PEFA snapshot described in Chapter 3 does not take such possible improvements into account in calculating PI scores. However, such factors are noted in the text, and several are critical to future improvements in PEFA ratings and in the formulation of the requisite reform strategy.

3. It needs to be noted that current reform programs have led to substantial improvements in the PFM systems. Two major PFM reform projects now underway, and described in Chapter 4, are the implementation of the Government Financial Management Information System (GFMIS) and the implementation of a Medium Term Budget Framework (MTBF). Together, these have contributed substantially to the current level of achievement against PEFA PI ratings. Even more importantly, continuation of the reforms initiated under these programs should contribute to substantial (and, in some cases, potentially rapid) improvement in PEFA scores in the future. More specific roles of these (and allied) programs are considered in more detail in the following sections summarizing each of the high-level sets of indicators.

I. PEFA Summary by High-level Indicators

A. Credibility of the budget

4. This PFM dimension is evaluated according to four PIs whose ratings are provided below

PI-1	Aggregate expenditure out-turn compared to original approved budget	**D**
PI-2	Composition of expenditure out-turn compared to original approved budget	**B**
PI-3	Aggregate revenue out-turn compared to original approved budget	**A**
PI-4	Stock and monitoring of expenditure payment arrears	**NS**

5. The performance on PIs 1-4 have attained relatively low PEFA scores in part because of recent economic shocks, but also because the budget system and fiscal and monetary policies have not been strong enough to react to the shocks experienced over the period 2005/6 to 2007/8. Revised policies in 2009, including elimination of SBP financing of the budget deficit and the phasing out of energy subsidies, should enable tighter control of the budget in the future. The GFMIS, which now can provide up-to-date tracking of expenditure and revenue for federal, provincial, and district levels of government, should also allow close monitoring of variance at all levels of government.

6. Consolidation and continuation of existing policies should thus enable substantial improvements in PEFA scores on this set of indicators in the near future. The proposed introduction of commitment accounting alone will have a favorable effect both on this area of PEFA scores and PI-24 (accounting, reporting, and recording—see below). A number of other elements, however, including structural aspects of the system of macro-fiscal management, will have to be thoroughly reviewed in developing a strategy that adequately addresses the issue of improving overall budget credibility.

B. Comprehensiveness and transparency

7. Six PIs comprise the basis for rating comprehensiveness and transparency of the PFM system. These are noted below along with their ratings.

PI-5	Classification of the budget	**A**
PI-6	Comprehensiveness of information included in budget documentation	**B**
PI-7	Extent of unreported government operations	**D+**
PI-8	Transparency of inter-governmental fiscal relations	**A**
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	**C+**
PI-10	Public access to key fiscal information	**C**

8. Recent reforms have helped to achieve relatively high scores on many elements of PI-5 to 10, which deal with the amount of information available in the budget system and documents and public access to this information. The implementation of a comprehensive and GFS-compliant chart of accounts (CoA) as an integral part of the GFMIS allows PFM data to be analyzed and presented in a variety of ways that support economic decision-making—though this functionality needs to be more fully utilized. The PEFA analysis points to several areas in which the GFMIS can be better used to make relevant information more readily accessible to recipients of public services, to the Parliament, and to the general public. Relatively small changes in current operations could lead to substantial improvements in terms of PI scores—with transparency improvements, in turn, leading to stronger public understanding and support of government programs.

C. Policy-based budgeting

9. The two PIs in this category, rated below, aim to give a picture of how responsive the budget is as an instrument for achieving the government's stated social and economic policies.

PI-11	Orderliness and participation in the annual budget process	**B+**
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	**C+**

10. These PIs were given moderate ratings, but there is considerable scope for improvement. The ratings reflect the introduction of the MTBF, which is to cover all federal ministries other than Defense from the 2009/10 budget, and a well-established budget calendar. It is noted, however, that the calendar itself is in transition because of the changes being introduced, and the budget framework needs major improvement, including through full integration of the development and non-development budget processes within the MTBF framework.

11. A critical aspect of the MTBF process that is highlighted in the PEFA assessment is that multi-year budget estimates (that is, beyond the current budget year) need to be clearly linked to future annual budget estimates and that differences between the annual estimates and previous forecasts for that year must be explained. This feature would add an important element of policy accountability to the budget process. Its achievement (which would be recognized in a higher PEFA score) should be given priority in the next stages of MTBF implementation.

D. Predictability and control in budget execution

12. A wide range of control functions, PIs 13 to 21, are included in this area of the PEFA, and their ratings are indicated below.

PI-13	Transparency of taxpayer obligations and liabilities	**B**
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	**B**
PI-15	Effectiveness in collection of tax payments	**D+**
PI-16	Predictability in the availability of funds for commitment of expenditures	**D+**
PI-17	Recording and management of cash balances, debt and guarantees	**B+**
PI-18	Effectiveness of payroll controls	**C+**
PI-19	Competition, value for money and controls in procurement	**C+**
PI-20	Effectiveness of internal controls for non-salary expenditure	**C**
PI-21	Effectiveness of internal audit	**D**

13. The overall scores were mainly in the C to D range, indicating significant concerns in the area of budget control. Some positive factors underlie this picture. Recent reforms in tax legislation and administration have helped improve transparency of taxpayer obligations and taxpayer registration systems (PI-13 and 14), but considerable problems remain in reducing the impact of remaining discretionary powers, improving compliance, and ensuring effectiveness of tax collection (PI-13, 14, 15). On the expenditure control side, major gains have been made through the introduction of a fully functional GFMIS for the core government ministries/departments/agencies (MDAs). This functionality, however, has not yet been fully extended to a number of self-accounting entities (SAEs) of federal government that constitute a significant part of the government non-salary and development spending. SAE controls, while applying New Accounting Model (NAM) standards, could be significantly strengthened by automation. This factor therefore points to the desirability of extending the GFMIS more fully to SAEs in the future.

14. Another element of expenditure control that has been recognized clearly within the GoP's ongoing PFM reform programs is the lack of development of line ministry capacity for internal financial control and management. As highlighted in PI-20, the present system of control relies heavily on central control by the MoF through its Financial Advisors, who are given responsibility for sanctioning all line ministry commitments. This system, while imperfect and open to abuse, ensures that commitments are generally held within available cash limits. The GFMIS and the MTBF, however, now offer a functionality that, once fully implemented, would give ministries the assurance of system-based controls and allow them to control their own budgets within authorized limits. A major effort is required, however, to establish an effective financial administration within the line ministries. One of the critical weaknesses in this regard that is highlighted by a D-level score on PI-21, is the lack of development of any effective internal audit function within government ministries.

15. An assessment of Pakistan's procurement system under OECD/DAC guidelines carried out in parallel with this PEFA assessment indicates in detail the substantial improvements required to establish a transparent, efficient, and effective procurement system. These conclusions are also reflected in the PEFA score for PI-19. The low score obtained on evidence on use of competition arises more from the lack of data than from direct evidence of non-competitive awards. Improved data and reporting, removal of opportunities for discretion, and establishment of an effective complaints mechanism could rapidly improve the PI-19 scores. The Pakistan Public Procurement Authority is actively engaged in supporting government to improve on its procurement processes and practices through a host of capacity building measures.

E. Accounting, recording, and reporting

16. This dimension is assessed according to four PIs, whose ratings are provided below

PI-22	Timeliness and regularity of accounts reconciliation	**C+**
PI-23	Availability of information on resources received by service delivery units	**B**
PI-24	Quality and timeliness of in-year budget reports	**C+**
PI-25	Quality and timeliness of annual financial statements	**B+**

17. Although very significant progress has been made in this area as a result of the GFMIS established under the World-Bank-supported PIFRA project, many of these benefits have only just begun to take effect. The PEFA scores, while moderately high overall, do not yet reflect the full extent of these achievements. The impact on government, moreover, is not yet comprehensive because a number of SAEs remain outside the GFMIS. Under PIFRA, considerable efforts have been made and continue to be made to improve the overall reliability of reports. These efforts include re-engineering of some processes to eliminate misuse of public accounts, and improving system connections and reconciliation processes among key financial management agencies such as AGPR, the FBR, the EAD, and the banking system (particularly the SBP and NBP).

18. Areas such as bank reconciliation, availability of information on resources by service delivery units, quality and timeliness of in-year reports, and quality and timeliness of annual financial statements have all improved remarkably over past performance. The preparation of the

IPSAS-compliant financial statements of the federal government was completed within six months of the end of FY 2007/08 and rendered for external audit – an achievement never realized in prior years. High-level performance is expected in all of these and other areas by the completion of the PIFRA project. By the same token, it is imperative for future strategy, that these gains continue to be maintained and further developed after the current project is completed.

F. External scrutiny and audit

19. This facet of PFM is evaluated using three PIs, whose ratings are in the table below.

PI-26	Scope, nature and follow-up of external audit	**C+**
PI-27	Legislative scrutiny of the annual budget law	**D+**
PI-28	Legislative scrutiny of external audit reports	**D+**

20. Despite significant improvements in audit practice and performance in recent years as a result of the PIFRA reforms, there are substantial continuing weaknesses in most aspects of this area of the PFM system.

21. The scope, nature, and timeliness of audit by the AGP have improved enormously relative to past practice as a consequence of computerization of the accounts and the application of systems and risk-based audit throughout government. These reforms have made government external audit both more efficient and more relevant to PFM issues. The score on timeliness, however, remains low because it is expected that audit reports can be submitted to Parliament within a more reasonable time after the draft public accounts are received by the AGP. Very good progress has been achieved in this area: the accounts of FY 2008/09 have already been audited and certified by the AGP barely within 3 months of receipt of the draft accounts from the AGPR. Follow-up to audit reports by the executive remains weak, but is getting increasing attention under current reform programs.

22. The PI scores in this area also reflect continuing weaknesses in legislative scrutiny of the budget and of external audit reports. Important issues in this regard are: first, the relatively short time (by international standards) given for parliamentary review of the budget; and, second, the power given to the executive to amend the budget within-year with only ex-post legislative authorization – a requirement that is accepted under the Pakistan Constitution. Particularly in light of the wide-ranging changes being introduced to the budget process through the MTBF, there appears to be a need to strengthen legislative authority substantially in both respects.

23. Historically, the record of parliamentary review of AGP reports through the Public Accounts Committee (PAC) has also been weak both in timeliness (with over 15 years of review back-log) and quality. Under the present PAC, however, significant steps have been taken to improve both aspects. Attention is now focused particularly on substantive issues arising from the most recent reports, though steps have also been taken to clear the backlog of audit reports from previous audit years. Continued strengthening of legislative performance in this area will be critical to achieving sustainable PFM reform.

G. Donor practices

24. Donor practices are evaluated along three dimensions, as indicated below.

D-1	Predictability of Direct Budget Support	**A**
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	**C+**
D-3	Proportion of aid that is managed by use of national procedures	**C**

25. Donor practices received a favorable overall rating, including making relatively good progress toward increasing the use of national procedures for managing donor funds. Further rapid improvement in this aspect is, however, crucial to improving the performance of the national PFM system. The current non-inclusion of donor funds in the national system is a significant contributing factor to the low score achieved in PI-7. As noted in Chapter 3, steps are being taken to overcome this problem with the full cooperation of all development partners.

II. PEFA Scores and Strategic PFM Priorities

26. Many further steps are necessary to move from the PEFA scores to developing a strategy for sustainable PFM reform. Foremost, the GoP needs to review the implications of the PEFA assessment thoroughly and determine which areas of PFM administration constitute priority areas for improvement. A range of stakeholders within the GoP must be included in the review process to help ensure full ownership of the strategy that is ultimately developed. This overview aims to assist this process by highlighting some key considerations in setting priorities.

27. Table 1, at the end of this summary, presents a framework that relates PEFA performance indicators and the strengths and weaknesses identified in Chapter 3 to four strategic PFM objectives. Three are technical objectives against which all PFM systems should be designed:[1] *Aggregate Management*, concerned with establishing a stable macro-economic framework and overall fiscal discipline; *Strategic Management*, concerned with setting of sectoral priorities and allocative efficiency; and *Operational Management*, concerned with efficiency and effectiveness of service delivery. Because they are aimed at different aspects of the PFM systems, the nature of risks that need to be addressed, and thus the mitigating measures required, differs significantly among the objectives.

28. A fourth strategic objective, *Transparency and Accountability*, is separately identified, because it is linked to the *public obligations* of PFM systems—although many elements contribute equally to one or more of the technical objectives. This objective relates particularly to the “Comprehensiveness and Transparency” and “External Scrutiny and Audit” core sets of PFM PIs. Its importance is that it is less concerned with technically-defined (sometimes called “supply-driven”) solutions to PFM weaknesses than with meeting parliamentary and public needs for accountability of the PFM system. This objective most closely corresponds to “demand-led” incentives for PFM reform, aimed particularly at strengthening parliamentary capacity and public and parliamentary demand for reform. Weaknesses in this area are

[1] See Annex 1 of *Public Financial Management Performance Measurement Framework*, June 2005 (PEFA Secretariat: Washington DC) for an illustration of the broad relationship between these objectives and the six core (high-level) sets of PFM performance indicators

potentially a source of very high risks for sustainability of reforms. Experience with PFM reform programs is making it increasingly clear that even well-designed technical measures do not provide lasting solutions, unless they are given sustained political support and become widely understood and accepted by the public.

29. The following sections briefly review the strengths, opportunities, and risks against each of these strategic objectives based on the PEFA performance assessment.

A. Strengths of PFM reforms to date

30. First, it is worth briefly reviewing the overall strengths of the present system as a basis for future reforms. Column 1 of Table 1 indicates the broadly sound basis for PFM reforms that is being established through current reforms, particularly the establishment of the GFMIS, and the progress made in establishing the MTBF. Much remains to be done in fully utilizing the fiscal and financial reporting capabilities of the GFMIS; and full implementation of an MTBF has been challenging for many emerging market countries. The stage that Pakistan has now reached, including the establishment of a GFMIS that can handle an output/outcome budget classification and timely reporting requirements needed for an MTBF, should enable it to meet these challenges. In both the GFMIS work and in initiating the MTBF, major institutional change hurdles have had to be overcome. It is essential in moving forward that these lessons are taken fully on board and that a broad coalition of stakeholders gives full support to the development of a comprehensive PFM reform strategy. This point will be discussed further in the final section of this overview.

B. Aggregate management

31. Many of the elements of sound macro-economic management have now been put in place as a result of recent reforms. The GFMIS provides a better fiscal information base than has been available in the recent past, but it needs further development and a number of other areas of macro-fiscal administration need to be addressed.

32. Both the MTBF Secretariat of the MoF Budget Wing, and the DPCO, have developed frameworks to establish macro-economic limits to fiscal spending and borrowing. Similar work is also undertaken by the Planning Commission, the Policy Wing of the MoF and the SBP. All of these activities could be better coordinated and linked more clearly to underlying expenditure policies and fiscal risks.[2] The need for some restructuring along these lines has been highlighted by the recent financial crisis and by the adjustments that have been necessitated under the current IMF SBA. In addition, a stronger legislative oversight of fiscal policy and its implementation (see discussion of accountability below) would help strengthen aggregate management over the long term.

[2] In this context, a significant aggregate management risk with regard to budget financing under public private partnerships (PPP) is highlighted in the procurement study carried out in parallel with this PFM report, which notes the absence of a stated PPP policy (pillar III, indicator 7(a). Such a policy should, among other things, define the approach taken to sharing of risks between the government and private sector.

33. Continuing attention is needed to improve the effectiveness of tax collection. Likely further efforts will be required after completion of the present Tax Administration Reform Project (TARP).

C. Strategic management

34. In many ways, development of an effective strategic management capacity presents the greatest medium-term challenges to further development of the PFM system. An MTBF, in principle, provides the means to harness both the technical expertise of line ministries and the broad vision of central agencies such as the Planning Commission and the MoF. The analytical and reporting capacity of the GFMIS will help toward this end, particularly by implementing its program classification function to link activities to outputs. But a critical area of development that is missing currently is a strong planning and management capacity within the line ministries. Such a capacity cannot be created in a short time span. While the MTBF has made a good start toward this end, it will need a sustained effort both to support the line ministries and to re-define the relationship between the Planning Commission and the line ministries. This topic will require a great deal of further debate in taking the next steps toward a PFM strategy.

35. Intergovernmental relations, while scoring highly on the PEFA scores also pose a number of challenges over the longer term. At this stage of development, however, establishing a strong PFM system that provides information and controls throughout government has major advantages for all levels of government in Pakistan. Improvements in intergovernmental dialogue, as advocated in the text, however, should be included in a PFM reform program.

D. Operational management

36. In principle, the GFMIS provides a very sound, albeit incomplete, basis for much more effective operational management by line ministries. It is important that these capacities should also be extended to the federal SAEs. The immediate implementation of commitment accounting functionality is another clear priority. The most critical weakness, however, is the absence of real executive financial control at line ministry level. At present, ministry commitment controls are exercised by the MoF through their Financial Advisors (FAs). While Chief Finance and Accounts Officers (CFAOs) have been appointed to a number of ministries, these officers have no authority to allow commitment against budget releases. The possibilities of trade-off between recurrent and development spending are also limited by the dual budget system. In turn, these limited capacities mean that line ministries lack incentive or ability to use available resources to achieve outputs and outcomes efficiently.

37. Given the recent development of the GFMIS, it should now be possible to transfer real authority to line ministries and begin the development of effective operational management in line ministries. This action will be critical also to achieving more effective strategic management capacity over the medium-term. By the same token, failure to implement these changes will pose a high risk for future development of the PFM system overall.

38. The CFAO position, once soundly established, will be a focal point for ensuring effective implementation of commitment accounting and reporting. It will also be the focal point for ensuring prompt departmental audit committee (DAC) response to external audit and PAC

recommendations. An effective CFAO position is thus a crucial link between the executive and parliamentary and public accountability.

E. Transparency and accountability

39. Because of the impact of PIFRA on financial and fiscal reporting, budgeting, and audit, a relatively sound basis has been established to achieve a good practice standard of fiscal transparency and accountability.[3] A weakness, however, is that information already largely available in the system is not readily accessible by the public—or indeed by parliament. Relatively small changes are required for instance to improve the budget presentation by adding (now more readily available) data on the prior year's budget to the current budget document. Public access to a variety of budget and accounts information could easily be granted through the MoF and AGPR websites. Substantial improvements in the standard of external audit have also been achieved as noted above.

40. Key remaining weaknesses that have been highlighted in the PEFA, as noted above, include poor responsiveness of the executive to audit and PAC recommendations and limited time and authority for the legislature to review fiscal policy, the budget estimates, and spending during the year. It will take time and sustained effort to address these issues, but improvement in this area is vital to long-term reform.

41. Further improvements in transparency and accountability will thus require a combination of immediate consolidation of improvements that have been put in place to make data more readily available to the public, and a long-term program to strengthen the role of the legislature. These efforts could also be helped by efforts to encourage the development of civil society groups that can independently examine government budget operations.

III. Toward Reform Planning and Implementation

42. The preceding sections provide material that can be used by the GoP to plan future development of a PFM reform strategy and action plan. A good basis has been established under the present program of reforms, but, as noted, the present program by no means constitutes a coordinated national PFM strategy. Experience in implementing separate programs has led to a measure of coordination between them, but this level of cooperation was not included in the original design.

43. A second feature of the present reforms is that there has been a continuing failure to address underlying structural issues. Civil service reform has tackled marginal issues rather than the fundamental structural problems. Such matters will take time and are highly dependent on high-level political support to have any chance of success. Nonetheless, it is vital to attempt to build a coalition of all significant stakeholders to move Pakistan to the next and crucial stage of its PFM reforms. The foundation created from the separate programs that have been initiated and the level of success that has been achieved have laid the ground for further reform. It will be

[3] Pakistan has also participated in and published on the IMF website http://www.imf.org/external/np/rosc/rosc.asp fiscal transparency assessments (Reports on the Observation of Standards and Codes (ROSCs) in 2000, with updates on 2002, 2004, and 2008. IMF data dissemination ROSCs were also published for 2004 and 2007. A number of the recommendations of these ROSCs were implemented by the authorities.

essential to create an appropriate representative group to carry the next stage forward and develop a strategy that enjoys support from all of the organizations involved.

44. Future reform strategy should aim to establish support both at a high political level and across the most relevant section of the civil service. A number of suggestions are put forward for consideration:

- The MoF will clearly play a central role, but structural change involving both the MoF and the Planning Commission should be part of the agenda. The Ministry of Establishment should play a role from this point of view, as well as permitting consideration of broader civil service issues of pay and promotion insofar as these affect PFM reform.
- It will also be essential to include some representation from key line ministries.
- To address the political and civil service dimensions of the reform, it will be desirable to establish a high-level Council at a political level, and a technical PFM Reform Committee with representation from the key agencies along the lines suggested above.
- All of the provinces have now completed PEFA assessments, and many of the issues identified above, as well as strengths and weaknesses, are common to all levels of government. A coordinated approach would be highly desirable, possibly by some form of provincial representation in a national PFM reform process.

Table 1 PEFA Scores and Strategic Priorities

Strategic Objective		Strengths and Opportunities	Risks to be Addressed
Technical objectives	Aggregate management	A comprehensive CoA and reliable aggregate budgeting and reporting has been established in GFMIS (PI-1).	Budget credibility is weak (PI-1-4).
		MTBF and DPCO are establishing overall fiscal frameworks for budget management (PI-11).	Macro framework is loosely coordinated, with some conflicting responsibilities (PI-11).
		A multi-year budget perspective has been established (PI-12)	Forward estimates are not yet linked to annual estimates; development and non-development budgets are not integrated. (PI-12).
		Fiscal risks are identified and partially controlled (PI-9).	Risks are only partially covered and risk analysis is not well integrated with the budget (PI-9). PPP policy, including risk-sharing, is not defined (OECD-DAC-BIS).
		Debt policy and management are established and data are being improved (PI-11).	As above, coordination with other elements of fiscal policy needs strengthening.
		Tax legislative framework and administration have been strengthened (PI-13, 14).	Effectiveness of tax collection remains weak (PI-14).
		Basic fiscal overview is being provided to legislature (PI-6, 27).	Legislature has insufficient time or procedures for effective fiscal policy scrutiny or in-year review (PI-27).
		The GFMIS and process changes have improved timeliness and quality of year-end financial statements. (PI-25) and fiscal reports (PI-1,7).	Further enhancements be incorporated over time (PI-25).
		The budget process is relatively orderly, with no extra-budgetary funds (PI-7, 11); good progress made in reconciliation (PI-7).	Management in line ministries is weak, and public account operations complicate expenditure allocation and tracking (PI-7, 20); reconciliation issues to be fully resolved (PI-7).
	Strategic management	CoA allows analysis of budget and spending by function and program and can be used for PRSP reports (PI-5).	Use of program classification has not yet fully implemented. (PI-12).
		The MTBF has initiated "bottom-up" planning and management in line ministries (PI-12).	As above, management in line ministries is weak (PI-20). Predictability in availability of funds is weak (PI-16).
		Intergovernmental fiscal relations are rule-based and transparent (PI-8).	Improvements in transparency and intergovernmental discussion of at-source deductions from awards are desirable.
	Operational management	The MTBF provides more authority for line ministries to plan, allocate, and manage ministry resources (PI-12).	As above, Financial Advisors retain key controls, and line ministry management is weak (PI-20); dual budgeting limits possibilities of trade-off between development and recurrent spending (PI-12).
		The GFMIS provides functionality for	Full functionality does not extend to

Strategic Objective		Strengths and Opportunities	Risks to be Addressed
		internal financial control and management for federal, provincial and district government (PI-18,20).	federal SAEs (PI-18, 20); commitment accounting functionality is not yet in place (PI-6, 24); weak financial control function in line ministries (PI-16); cash forecasting and cash management are not yet established (PI-17); internal audit is not established (PI-21).
		The GFMIS and process improvements have improved reconciliation processes (PI-22).	Further enhancements are needed for consolidation (PI-22).
		The GFMIS has established timely, reliable, and relevant monthly budget execution reports to ministry PAOs (PI-24).	Further enhancements (including commitment accounting) are required for consolidation (PI-24).
		A Federal Public Procurement Regulatory Authority has been established (PI-19).	PP rules and their application are inadequate to ensure competitive procurement or adequate complaints handling mechanisms.
Public obligations	**Transparency and accountability**	Modern systems and risk-based audit is now widely applied throughout government (PI-26).	Executive follow-up of external audit is weak (PI-26); legislative scrutiny of external audit reports requires continuing strengthening (PI-28).
		Relatively comprehensive information is included in budget documents (PI-6); and basic fiscal policy documents are provided to legislature (PI-27).	Legislative scrutiny of the annual budget law is given limited time, procedures have not been developed to assess fiscal policy prior to detailed estimates review, and only ex post authorization of in-year changes by executive are required (PI-27); significant improvements should be made in the quality of budget information and its organization during the budget cycle (PI-6).
		The GFMIS incorporates a comprehensive CoA that provides data by economic, functional (both GFS-compliant) , administrative, and program classifications (PI-5).	Analytical reporting is to be upgraded to use functionality (PI-5); and program classification is to be fully developed for MTBF (PI-12).
		The GFMIS provides a means whereby a wider range of relevant budget information can be made available to the public (PI-10).	A number of weaknesses in the provision of available data to the public remain to be addressed fully (PI-10).
		There are no unreported expenditures, and reconciliation is being improved through the GFMIS (PI-7).	Further action is required to eliminate reporting errors from the public account and integrate donor fund transactions (PI-7/D-3).
		PPRA and basic regulations are in place (PI-19).	Procurement transparency and accountability mechanisms need strengthening. (PI-19).
		Data on fiscal risk and sustainability are made available in the budget documents (PI-9).	Further development of budget documents is required to provide more complete analysis to the public (PI-6,9)].

Chapter 1: Introduction

1.1 This Public Expenditure and Financial Accountability (PEFA) Assessment[4] applies the PEFA framework and methodology to provide a snapshot of the current status of the federal government's public financial management (PFM) system.[5] This picture will serve three main purposes. It will:

- Establish an evidence-based database of information that can be developed and maintained by the GoP and development partners to monitor progress of PFM reform programs
- Identify key strengths and opportunities, weaknesses and risks as a basis for continuing PFM reform
- Serve as a starting point for developing a PFM reform strategy to be developed by the GoP and which can be supported and monitored over the long term by the GoP and its development partners.

1.2 The PEFA framework consists of 28 performance indicators (PIs) of the level of achievement of the national PFM system, plus 3 PIs that indicate performance on donor activities. The former are grouped into 6 high-level (or core) sets of indicators that relate to a broad dimension of the PFM system (such as "budget credibility," "policy-based budgeting" etc.). The performance indicators each have one or more dimensions that are scored on a rating system from A (high) to D (low) according to a clearly defined set of descriptive or quantitative data. For multi-dimensional ratings an overall indicator score is calculated by one of two clearly defined methods.[6]

1.3 Chapter 3 of this report provides a detailed assessment of the federal government's PFM system. The scores, plus a summary of the rationale for each score based on the PEFA framework guidelines, are given in a table, and a more detailed description of the evidence for the score is given in the text. All evidence has been discussed thoroughly with the GoP officials and the assessment has been subject to peer review as part of the World Bank process, as well as from other development partners. The evaluation work was carried out under the direction of a

[4] The assessment was carried out by the Development Partners The World Bank (WB), Asian Development Bank (ADB), the European Commission (EC); the UK Department for International Development (DfID); and the US Agency for International Development (USAID); the task team comprised Ismaila B Ceesay (WB, Co-task leader), Peter McDermott (DfID, Co-task leader), Frank Hess (EC, Co-task-leader), Lucy Arthur (ADB, Co-task leader), Asif Ali (WB, Co-task leader), Hanid Mukhtar (WB, Co-task leader), Clinton White (USAID Co-task leader), with assistance from development partner key staff :M. Asif Shah, ADB; Furqan A. Saleem, WB; Altaf Ahmad, WB; Shiraz Ashraf, USAID, and Wajahat Anwar, DfID); and local and international consultants (William A. Allan - international consultant; Shershah Khan, Zeeshan Tariq and Naveed Saeed – national consultants).

The PEFA Secretariat, The World Bank, USA and The IMF, Fiscal Affairs Department, Washington DC, USA provided most useful and valuable comments that helped the task team to enhance the quality of the report.

5 This snapshot can be viewed in relation to the 2003 Country Financial Accountability Assessment (CFAA), which provides an earlier assessment against a framework with many similar dimensions.

6 M1: weakest-link, where dimensions are perceived as interdependent and a low score for one dimension limits the overall score to that level plus (e.g., D+); and M2, a calibrated average score, if the dimensions are thought to be more independent.

GoP Steering Committee, chaired by Mr. Asif Bajwa, Additional Secretary (External Finance & Policy Wing), MoF. It was initiated in December 2008 and substantially completed by early April 2009, with continuing dialogue on key points through to end-April. A stakeholders' workshop, on April 20-21, 2009, discussed an earlier draft in an open dialogue forum with the government, including representatives from provincial governments, and other interested stakeholders. The present draft incorporates agreed changes that have resulted from these dialogues.

1.4 The report makes no recommendations on policy matters—it is specifically concerned with the status of the PFM system and issues relating to financial management processes. It does suggest weaknesses and strengths as well as possible priority areas to take advantage of strengths or to address higher-risk weaknesses. It makes no recommendations, however, on specific measures or action plans. The report provides a basis for these matters to be taken up subsequently, but, consistently with the PEFA framework, they should be subject to a separate discussion during the formulation of a government-led PFM reform agenda.

1.5 The structure of the PFM Performance Report is as follows:

- Chapter 2 gives background information and the country economic, fiscal, and institutional context.
- Chapter 3 provides details on each PI score.
- Chapter 4 summarizes the government's ongoing PFM reform programs.
- Annex 1 gives a summary of the PEFA assessment; Annex 2 provides sources of information, including a list of documents reviewed and officials consulted; and Annex 3 shows key organizational elements of Pakistan's PFM structure.

Chapter 2: Country Background Information

A. Country economic situation

2.1 Pakistan is a predominantly agricultural country, with about two thirds of its population living in rural areas. Its major industries are textiles, leather and food processing, with recent development particularly in the services sector. A growing population with limited land and water resources has led to urban migration beyond the capacity of the industrial sector to absorb. The GoP completed its second Poverty Reduction Strategy Paper (PRSP II) in December 2008, taking recent global developments into account while continuing to address these long-term issues. The PRSP II focuses on regaining macro-economic stability and a growth momentum of 5-7 percent per year, while protecting the poor and vulnerable. Selected economic indicators for Pakistan, giving a snapshot of development as at 2007/08-09, are given in Table 2.1 below.[7]

Table 2.1 Pakistan: Selected Economic Indicators: 2007/08–2009/10

	2007/08	2008/09 (projected)
Population (million)	160.9	
GDP and Price		
Real GDP growth at factor cost (percent)	5.8	2.5
Per capita GDP (US dollars)	1,042	
Consumer prices (period average)	12.0	20.0
Consumer prices (end of period)	21.5	10.0
Public finances (percent of GDP)		
Revenue and grants	14.6	15.4
Expenditure (including statistical discrepancy)	21.7	19.6
Budget balance (including grants)	-7.1	-4.2
Budget balance (excluding grants)	-7.4	-4.3
Primary balance	-2.5	0.6
Total government debt	57.4	56.9
External government debt	26.2	27.9
Domestic government debt	31.2	29.1
External sector		
Current account including official current transfers (percent of GDP)	-8.4	-5.9
Debt service (percent of GDP)	15.2	23.1
Gross reserves (in millions of U.S. dollars)	8,591	9,091
Gross reserves (in months of next year's imports of goods and services)	2.7	3.0

Source: IMF Public Information Notice, April 3, 2009, based on Pakistani authorities' data and IMF staff estimates and projections.

[7] Unless otherwise indicated, PFM data in this section relate to consolidated general government, which give a picture of Pakistan's overall fiscal position.

2.2 Pakistan's development performance from the early 2000s to mid-2007 was relatively impressive. However, it is now facing an economic crisis triggered by a combination of external economic shocks (oil and food prices) and a loss of fiscal discipline during 2007/08, a year of major political change. The economy grew at 7.3 percent on average per year during 2003/04-2006/07, driven by solid performances in the services and industrial sectors. Growth translated into rising household incomes, with per capita income growing to $878 in 2006/07, an 18.3 percent increase from $742 two years earlier.

2.3 Since 2006/7 however, a worsening current account balance and rising inflation left the economy vulnerable to external shocks. Pakistan was slow to initiate the needed policy adjustments despite clear signs of overheating. An insufficiently tight monetary policy, combined with an increased fiscal deficit, allowed continued growth in aggregate domestic demand leading to persistent inflationary pressures and a rising current account deficit. Inflation remained high at 7.8 percent in 2006/07, with the headline CPI inflation rising to 25 percent in October 2008. The current account balance deteriorated sharply, from a surplus of 4.7 percent of GDP in 2002/03 to a deficit of 4.8 percent in 2006/07—reaching 8.4 percent of GDP in 2007/8.

2.4 Increases in interest rates were not adequate to address inflationary pressures. The State Bank of Pakistan (SBP) introduced a series of increases in the policy discount rate by a total of 500 basis points from January through to November 2008, but real interest rates remained negative by a very large margin. SBP also, at that time, increased the CRR and statutory liquidity requirement, imposed a minimum interest rate on savings deposits, increased letter of credit margins on most imports, tightened controls on exchange companies, and re-imposed limits on some advance payments.

2.5 International reserves were rapidly run down as a result of these factors from a peak of almost $16bn to $9bn in less than 12 months. SBP foreign exchange reserves had dropped to US$8.6 billion at end-2007/8, a fall of about US$5.7 billion since October 2007. The level of reserves had further dropped by US$5.3 billion, to a dangerously low level of about US$3.3 billion (about three weeks of imports) on November 18, 2008. To mitigate the outflow, SBP tightened restrictions on foreign exchange transactions in early July 2008, and additional duties were imposed on imports of luxury items.

2.6 The economy adjusted to the widening imbalances through a slowdown in growth, with real GDP growth declining to 5.8 percent in 2007/08. Additional supply side shocks dampened economic activity in all three key sectors. In agriculture, floods and pest attacks depressed rice and cotton production, while industrial production and services were constrained by acute power and gas shortages. Real GDP growth has been projected in April 2009 to further decline to 2.5 percent in 2008/09, and increase to 4 percent in the following year, depending partly on the policy measures taken.

2.7 The worsening economic situation led to a substantial downgrading of Pakistan's risk rating from May 2008 onward until agreement was reached on IMF support in December 2008. Standard & Poor's Pakistan's sovereign debt ratings were downgraded in May 2008 from B+ to B, from B to CCC+ in early October 2008, and to CCC in early November 2008. Following agreement with the IMF, the rating was restored to CCC+. A similar trajectory was followed by

Moody's, which initially downgraded the rating from B2 to B1, and further downgraded its ratings outlook from stable to negative in September 2008 and the rating from B2 to B3 in October 2008. Moody's rating remained unchanged as at end-December.

2.8 To avoid an impending balance of payments crisis and default on foreign debt payments, Pakistan entered into a Stand-by Arrangement (SBA) with the IMF on November 24, 2008 to support the authorities' macroeconomic stabilization program for 2008/09 and 2009/10. In this context, the authorities are implementing a medium-term macroeconomic framework as part of the PRSP II, which envisages both fiscal and monetary tightening over the medium-term to bring down inflation and reduce the external current account deficit to more sustainable levels. As at April 2009, all quantitative performance criteria under the SBA were met and the structural reform agenda was on track. Headline inflation had decreased from 25 to 20.5 percent, the exchange rate was broadly stable, and the international reserve position had strengthened. At the same time, it is recognized that the global economic slowdown poses significant dangers for the program envisaged under the PRSP II.[8]

B. Fiscal performance and budgetary outcomes

2.9 Spending overruns led to a sharp increase in the 2007/08 fiscal deficit, which is estimated at 7.4 percent of GDP, compared to the budget target of 4.0 percent of GDP. Increases in the oil and food commodity prices were not fully passed on to consumers, but financed through the budget with mounting subsidies. Subsidies on fuel and power amounted to 2.9 percent of GDP and on food (primarily wheat) to about 0.5 percent of GDP. At the same time, interest payments were revised upwards from the budgeted level by about 1 % of GDP, owing primarily to under-forecasting of domestic interest payments on Defense Savings Certificates. To adhere to the overall fiscal year target, however, the authorities started passing on the international fuel price increases to consumers starting July 2008. Domestic fuel prices were gradually increased, and the parity with international fuel prices was reached in mid-October 2008, largely because of declining international oil prices.

2.10 The pattern of aggregate and compositional change in federal government expenditure is illustrated in Chart 1 below, showing changes in 2007/08 and previous years. As described in Chapter 3, the federal government has overall responsibility for macro-economic and fiscal policies. Most of the significant changes in general government spending impacted the federal budget most heavily. The composition of spending shown illustrates the functional distribution of federal government spending and the relation between actual and original budget spending over the past three years (see discussion of PI-1 and 2 in Chapter 3).

[8] *Pakistan: 2009 Article IV Consultation and First Review Under the Stand-By Arrangement—Staff Report,* April 2009, IMF Country Report No. 09/123.
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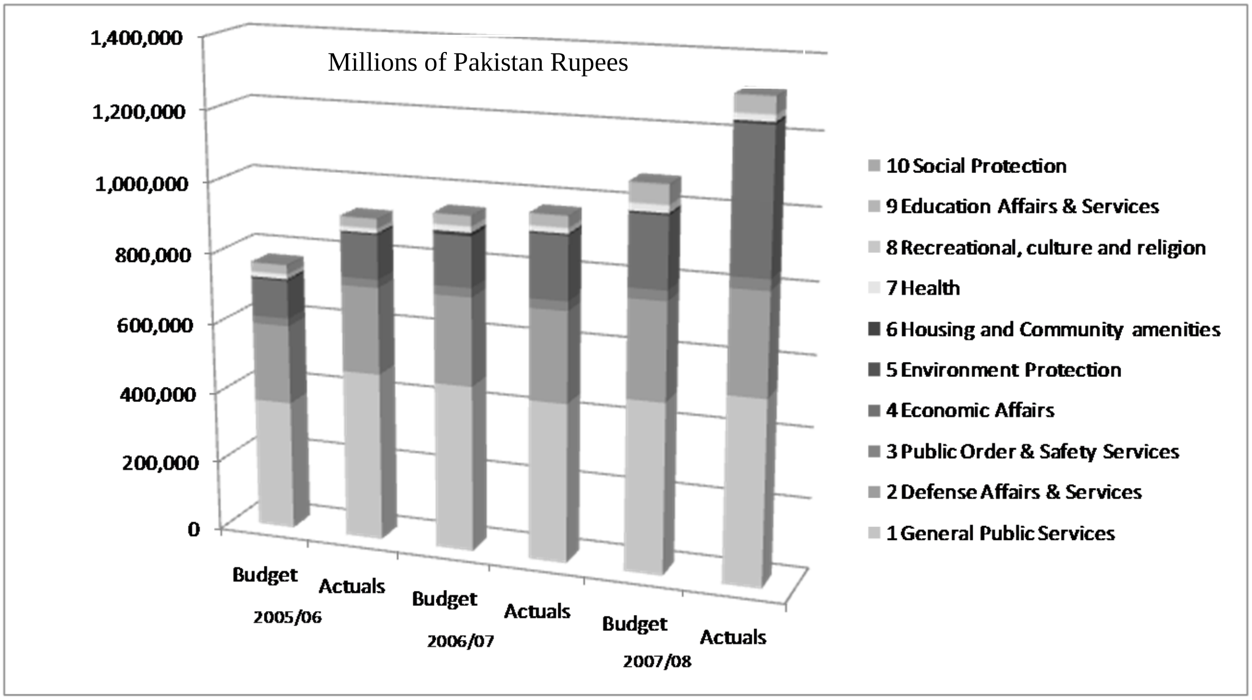
Chart 1 Aggregate and Compositional Change in the Federal Budget 2005/06 to 2007/08



Source: MoF: ABS and AGPR (see Annex 2)

2.11 Increased public spending by general government and its financing through borrowing from SBP, as noted above, contributed to increasing inflation. Owing to substantially lower than budgeted external financing and privatization receipts (the privatization process came to a halt in 2007/08), government borrowing from SBP amounted to Rs 689 billion during 2007/08, increasing the total stock of government debt owed to SBP to Rs 1.1 trillion at end June 2008. During July 1-November 8, 2008 government borrowed additional Rs 365 billion from SBP.

2.12 In 2008/09, the fiscal deficit is projected to decline to 4.3 percent of revised GDP. This reduction is to be achieved by a combination of expenditure cuts and revenue increases, with the burden of adjustment falling primarily on expenditures. Overall expenditures are to be cut by 2.8 percent of GDP (about two-thirds of the cut falling on current spending—primarily on fuel and power subsidies--and about one-third on development spending) to 19 percent of GDP, while overall revenues are to be increased by 0.5 percent of GDP to 15.1 percent of GDP. As economic activity slows down, the import growth is projected to rapidly decline and the trade balance to improve. In parallel, further monetary tightening is envisaged and, as a result, the current account deficit is projected to decrease to 6 percent of GDP in 2008/09. The IMF Program targets an increase in foreign exchange reserves to about US$8.6 billion at the end of the fiscal year. The IMF SBA projects a gradual recovery in GDP growth to around 6.5-7 percent by 2012/13 supported by continuing expenditure consolidation and a sustained revenue effort.

C. Legal and institutional framework for PFM

2.13 The 1973 Constitution (as amended) provides the overarching legislative framework for public financial management in Pakistan. A separate law for public finance is not yet in place. The Constitutional provisions, however, are relatively detailed and provide a basic enabling operational basis for public finance management in the Federation. The Constitution is supported by extensive General Financial Rules and Rules of Business. The annual Appropriation Law, prepared consistently with the Constitution and the financial regulatory framework, provides the legal basis for spending over the financial year, which is from July 1 to June 30 each year. An annual Finance Act covers the raising of public revenues in pursuance of the annual budget.

2.14 At the federal level, a rule-based fiscal policy, enshrined in the Fiscal Responsibility and Debt Limitation (FRDL) Act 2005, was passed by the Parliament in June 2005. This Act aims to establish responsible and accountable fiscal management by all governments and to encourage informed public debate about fiscal policy. It requires the government to be transparent about its short- and long-term fiscal intentions and sets high standards for fiscal disclosure. The provisions of the FDRL Act are in practice equally applicable to the provincial governments, who have no direct borrowing powers but whose loans are contracted, in pursuance of their respective Poverty Reduction Strategy Programs, through the federal government and within the ambit of the FRDL Act.

2.15 In 2001, the GoP separated the accounting function from auditing by transferring powers to prepare and maintain accounts to the Office of the Controller General of Accounts (CGA) under the Controller General of Accounts (Appointments Functions and Powers) Ordinance of May 2001 and the audit powers under the Auditor General's (Function, Power And Terms And Conditions Of Services) Ordinance, 2001. These ordinances are founded on Article 169 of the Constitution and they govern the audit and accounting processes in the entire federation, including sub-provincial governments (see below). The Auditor General of Pakistan (AGP), which is the country's Supreme Audit Institution, retains authority to prescribe the forms of accounts and financial reports of the Federation. The human resources of the two functions remain under one civil service cadre (Audit and Accounts).

2.16 Along with these reforms of PFM institutions, the GoP has initiated a series of fundamental changes in PFM processes that are, among others, supported by a World Bank-financed project, Project to Improve Financial Reporting and Audit (PIFRA). These process changes, which represent significant improvements over those recorded in the 2003 Country Financial Accountability Assessment (CFAA), have had an impact on all stages of the budget cycle and will be covered in detail in this assessment report. A second initiative that is contributing to improvements in budget planning and preparation is the UK-supported introduction of a Medium Term Budget Framework (MTBF). The impact of this project is also covered in detail in the assessment report.

2.17 The federal budget process is directed overall by the MoF, which oversees budget preparation and implementation by the ministries and divisions of government (see Annex 3 for structure of government and the MoF organization). The budget process is presently a dual process, whereby development projects are first approved by the Planning Commission under its Medium Term Development Framework (MTDF) and its annual Public Sector Development

Programme (PSDP). The budget incorporates federal and provincial projects approved by the Planning Commission under the Development Budget (part B of the federal budget estimates). Non-development spending is shown under part A of the estimates as charged against the revenue account (and sometimes called the revenue budget). The revenue budget includes some capital spending, and the development budget includes recurrent costs during the "development" phase of the project—continuing recurrent costs after project completion should be taken up by the revenue budget. The MTBF now underway is progressively unifying the budget process and will relate both capital and recurrent inputs to programme outputs and outcomes.

2.18 Principal Accounting Officers (PAOs), generally Secretaries, of line ministries are responsible for preparing their ministries' budgets and controlling commitment of funds within the limits authorized in the budget. The MoF controls spending during the year through periodic cash releases and through Financial Advisors (under the Expenditure Wing of the MoF) who sanction expenditure commitments by the line ministry to ensure that commitments do not exceed available cash. Implementation of the MTBF involves developing management capacity within line ministries to support the PAOs to balance their capital and recurrent spending needs in line with their objectives and targeted outcomes. Management and control at line ministry level is increasingly being supported by the GFMIS being established under PIFRA.

2.19 The accounting system has been substantially revamped under PIFRA by the introduction of the New Accounting Model (NAM), which modernized the CoA and established a framework for progressively introducing commitment accounting and eventually accruals. At present, however, accounting and financial reporting are on a cash basis. The NAM framework and principles are covered in 7 volumes.[9] NAM is now applied throughout government down to the district level and its principles apply to both centralized and SAEs[10] of government.

2.20 The Constitution provides for a Federal Parliamentary System of government, with President as the Head of State and the popularly elected Prime Minister as Head of Government. The Federal Legislature is a bicameral Majlis-e-Shoora (Parliament), composed of the National Assembly and the Senate. The Federal Executive Government comprises 41[11] ministries, including the Cabinet Secretariat, each with one or more Divisions and subordinate departments and agencies. All are subject to audit by the AGP, and accounts for all but 10 federal SAEs are prepared by the Accountant General Pakistan Revenues (AGPR), who also consolidates SAE accounts prepared by their Accountant Generals (AGs) under the authority of the CGA.[12] The provincial Forestry Departments are provincial SAEs and their accounts are consolidated by their respective provincial AGs.

2.21 Devolution, through the Local Government Ordinance of 2001, established three sub-provincial levels of government (Districts, Tehsils and Unions). Legislative scrutiny of public

[9] See http://www.pifra.gov.pk/1/nam.html

[10] Except for the Ministry of Defense, and Pakistan Railways; the former applies its own model, broadly consistent with NAM, the latter operates under commercial accounting principles. However, their accounts are consolidated as part of general government at the federal level.

[11] As indicated by Ministry budget appropriations in *Demands for Grants and Appropriations* 2007/08 (but excluding National Assembly and Senate).

[12] The federal SAEs are: National Savings Organization; Pakistan Mint; Food Wing of the Food and Agriculture Division; Forestry, Pakistan Public Works Department; Ministry of Foreign Affairs; Pakistan Post Office Department; Geological Survey of Pakistan; Pakistan Railways; and Ministry of Defense.

accounts is conducted by the Public Accounts Committees (PACs) at the federal and all four provincial government levels. However, the Zila Accounts Committees (the district and tehsil equivalent of the federal and provincial PACs) are, since devolution, being progressively established and have not yet become fully operational.

Chapter 3: Assessment of PFM Systems, Processes, and Institutions

3.1 This chapter assesses the current status of all relevant PFM systems, processes, and institutions in the Federal GoP against all PIs prescribed in the PEFA framework. Each PI is assigned a rating calculated from the score achieved in each dimension and the minimum requirements for that score as defined in the framework.[13]All data used in reaching the assessment have been provided with the full cooperation of GoP officials and the assessments have been discussed in detail with the GoP PEFA Steering Committee and at the PEFA Workshop held on April 20-21, 2009. The PI assessments are given below for each PI, grouped into the six high-level sets of PFM system indicators and a seventh covering donor activities. Summary assessments showing compliance against the relevant minimum requirements for each PI are given in a table in each section below, and an overall summary of PEFA PFM Performance scores is given in Annex 1.

3.2 This PEFA assessment aims to establish an objective baseline set of ratings that will help identify areas of strength and weakness and facilitate monitoring of future progress. Ratings take account of all relevant factors in each dimension, in keeping with the PEFA methodology and to identify all areas that may be important for a PFM reform program. It should be noted, however, that, in a few cases, issues that are relevant to PFM performance can fall outside the PEFA rating methodology but may be considered important for future progress. These aspects have been noted in the text as areas that could be considered in the reform strategy and monitoring program to be developed.

1. Budget Credibility

A. Aggregate expenditure out-turn compared to original approved budget (PI-1)

3.3 This PI is assessed against the single dimension of the degree of variation between the original budget proposal placed before the parliament and the final out-turn at the end of the fiscal year, as measured in the final accounts statements. PEFA PIs are generally assessed for particular levels of government. From an overall fiscal policy perspective, however, the federal government plays a central role in controlling the aggregate level of spending and revenue for the consolidated general government, as well as being directly responsible for federal budget operations and control. Accordingly, the analysis also provides an overview, for illustration purposes, of variation for consolidated general government and as a basis for future work.[14] It should be noted that in both individual jurisdictions and for consolidated general government, there has been a weakness in expenditure data recording in the civil accounts up until 2007/08 because of operations conducted through the public account or donor-funded project imprest accounts (see further discussion under PI-7). For 2005/06 and 2006/07 there has been a net

13 Detailed definitions of minimum requirements related to each score for each indicator, and the overall PEFA methodology are described in PEFA Public Financial Management Performance Measurement Framework, June 2005, PEFA Secretariat: Washington DC.

14 Recent reforms in Pakistan have successfully established a GFMIS that is capable of monitoring budget against outcome for federal, provincial, and district levels of government. From 2008/09 budget reports on original budget versus outcome can be system generated for all three levels of government. This capacity provides the government with the means to monitor progress against PI-1, as well as PI-2 and 3. In the future, deviation of general government as well as federal government can be monitored.

tendency to over-record expenditure by including flows from civil accounts to other government accounts that show a net accumulation. This problem has been significantly reduced from 2007/08 onwards.

3.4 The PI rating is measured, under the PEFA framework against the dimension of variation between the original budget and final out-turn for the federal government. The assessment is shown in the table below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-1 Aggregate expenditure out-turn compared to original approved budget.	**D**	Deviation of actual expenditure from original budget was greater than 15 percent for two out of the last three years.

(i) Federal government

3.5 The data in table 3.1 below show federal government aggregate variance of primary expenditure was greater than 15 percent for two out of the last three years, 2005/06 and 2007/08. However, there were certain circumstances which were largely beyond the control of government that gave rise to the excess budget spending: these included the rehabilitation and recovery expenditures related to the October 2005 earthquake - that could not have been foreseen at time of approval of the original budget – as well as the increased fiscal pressures arising from upsurge in the law and order mitigation effects. Again, exceptional increases in oil and food prices in 2007-08 put great pressure on the federal government, with subsidized power tariffs adding to budgetary slippages. The lack of appropriate policies to pass these prices on to domestic consumers,[15] together with constitutionally permitted executive control over supplementary spending during the year (see PI-16 below) allowed major upward deviations to take place.[16] These factors gave rise to much of the unbudgeted increases in current expenditures as the government continued to subsidize these price increases through the budget.

Table 3.1 Aggregate Federal Expenditure - Budget and Actual

(Rupees in millions)

	2005-06	2006-07	2007-08
Budgeted	767,807	948,160	1,072,436
Actual	**918,950**	**968,738**	**1.315,700**
Deviation (%)	**19.7%**	**2.2%**	**22.7%**

*Source: AGPR, ABS, and audited financial statements for FYs 2005/06 and 2006/*07 (See worksheet in Annex 2)

(ii) Consolidated general government

3.6 Table 3.2 shows consolidated general government data over the period 2005/06-2007/08 drawn from the Pakistan Fiscal Operations data posted on the MoF website. These data, while consistent with ABS budget data in original budget and AGPR and provincial AGs civil accounts for actual, show provisional rather than final data for the latter. The Pakistan Fiscal Operations

[15] These policies are now being addressed by the GoP as part of the IMF Standby Arrangement (SBA).
[16] The Auditor General of Pakistan in the Audit Report on the Accounts of Federal Government (Civil) for Audit Year 2007/08 (p 6) noted that Supplementary Grants and Surrenders accounted for 19 percent of variance in 2006/07.

tables, moreover, aim to reconcile deficit-creating fiscal data with deficit-financing data drawn from the State Bank of Pakistan (SBP), the Central Directorate of National Savings (CDNS), and the Economic Affairs Division (EAD). As noted above, weaknesses in this reconciliation process (see PI-7 below) reveal overall weaknesses in expenditure data that are only recently being overcome. Table 3.2 indicates rather less variance at the general government level than at the federal. The main factor in this pattern is the fact that subsidies are controlled at the federal level. These results, which are provided here for illustration purposes only, would, ordinarily, warrant a C rating for consolidated general government variance when assessed under the PEFA framework.

Table 3.2 Consolidated Government Expenditure - Budget and Provisional Actual

(Rupees in millions)

	2005-06	2006-07	2007-08
Budgeted	1,039,400	1,296,700	1,500,100
Actual	1,164,700	1,306,700	1.785,800
Deviation (%)	**12.1%**	**0.8%**	**19.0%**

B. Composition of expenditure out-turn compared to original approved budget (PI-2)

3.7 The changes reflected above in aggregate actual spending relative to budget will also give rise to changes in spending policies between ministries and functions. This PI is assessed by the extent to which re-allocations between budget lines have contributed to variance in expenditure composition beyond that resulting from changes in the overall level of expenditure. This PI is assessed only at the federal level of government. The assessment and summary justification are given in the PI indicator table and details of the variance calculation are given in tables 3.3 to 3.5 below.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-2. Composition of expenditure out-turn compared to original approved budget.	**B**	The average weighted variance calculated on the basis of the PEFA guidelines for PI-2 shows the compositional variance exceeded aggregate variance by slightly more than 5% in one of the last three years.

3.8 As shown in table 3.3, which depicts changes in the main functional heads, substantial changes in composition have been associated with the aggregate changes cited above.[17] The most substantial deviations have occurred in the General Public Services and Economic Affairs ministries largely associated with energy and food subsidies. In 2007/08 alone, the Grants, subsidies, and loan write-off heads, under these two function heads, amounted to Rs 229 billion and Rs 366 billion respectively.

[17] See Annex 2 for the source data covering all 10 functional heads.

Table 3.3 Primary Expenditure - Budget and Actual

(Rupees in millions)

Head/year[18]	2005-06 Budget	2005-06 Actual	2006-07 Budget	2006-07 Actual	2007-08 Budget	2007-08 Actual
General Public Services	368,868	479,845	472,899	452,831	485,236	524,122
Defense Affairs	223,653	245,672	250,285	257,090	275,199	287,884
Public Order & Safety	21,953	23,399	25,783	26,554	28,950	31,245
Economic Affairs	107,577	124,332	142213	178,231	199,589	398,677
Health Affairs	13,124	12,162	15,910	14,100	19,904	16,737
Education Affairs	21,524	22,265	25,541	28,252	48,990	41,248

Table 3.4 Primary Expenditure – Actual Deviation from Budget

Percent increase/decrease

Head/year	2005-06 Deviation	2006-07 Deviation	2007-08 Deviation
General Public Services	30.1%	- 4.2%	8.0%
Defense Affairs	9.8%	2.7%	4.6%
Public Order & Safety	6.6%	3.0%	7.9%
Economic Affairs	15.6%	25.3%	99.7%
Health Affairs	- 7.3%	- 11.4%	- 15.9%
Education Affairs	3.4%	10.6%	15.8%
Weighted Average Variance	**19.9%**	**7.6%**	**24.7%**

3.9 Based on the above estimates and data from PI-1, the final column of Table 3.5 shows the variance in excess of total deviation over the three year period. A PEFA rating of B applies, since excess variance exceeded 5 percent in 2006/07.

Table 3.5 Compositional Variance

Year	For PI-1 total expenditure deviation	Total expenditure variance	For PI-2 variance in excess of total deviation
2005-06	19.7%	19.9%	**0.2%**
2006-07	2.2%	7.6%	**5.4%**
2007-08	22.7%	24.7%	**2.0%**

C. Aggregate revenue out-turn compared to original approved budget (PI-3)

3.10 This PI is assessed against the single dimension of the percentage of actual domestic revenue collected relative to the domestic revenue estimates in the original approved budget. The rating by M1 method is given in the table below:

[18] The Chart of Accounts was changed for 2005-06 in accordance with the New Accounting Model.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-3 Aggregate revenue out-turn compared to original approved budget.	**A**	Revenue collection was not below 97% of budgeted domestic revenue estimates in any of the last three years.

3.11 Details of the revenue estimates and actual results for revenue receipts (not including capital receipts), as provided by the AGPR are provided in table 3.6.

Table 3.6 Revenue Out-turn and Actual Budget - 2005/6 to 2007/8

Revenue Collection **(Rupees in millions)**

Year	2005-06	2006-07	2007-08
Budget estimates	967,400	1,157,810	1,443,138
Less: Provincial share	(284,319)	(378,260)	(465,963)
Net Budget estimates	683,081	779,550	977,175
Actual revenues	1,121,743	1,304,728	1,400,832
Less: Provincial transfer	(300,454)	(400,128)	(457,113)
Net actual revenues	821,289	904,600	943,719
Revenue difference as % of budget estimates	**20%**	**16%**	**-3%**

3.12 Under the PEFA requirements an A rating is appropriate. However, in terms of PFM reform, it should be noted that in 2 of the 3 years, actual revenue collection averaged around 18 percent higher than the estimates. Persistent under-estimation of revenue is as much a concern for credible budgeting as over-estimation. It is suggested therefore that this aspect of budget estimation also be taken into account in developing a PFM reform program.

D. Stock and monitoring of expenditure payment arrears (PI-4)

3.13 This PI is assessed against two dimensions: (i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year); and (ii) Availability of data for monitoring the stock of expenditure payment arrears. The assessment and rating under M1 methodology is given in the table below. Because of the lack of data on arrears, “No Score” (NS) was given on this PI.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-4 Stock and monitoring of expenditure payment arrears.	**NS**	
(i) Stock of expenditure payment arrears	*NS*	No reliable data are available to assess the stock of arrears. While year-end problems occur, there is no evidence to suggest a major problem of payment arrears.
(ii) Availability of data for monitoring the stock of expenditure payment arrears	*D*	The government does not keep reliable data on expenditure arrears. Commitment accounting and reporting is being introduced, but is not yet effective.

3.14 The Government does not record a consolidated stock of expenditure payment arrears. While there are known problems of continuing inter-corporate debt among the public enterprises, particularly in the energy sector, no documented evidence exists to suggest (or disprove) a growing stock of payment arrears by the federal government. Some payment delays do occur, but these are not yet systematically recorded. Some arrears may arise at departmental level simply because due bills are not presented to AGPR. Other arrears may occur if some public works exceeds the current year's authority, but is completed on an understanding, again at departmental level, that payment will be made from the following year's budget. The present cash basis system does embody a bill-tracking system that allows tracking of payments, but only from the point of presentation and acceptance of a payment request accompanied by invoices to the AGPR.

3.15 The full introduction of commitment accounting and reporting would allow complete tracking of transactions from the time of contract and purchase order, and would thus help minimize payment arrears as well as track most sources of delay and arrears in payment. A task-force of federal and provincial finance officers is examining the modalities of introducing commitment accounting from July 2009 (see PI-24 and 25).

2. Budget Comprehensiveness and Transparency

A. Classification of the budget (PI-5)

3.16 This PI is assessed on the basis of the capacity of the CoA to support expenditure tracking and reporting on all key PFM functions regarding allocation of resources and implementation of activities: administrative, economic, functional, and program. The summary assessment using M1 scoring methodology is given below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-5 Classification of the budget.	**A**	The NAM CoA is a robust classification, which is fully operational at federal, provincial, and district levels, and permits tracking of spending against budget on administrative, economic, functional, and program bases

3.17 The NAM, which applies to all levels of government in Pakistan, was approved by the President in 2000. The NAM has now been fully rolled out as part of the GFMIS, which is used for budgeting and accounting (see PI-16-21 below) by federal, provincial and district governments. This NAM embodies a CoA which is compliant with IMF GFSM 2001 fiscal reporting standards.[19] In principle, the NAM will allow tracking of budgetary commitments; fixed assets and liabilities; and cash receipts and expenditures; as well as to generate timely, accurate and comprehensive financial statements/reports covering all aspects of PFM (progress in establishing functionality in these areas is covered under relevant PIs below).

3.18 The CoA is fully operational, covers all general government entities, and allows GFS-compliant reports on economic and functional/sub-functional (COFOG) classifications, as well as classification by administrative unit/sub-unit/demand for grants, and by fund. In conjunction

[19] Though there are differences between the high-level object reporting under the NAM CoA, detailed object level mapping to GFSM 2001 categories allows fully compliant GFSM reports to be generated. These reports have now started to be generated. Past failures to generate the reports were due to weaknesses in accounting and reporting practice (see PI-7) not because of weakness in the CoA.

with the introduction of an MTBF (see PI-12), the program classification functionality is being activated

B. Comprehensiveness of information included in budget documentation (PI-6)

3.19 This PI is assessed according to whether the budget provides information on all or some of 9 data sets regarded as critical to effective PFM. The summary assessment is given below drawn from the details given against each of the 9 data sets.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-6 Comprehensiveness of information included in budget documents.	**B**	Information on most key elements is available within government, but a number of important components are presented separately at mid-fiscal year and are not covered in the budget presentation. Assessed as 5-6 of the 9 data sets

(i) Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate.

3.20 The budget documents presented to the National Assembly[20] contain some details of the major macro-economic assumptions. A short Medium Term Budgetary Framework paper is presented with the budget documents and gives some key assumptions and fiscal projections, but is not yet well integrated with the budget presentation. The Budget Speech does describe performance against key macro-economic assumptions during the preceding year and lays down key assumptions for upcoming year for which budget are being tabled. In a number of cases the underlying assumptions are not fully explained.[21] A detailed description of economic, fiscal, and monetary developments is given in the annual Pakistan Economic Survey report prepared by the Finance Ministry's Economic Advisor's wing and presented with the budget.

3.21 Prior to the budget, a Budget Strategy Paper, which provides an analytical basis for budget policy, is prepared by the Budget Wing of the Finance Division as part of the MTBF process for internal consideration prior to presentation to the National Assembly, but this document is not at present made public. The DPCO of the MoF produces annual Fiscal Policy Statements and Debt Policy Statements, which are reviews of policy implementation during the current year that are laid before the National Assembly and published in January each year; each of these documents provides a range of information on the policies and assumptions underlying the budget at the mid-stage of its execution.

[20] These are as follows: *Budget Speech; Federal Budget in Brief; Annual Budget Statement; Demands for Grants and Appropriations; Explanatory Memorandum on Federal Receipts; Estimates of Foreign Assistance;* and the *Economic Survey.*

[21] For instance, the Budget Speech for 2008-09 budget highlighted performance against key assumptions such as actual growth of economy for 2007-08[21] being 5.8% against the target of 7.2%, (at disaggregate level: Growth in manufacturing and agriculture being 5.4% and 1.5% respectively against targets of 10.5% and 4.8%[21]; Inflation being 11% and depreciation of exchange rate by 6.4%. The key macro economic assumptions for 2008-09 are; (i) GDP Growth (aggregate) will increase by 5.5% during 2008-09; (ii) Inflation will be contained at 12%; (iii) Gross Investment to GDP ratio will be maintained at 25%; (iv) Fiscal Deficit will be contained to 4.7%; (v) Current Account Deficit will be reduced to 6% of the GDP; and foreign exchange reserves will be increase to USD12 billion.

(ii) The fiscal deficit is defined in accordance with internationally recognized standards.

3.22 The budget estimates themselves (including the budget speech and the Budget in Brief) do not present the deficit according to international standards (but rather according to administrative practice—the term "deficit" is used in the 2007/8 budget speech, but its linkage to the ABS and Budget in Brief[22] is not explained). The term deficit is used consistently in reference to the consolidated general government, but not to either the federal or provincial budget presentations. All statements of fiscal policy (such as the Economic Survey, the Fiscal Policy Statement, and the statement of fiscal operations on the Finance Division website[23]), however, broadly apply international standards to define the fiscal deficit with reference to general government.[24]

(iii) Deficit financing, describing anticipated composition.

3.23 Similarly to the previous point, 'borrowing' to finance the government program is described in the budget documents along with composition for the outgoing and incoming financial years. Borrowing is a gross concept, distinct from the net concept of 'deficit financing' defined in GFS—which is the standard concept used for fiscal policy analysis. However, fiscal policy statements by the GoP, separate from the budget documents as described above, do describe deficit financing and its composition. For the outgoing financial year, the deficit financing, its composition and associated estimates are provided along with the revised estimates (based on actual accounts of first 9 months and projections for the remaining 3 months of the same financial year). For the incoming year, the estimates against each component of deficit financing are provided. Credibility of the borrowing estimates remains an issue. The budget brief for 2008-09, describes the borrowing requirement to be met through external resources (foreign loans), privatization proceeds and bank borrowing. However last year (2007/08), with the sharp increase in current expenditure and reduced receipts from privatization proceeds (Rs. 1,650 million against estimated Rs. 75,000 million), Bank Borrowing was increased from the estimated Rs. 80,938 million to Rs. 424,107 million. This year (2008/09), Bank Borrowing is estimated at Rs. 149,008 million for deficit financing.

(iv) Debt stock, including details at least for the beginning of the current year.

3.24 Public debt data covering internal and external debt stock, as well as contingent liabilities are covered fully in the Economic Survey presented each year with the budget documents. However, no data is available on the outstanding stock of contingent liabilities. In addition, under Section 7 of the Fiscal Responsibility and Debt Limitation Act 2005[25], the Federal Government is required to lay before the National Assembly, the Debt Policy Statement; presenting as overview of the public debt to assess the Federal Government's performance against a range of objectives including provision of reliable information to the public on overall

[22] In these documents, repayment of foreign debt is included as expenditure rather than being netted against foreign borrowing as would be done for a "deficit" calculation.
[23] http://www.finance.gov.pk/finance_fiscal_operation.aspx
[24] The IMF sets the generally recognized standard definition for government deficit concepts in its Government Finance Statistics Manual (GFSM 2001). In practice, many of the definitions (including those currently applied in Pakistan) derive from the earlier GFSM 1986—often modified to accommodate data weaknesses.
[25] The Fiscal Responsibility and Debt Limitation Act 2005

public debt and its management.[26] As noted, however, this document is not included as part of the budget presentation, but rather in mid-fiscal year to allow review of the position.

(v) Financial assets, including details at least for the beginning of the current year.

3.25 The budget documents provide limited information on financial assets, showing only budgeted amounts for loans and investments for the current year and the budget year. A brief statement of financial assets (primarily covering bank balances, investments, and loans) and liabilities is, however, included in the Financial Statements of the Federal Government.[27]

(vi) Prior year's budget out-turn, presented in the same format as the budget proposal.

3.26 The budget does not include detailed information by grant on the year prior to the current year (that is, two years prior to the budget year). This information is available on the Finance website (http://www.finance.gov.pk/index.aspx) and in summary form in the Economic *Survey*.

(vii) Current year's budget (either the revised budget or the estimated out-turn), presented in the same format as the budget proposal.

3.27 The current (that is the year immediately preceding the budget) year's original and revised estimates (actual of 9 months and projected estimated for the remaining 3 months of a financial year) are shown in comparison with the new budget.

(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.

3.28 Budget data for both revenue and expenditure at aggregate and disaggregate levels are summarized and placed in the form of 'Budget in Brief'. However, it contains the summary of current (as described in (vii) above) and budget data only, not for the previous year (as per (vi)).

(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.

3.29 The Budget Speech contains explanation of budget implication of new policy initiatives with estimates of budgetary impact.

C. Extent of unreported government operations (PI-7)

3.30 Assessment under this indicator examines the extent of central government monitoring of fiscal risks in two dimensions: (i) the level of extra-budgetary expenditure (other than donor-funded projects) which is unreported (i.e. not included in fiscal reports); and (ii) income/expenditure information on donor-funded projects which is included in fiscal reports. A

[26] See Debt Policy Statement 2007-08 of 31st January 2008, Ministry of Finance; p. 2 lists the requirements of the FDRL Act and the main objectives of the Statement.
[27] For the Financial Year 2006/07, see Notes to the Financial Statements No. 28.

summary assessment in each dimension and the overall rating by M1 methodology is given in the table below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-7 Extent of unreported government operations.	**D+**	
(i) The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported	*A*	There are no known unreported extra budgetary expenditures. The level of unidentified (rather than unreported) expenditure has been greater than 5 percent over two of the past three years, but has been reduced to less than 1 percent in 2007/8 because of remedial actions taken.
(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports	*D*	Accounting for donor-funded expenditure outside the civil accounts and incomplete inclusion of third party payments means that incomplete information is reported on most projects, including loan-financed projects. Steps are being taken to include third party payments in EAD reports on donor activities and to require donor-funded projects to report expenditure as part of the civil accounts.

(i) The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported.

3.31 There is no unreported expenditure in Pakistan in the sense of unreported extra-budgetary activities. Rather, there has been a serious issue of “unidentified” expenditure which arises from two sources: un-reconciled flows of funds between the Civil Accounts and the Public Account; and ring-fenced donor fund accounts. The latter issue will be dealt with in (ii) below. In both cases, however, much of the problem arises because expenditures are recorded against the consolidated fund when authority to spend is transferred to a suspense, advance, deposit, or imprest account held either in the Public Account or a donor project imprest account held in a commercial bank. Actual expenditure is recorded only when funds are spent from the relevant Public or donor-funded project account. In 2004/5 the levels of unidentified expenditure (for consolidated general government) were recorded as equivalent to 1.2 percent of GDP, or around 6.5 percent of total expenditure. Various remedial actions have been taken and the level of unidentified expenditure in 2007/8 was estimated as being around 0.04 percent of GDP or 0.2 percent of total expenditure (see http://www.finance.gov.pk/finance_fiscal_operation.aspx); but some of the underlying problems are still to be fully addressed. These discrepancies arise from a series of systemic accounting and reporting problems, not from extra-budgetary accounts that are separate from the consolidated fund.

3.32 Until recently, much of development expenditure was handled through Personal Ledger Accounts (PLAs), which recorded expenditure when the authority to spend was given (in the Public Account) to project directors. Actual spending was then recorded against public account balances rather than against the appropriation in the consolidated fund. This system contributed to discrepancies between expenditure recorded against appropriation and actual disbursements from government accounts as reflected in bank balances; it also provided relatively weak expenditure controls (particularly in the case of non-lapsable PLAs, which allowed accumulation of balances to be spent in subsequent years). The CGA introduced amendments to PLAs, changing them to Assignment Accounts to establish greater transparency and accountability.[28]

3.33 The federal Fiscal Monitoring Committee has initiated a number of reforms (including the work on PLAs) to ensure that the level of unidentified expenditure is reduced. As a result, a number of other changes have been introduced: Pakistan Post now provides detail of domestic debt (National Savings Schemes) and pension expenditure along with its monthly civil account; actual spending on military pensions and civil works is to be posted (rather than, as previously, recording transfers to exchange account and special accounts).

(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports.

3.34 Many of the remaining problems are associated with the special accounting arrangements set up for donor funds. Most donor- funded projects are managed using parallel systems to those of the Government—but are now being considered for streamlining in continuation of MoF’s and CGA’s policy of streamlining all assignment accounts.

3.35 An important remaining problem in this area is that third party payments (that is, payments to contractors / suppliers directly from a donor account) are not yet recorded fully in the government accounts. The CGA, however, has adopted IPSAS principles for recording third party payments provided that documentation of the transaction can be verified. This criterion should be met for all loan-funded transactions since EAD has to verify donor statements of liability, and arrangements are in process to include both direct and third party payments in EAD/AGPR disbursement reconciliation processes. Further work is required to ensure that third-party payments from donor-funded projects are properly reported and recorded.

D. Transparency of inter-governmental fiscal relations (PI-8)

3.36 Assessment under this indicator examines the transparency of inter-governmental fiscal relations in three dimensions: (i) transparent and rules-based systems in the horizontal allocation among lower level governments of unconditional and conditional transfers (both budgeted and actual allocations); (ii) timeliness of reliable information to lower level governments on their allocations for the coming year; and (iii) extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sector categories. A summary assessment in each dimension and the overall rating by M2 methodology is given in the table below:

[28] Some of the important provisions include that the funds in assignment accounts will be part of Consolidated Fund; amounts remaining unspent at the close of financial year will appear as saving under the respective budget grant unless surrendered in time; unspent amounts cannot be carried forward to next financial year and that the drawing authorities shall be primarily responsible for accounting of expenditure on a daily basis; drawing authorities will render classified account of expenditure to the AG/DAO on a monthly basis (by 5th of each month) and ensure its inclusion in the AG/DAO’s account; variations will be reconciled and appropriate entries made to bring the accounting records up-to-date; monthly/quarterly release of fund will be subject to reconciliation with AGPR and that the balance in the existing non-lapsable Assignment Accounts, if any, remaining un-spent on June 30, 2008 will not be available without its revival through fresh budgetary ceiling.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-8 Transparency of inter-governmental fiscal relations.	**A**	
(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*	The allocation of unconditional grants among provinces is entirely rules based. Unconditional grants are few and do not have a major impact on provincial budgeting.
(ii) Timeliness of reliable information to lower level governments on their allocations for the coming year	*A*	Relative shares are known and best available information on estimates is made available to the provinces as timely as possible.
(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sector categories	*A*	Consolidated fiscal data is available on the GFMIS and reports are generated according to sectoral categories (e.g., for PRSP).

(i) Transparent and rules-based systems in the horizontal allocation among lower level governments of unconditional and conditional transfers (both budgeted and actual allocations).

3.37 A structured rule-based allocation system governs the allocations to and among sub-national governments in Pakistan under the direction of the National Finance Commission (NFC). Allocations from shares in federal taxes are made through a divisible pool, with shares being determined by the NFC. The earlier NFC Award 1997 was amended and allocations since 2006 onwards are being made under the Distribution of Revenue and Grant-in-Aid Amendment Order 2006. This includes the distribution of revenue among the Provincial Governments as a pre-determined share percentage from the net proceeds of direct and indirect taxes.[29] The disbursements are made from the divisible taxes pool-- pro rata as per collection. If there is a short-fall in revenues, the disbursements are reduced. However the net collection (after 5% collection charges) is distributed as per the pre-determined formula.

3.38 Royalties on crude oil and development surcharge on natural gas are transferred to the provinces on the basis of well-head production (after deducting 2 % collection charges). Royalty and excise duty on natural gas is similarly transferred to the provinces (less 2%) in accordance with Article 161 (1) of the Constitution. GST on Services (provincial) is likewise transferred to the relevant provinces after deducting 2% for collection. Overall, transfers to provinces are thus

[29] The overall percentage share has been increased from 41.50% in 2006-07 to 42.50% in 2007-08 to 43.75% for the current 2008-09 financial year. Out of the sum assigned to the Provincial Governments under Article 3 of Ordinance 2006, an amount equal to the net proceeds of 1/6th of Sales Tax shall be distributed amongst the provinces (Punjab 50%, Sindh 34.85%, NWFP 9.93% and Balochistan 5.22%) at the following ratio and the Provincial Governments shall further transfer the whole of such amount to the District Governments and Cantonment Boards without retaining any part thereof. The balance shall be distributed amongst the provinces (Punjab 57.36%, Sindh 23.71%, NWFP 13.82% and Balochistan 5.11%) on the basis of their respective population in the percentage specified against each. Further a grant-in-aid of Rs. 27 billion, to be charged upon the Federal Consolidated Fund, is to be provided each year to the provinces on the basis of predetermined share (Punjab 11%, Sindh 21%, NWFP 35% and Balochistan 33%). These grants-in-aid will be increased annually in line with the growth of net proceeds of divisible taxes for each year.

rule-based and transparent; conditional transfers are relatively few and have little impact on overall budgeting.

3.39 Although the system is substantially rules-based and meets the PEFA criteria, provinces have recorded some concerns about its practical application. In particular, the federal government deducts a variety of provincial liabilities to the federal government at source (that is, directly from the provincial transfers). In a number of cases cited, the amounts deducted have not been discussed in detail with the provinces. For example, pension liabilities of personnel working in FATA have been deducted from NWFP transfers, but the province considers this function as primarily a federal responsibility; arrears of electricity charges are similarly deducted. There appears to be scope for improved dialogue between the provincial and federal government in these regards. Further improvement in transparency could also be achieved by making NFC awards available on the internet.

3.40 Table 3.7 shows federal and shared taxes, together with division by provinces as budgeted and actual transfers for 2007/08.

Table 3.7 Federal Taxes and Provincial Revenue Shares 2007/08

(Rupees in millions)

Federal Tax	Budget	%	Actuals	%
Income Tax	155,006	33%	144,210	32%
Sales Tax	149,135	32%	153,982	33%
Federal Excise (net of gas)	34,194	7%	41,977	9%
Customs duties	62,178	14%	58,925	13%
Dev. Surcharge & Royalties	57,314	12%	55,116	12%
Others	8,137	2%	2,903	1%
Total	465,964	100%	**457,113**	***100%***
Provincial Revenue Shares				
Punjab	236,239	51%	228,009	50%
Sindh	144,153	31%	142,927	31%
NWFP	55,936	12%	56,539	12%
Balochistan	29,636	6%	29,638	7%
Total	**465,964**	***100%***	***457,113***	***100%***

Source: Budget- ABS; Actuals - AGPR

(ii) Timeliness of reliable information to lower level governments on their allocations for the coming year.

3.41 Budget estimates are shared with the provinces before they prepare their annual budgets. Actual shares depend on actual collections. While there is a degree of uncertainty about the final amount to be transferred, this uncertainty is unavoidably part of any budget process and information is shared in as timely a way as is practicable.

(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sector categories

3.42 The GFMIS operates effectively down to district level and data on general government is readily consolidated by economic, functional, and sectoral categories. The GFMIS is used in particular to generate cross-jurisdictional PRSP reports.

E. Oversight of aggregate fiscal risk from other public sector entities (PI-9)

3.43 Assessment under this indicator examines the extent of central government monitoring of fiscal risks in two dimensions: (i) Autonomous government agencies (AGAs) and public enterprises (PEs); and (ii) Sub-national government. The summary assessment is given in the table below, with the overall rating by M1 scoring methodology.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-9. Oversight of aggregate fiscal risk from other public sector entities.	**C+**	
(i) Extent of monitoring public enterprises	C	The major AGAs/PEs are monitored to assess the profit and loss implications through the year and consolidation of the fiscal risk is reported annually by the Pakistan Economic Survey and the Debt Policy Statement, but there are significant gaps in the data and consolidation. Significant improvements are required both to AGAs/PEs reporting and to link fiscal risk assessment to the budget process.
(ii) Extent of central government monitoring of sub-national governments' fiscal position	A	Major risks to the federal government from provincial fiscal operations are monitored and controlled. All borrowing by SN governments requires approval of the federal government. Debt recording by EAD and monitoring of fiscal and debt position is carried out through EAD, CGA/AGPR, and the SBP. The Provincial fiscal position is monitored monthly. Risks to the federal government from unfunded provincial pensions and provincial PEs are not included in risk reviews.

(i) Extent of monitoring fiscal risk from AGAs/PEs.

3.44 The Corporate Finance Wing of the Finance Division is given general responsibility for all public sector entities and is responsible for broad financial oversight, particularly on the performance of the five major PEs (WAPDA, KESC, Pakistan Railways, Pak-Steel Mills, and PIA). The CF Wing monitors most of the major AGAs and PEs for profit and loss implications[30], as well as dividend accrual,[31] including return on equity and asset analyses[32]. The consolidated and overall fiscal risk issues are reported in the Pakistan Economic Survey and Debt Policy Statement, both of which are submitted to the Parliament. The 2007-08 Survey[33] reports 17 items

[30] PEs are categorized as: consistently profit making (17); lately profit earning (17); consistently loss making (6); and lately loss making (14). The CF Wing has conducted an entity wise comparative analysis for 2005, 2006 and 2007, starting with 2001.

[31] Received from 27 entities during 2006-07, 29 during 2007-08 and 30 during 2008-09 as on 19 January 2009.

[32] The Analysis of GOP's Investment in Public Sector Enterprises (PEs) for the year 2007 includes 49 PEs with 100% GoP Investment; 6 with more than 75% and less than 100%; 5 with more than 50% and less than 75%; and 17 PEs with less than 50%.

[33] Government of Pakistan, Finance Division, Economic Advisor's Wing Islamabad, Pakistan Economic Survey 2007-08, pp 285-287.

of explicit liabilities[34] and the same number of implicit liabilities[35] over a three years timeframe i.e. 2005/06, 2006/07 and 2007/08. The Debt Policy Statement 2007-08[36] reports the contingent government liabilities by reflecting the new guarantees on loans issued by the government[37] within the year. Whilst the CF Wing requires the loss making entities to submit annual fiscal reports and some profit making entities provide even quarterly reports, there is no evidence that all major AGAs/PEs submit fiscal reports to central government at least six-monthly, as well as annual audited accounts. The AGA/PEs, are however required to, and do, submit fiscal reports and annual audited accounts to their Boards of Directors, which may include representatives of MoF and perhaps the parent line ministries.

3.45 Overall, the reporting by individual entities to the central government does not meet good practice standards and the Auditor General's reports provide comprehensive and reliable information, on the AGAs/PEs status, in this regard. Ascertaining the number of PEs as 107 in 2005/6 and 118 in 2003/4, [38] the Audit Reports for 2006-07 and 2005-06, confirm non-availability of annual accounts for 29 and 46 PEs respectively, by the prescribed date for submission to the Directorate General of Commercial Audit and Evaluation[39]. The non-availability gap varies from single to multiple years. The 2006-07 Report confirms that 10% of the 29 PEs did not submit accounts for a single year, 34% for two years and 55% for more than two years. Similarly, the 2005-06 Report finds 37% of the 46 PEs not submitting accounts for a single year, 26% two years and 37% for more than two years. Similar concerns have been identified in the 2007/8 audit year Audit Report. Public sector reform in Pakistan over the last decade, has led to privatization of some PEs and statutory autonomy of others. Such entities are perceived as unwilling to provide annual accounts to the CF Wing by virtue of statutory safeguards and independent governance structures. The CF Wing's limited profit and loss analyses of PEs provide a reasonable overview of major fiscal risks. Further action is required, however, to improve the frequency of reporting by AGAs and PEs, to consolidate analysis of overall AGA/ PE fiscal risk, and to strengthen linkages of risk analysis with the budget process. The current substantial gaps in the annual consolidated overview of fiscal risk that is produced is consistent with a C rating for the dimension.

(ii) Extent of *central government monitoring of sub-national governments' fiscal position.*

3.46 The four Provincial Governments pose little risk to generate liability for the GoP, and the systems and processes in place ensure that the fiscal liability is consolidated and risk monitored.[40] In practice, and since foreign trade and foreign exchange is controlled by the Federal Government, the SN Governments get foreign loans through express consent and coordination of GoP. These loans are then on-lent to the provinces. The Economic Affairs

[34] Pertaining to GCP, RECP, TCP, CEC, Saindak Metal Ltd, HEC, PODB, USC, Pakistan Steel Mills, PIA, FFC Jordan, SOPREST / GIK, Peoples Steel Mills, KS&EW, Pakistan Railways, WAPDA, KESC, Loan from HBL, ABL, Bank Al-Falah, Askari Bank and Brunal Investment Company etc.

[35] Pertaining to WAPDA, KESC, TCP, Pakistan Railways, PASSCO, DDC, Pakistan Textile City Ltd. Etc.

[36] Government of Pakistan, Ministry of Finance, Debt Policy and Coordination Office, Debt Policy Statement 2007-08, pp. 22

[37] Pertaining to PIA, WAPDA, PNSC, TCP etc.

[38] The Auditor General of Pakistan, Audit Report on the Accounts of Public Sector Entities Audit Year 2005-06 and 2006-07, page 3 in each.

[39] The Auditor General of Pakistan, Audit Report on the Accounts of Public Sector Entities Audit Year 2005-06 and 2006-07

[40] Article 167 of the Constitution deals with borrowing by Provincial Governments.

Division (EAD) is responsible for recording, reporting and monitoring of repayments of the on-lent loans as other GoP foreign loans. GoP makes at-source deduction for re-payments of the SN loans, the Accountant Generals (AGs) reconcile accordingly with AGPR on a monthly basis, and the Finance Secretary Meeting, held quarterly, reviews the position and related pending issues. Risks arising from unfunded pension liabilities are not yet explicitly addressed, but complete historical data on Pension and National Provident Fund liabilities are being compiled in the GFMIS. Quasi-fiscal activities of SN governments are not considered to be large, but are not systematically monitored. The level of risk to the federal government from these SN government operations is not considered to be high, but is not yet taken into account in overall risk assessment.

F. Public access to key fiscal information (PI-10)

3.47 PI-10 is assessed according to the extent to which essential PFM information is made available to the public. Essential PFM information is grouped in 6 categories (as per following sections). The PEFA score by M1 methodology is given in the summary table below, and assessment of compliance in each the six categories given in the following sections.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-10 Public access to key fiscal information.	**C**	While improvement is underway as a result of the GFMIS, public access criteria are presently met in 2 of the 6 essential areas.

(i) Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature. (Met).

3.48 The budget brief and budget speech are available through the MoF website. A complete set of budget documents is published, and is available in the market and through libraries; however, details are not made available on the website.

(ii) In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion. (Met).

3.49 Reports on budget execution are prepared by the AGPR. These are now being distributed to PAOs, as a result of the recent completion of the GFMIS roll-out and will be available within 15 days of month end. These reports are not yet made public, but consideration is being given to putting the reports on AGPR website when data quality is stabilized. Quarterly reports on Pakistan fiscal operations are available on the MoF website around three months from the quarter-end.

(iii) *Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit*. (Not Met).

3.50 The year-end financial statements are generally published within six months of completed audit,[41] but are not placed on the AGPR website nor otherwise made readily available to the public.

(iv) *External audit reports: All reports on federal government consolidated operations are made available to the public through appropriate means within six months of completed audit. (Not Met).*

3.51 External audit reports on federal government consolidated operations are not made available to the public through appropriate means within six months of completed audit.

(v) *Contract awards: Awards of all contracts with value above approx. USD 100,000 equivalent are published at least quarterly through appropriate means. (Not Met).*

3.52 Awards of contracts with value above approx. USD 100,000 equivalent are not made available or published quarterly or annually. Some awards of contracts of foreign funded projects are, however, made available, but mostly on the website of the concerned funding agency.

(vi) *Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics). (Not Met).*

3.53 Broad information on resources allocated annually to poverty reduction sectors including primary schools and health clinics is available through the MoF website (http://www.finance.gov.pk/poverty/poverty_PRSP_progress.aspx), but detailed information at service unit level is not readily accessible.

3. Policy-based Budgeting

A. Orderliness and participation in the annual budget process (PI-11)

3.54 This PI is assessed on three dimensions: (i) Existence of and adherence to a fixed budget calendar; (ii) Guidance on the preparation of budget submissions; and (iii) Timely budget approval by the legislature. The assessment on each dimension and overall score using M2 methodology is given in the table below.

[41] The financial statements become public documents after the President transmits the audited accounts to the Speaker of the National Assembly. However, there have been significant delays in this process.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-11 Orderliness and participation in the budget process.	**B+**	
(i) Existence of and adherence to a fixed budget calendar	*A*	The budget calendar is clear, is adhered to, and allows MDAs ample time to complete their estimates.
(ii) Guidance on the preparation of budget submissions	*C*	The budget circular gives clear and detailed directions, but does not include budget ceilings, and the process is complicated by three different circulars. These weaknesses should be overcome when all ministries are on the MTBF.
(iii) Timely budget approval by the legislature	*A*	The budget is regularly approved prior to the start of the fiscal year.

(i) Existence of and adherence to a fixed budget calendar.

3.55 A clear annual budget calendar exists, is adhered to and allows MDAs enough time (more than six weeks from receipt of the budget circular) to complete their detailed estimates on time. A typical schedule is illustrated by the 2008-09 budget preparation—detailed below:

a.	Issuance of guidelines for compilation of budget (By MoF)	By Nov. 15, ‘07
b.	Submission of proposals by ministries/divisions to MoF	By Dec. 15, ‘07
c.	Examination of preliminary estimates by FA[42] organization	By Jan. 16, ‘08
d.	Mid-year review of estimates	By Jan. 21, 08
e.	Final Submission of estimates	By Mar. 1, 2008
f.	Finalization of development budget/ PSDP by the priorities committee	By Apr. 2 to 12, ‘08
g.	Fair Copies of Dev./Capital Budget after endorsement by P&DD	By Apr. 26, ‘08
h.	Completion of all budget documents	By May 31, ‘08
i.	Presentation of budget to the Federal Cabinet	By Jun. ‘08

3.56 The time schedule was followed for the year and the final budget was presented to the National Assembly after approval from the Cabinet, on the 11th of June 2008, which was approved by the NA in the last week of June 2008. This type of sequence is followed every year

(ii) Guidance on the preparation of budget submissions.

3.57 Budget preparation is guided, first by a budget circular, and subsequently through detailed negotiations between line ministries and the MoF. The budget call circulars give clear and detailed instructions, but the process is complicated by the fact that separate call circulars are issued for the revenue budget, the PSDP/development budget, and the Medium Term Budgetary Framework (MTBF) circular for those ministries now on MTBF. Circulars issued by Finance and Planning Commission (PC) initiate the preparation process 8-10 months before submission of the budget. By December-January each year, line departments submit budget proposals after vetting

[42] FA: Financial Advisor, under the Expenditure Wing of the Finance Division, which oversees budget preparation and execution

by the Ministry of Finance (MoF) Financial Advisors. Negotiations between MoF, PC, and the respective Ministries continue until March or April until such time as expenditure aggregates are consistent with revenue and foreign project assistance forecasts. Review of budget proposals varies greatly depending on whether the expenditures are fixed or new. Most of the current budget is treated as fixed and therefore, is not reviewed in detail unless there is an extraordinary change in estimates from the previous year.

3.58 The budget circular does not regularly include budget ceilings approved by Cabinet prior to the issuance of the circular, although ceilings are being introduced as part of the MTBF process. The MTBF project has established a top down process for setting ceilings based on (a) a financial programming framework, and (b) regular preparation of a Budget Strategy Paper (BSP). Twenty five ministries are preparing their budget on the basis of the MTBF specific Budget Call Circular (BCC). The MTBF will be rolled out to all federal ministries other than Defence for the 2009/10 budget. This step should help to reduce the complexity of the present budget process and, in the long run, help unify the revenue and development budgets.

(iii) Timely budget approval by the legislature.

3.59 The National Assembly regularly approves the budget before the start of the financial year.

B. Multi-year perspective in fiscal planning, expenditure policy and budgeting (PI-12)

3.60 PI-12 is assessed in terms of four dimensions: (i) Preparation of multi -year fiscal forecasts and functional allocations; (ii) Scope and frequency of debt sustainability analysis; (iii) Existence of sector strategies with multi-year costing of recurrent and development/investment expenditure; and, (iv) Linkages between investment budgets and forward expenditure estimates. A summary rating against these dimensions and overall, using M2 scoring methodology, is given in the table below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-12 Multi-year perspective in fiscal planning, expenditure policy, and budgeting.	**C+**	
(i) Preparation of multi -year fiscal forecasts and functional allocations	C	Rolling three-year budget forecasts are made for most ministries, but linkages between multi-year forecasts and annual appropriations are not yet firm and differences are not explained. Linkages between the development plan and the MTBF also need to be strengthened.
(ii) Scope and frequency of debt sustainability analysis	B	As part of the SBA arrangement with the IMF, external and fiscal DSAs were undertaken in 2008. The DPCO does not undertake DSAs regularly, but tracks indicators of sustainability
(iii) Existence of sector strategies with multi-year costing of recurrent and development/investment expenditure	B	Sector strategies are developed only partially even within MTBF ministries; MTBF, however, now accounts for more than 50 percent of primary expenditure and will cover all except Defense from July 2009.
(iv) Linkages between investment budgets and forward expenditure estimates	C	Linkages between investment budgets, sector strategies, and forward estimates are weak.

(i) Preparation of multi -year fiscal forecasts and functional allocations.

3.61 The Federal Government initiated its medium-term budget framework (MTBF) a multi-year fiscal and expenditures forecast based on functional classifications in 2003. It was piloted in 2005-06 first with MTBF-based budgets for the Ministry of Health and the Ministry of Population Welfare. In 2006-07, it was rolled out to another three Ministries (Food & Agriculture, Education and Women Development). 2007-08 and 2008-09 witnessed rollout to another 20 (10+10) ministries. The Cabinet has approved a complete the roll out of MTBF to all line ministries other than Defense for Financial Year 2009-2010. The approach now combines top-down direction on budget ceilings by the MoF with bottom-up planning of service delivery by line ministries. A basic aim of the MTBF process is that line ministries will have more flexibility to define objectives, outputs, and outcomes, and will work towards performance-based budgeting by formulating, planning and implementing policies focused on 'outputs'. This will improve the overall service delivery. A financial programming framework is used to establish broad macro-economic and fiscal policy parameters, and a Budget Strategy Paper is prepared as a basis for the Cabinet to set budget ceilings. A short Medium Term Budgetary Framework is prepared as part of the budget presentation to the National Assembly.

3.62 Linkages between multi-year estimates and final budget allocations have not yet been firmed up, though this situation should improve with the 2009/10 budget, with most ministries under the MTBF. PEFA minimum requirements for an A or B rating are that budget ceilings should be linked to the previous budget's forward estimates and any differences explained, but this has not yet been achieved. Further work is also required to unify the development planning and budgeting process with the MTBF. The Medium Term Development Framework 2005-2010 has been developed by the Planning Commission. These plans are incorporated into the MTBF, but linkages between planning and MTBF processes need further strengthening. The agreed adoption of the GFMIS program classification for the MTBF covering both revenue and development budgets should facilitate this linkage in the future.

(ii) Scope and frequency of debt sustainability analysis.

3.63 Debt Sustainability Analysis (DSA) is not carried out regularly by the DPCO (which does track various indicators of the sustainability of Pakistan's debt). However, an external and fiscal DSA was carried out in conjunction with the IMF in late 2008 (and has been published on the IMF website—indicating GoP agreement) as part of the overall risk assessment for endorsing Pakistan's request for an SBA (see chapter 2 discussion). These analyses indicated broad debt sustainability over the medium term.[43]

[43] See IMF Staff Report, December 2008: "The external DSA ….estimated the impact of a combined shock including lower growth, a higher current account deficit, lower FDI, and a 30 percent real depreciation, while the fiscal DSA estimated the effects of a combined shock including lower growth, a higher real interest rate, and a lower primary surplus. In both cases, debt ratios remain sustainable." A number of important downside risk factors were also identified. The April 2009 review of progress indicated that debt dynamics had not changed substantially since approval of the SBA.

(iii) Existence of sector strategies with multi-year costing of recurrent and development/investment expenditure.

3.64 Statements of sector strategies exist for several major sectors and will be increasingly developed within the MTBF, though as yet costing and firm commitment to strategies are weak. More work is needed to link development and recurrent costing and budgeting within the MTBF framework. The MTBF now accounts for more than 50 percent of primary expenditure, and will cover all ministries other than Defense from July 2009.

(iv) Linkages between investment budgets and forward expenditure estimates.

3.65 Sector strategies and multi-year development and investment decisions are relatively weakly connected, and the recurrent cost impact of most investment decisions are not integrated and included in the forward estimates.

4. Predictability and Control in Budget Execution

A. Transparency of taxpayer obligations and liabilities (PI-13)

3.66 PI-13 is assessed in terms of three dimensions: (i) Clarity and comprehensiveness of tax liabilities; (ii) Taxpayer access to information on tax liabilities and administrative procedures; and (iii) Existence and functioning of a tax appeals mechanism. A summary rating against these dimensions, and overall, using M2 scoring methodology, is given in the table below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-13 Transparency of taxpayer obligations and liabilities.	**B**	
(i) Clarity and comprehensiveness of tax liabilities	*C*	Legislation and procedures for most of the major taxes are comprehensive and clear, with some significant remaining official discretionary powers.
(ii) Taxpayer access to information on tax liabilities and administrative procedures	*B*	Taxpayers have easy access to comprehensive and up-to date information on most major taxes. Taxpayer education programs are underway, but could be improved.
(iii) Existence and functioning of a tax appeals mechanism	*B*	Taxpayers have easy access to tax appeals mechanisms for most major taxes and improvements in appeals processes are underway.

(i) Clarity and comprehensiveness of tax liabilities.

3.67 The Federal Board of Revenue (FBR) has a continuing program of streamlining and simplifying the process of tax payment initiated in 2001. The FBR's policy reform program includes simplifying laws, introduction of universal self-assessment, elimination of exemptions, reducing dependence on withholding taxes, and establishing effective dispute resolution mechanisms. The enactment of the Income Tax Ordinance, 2001, and simplification of rules and procedures have helped modernize the regulatory framework for direct taxes. To facilitate tax payment, electronic filings of income tax and sales tax returns have also been introduced. Similarly, the sales tax refund process has been automated and the implementation of the Customs Automated Reform Project (CARP) has improved efficiency in key processes including cargo clearance and auction management. In light of these recent tax reforms, tax liabilities for major taxes have become well defined, although discretionary powers of tax assessment officials are significant Discretion over application of penalties is discussed under PI-14 below. As another example, assessment officials can extend the date of filing of return (for a maximum of one month), and may select a case for audit of any person with regard to his income tax affairs (section 177 of the Income Tax Ordinance, 2001). Assessment officials can also give a stay for the recovery of tax due for a maximum period up to the settlement of case by the appellate forum.[44] Remaining official powers thus may still give scope for significant abuse that needs to be addressed through effective complaints and internal review mechanisms—covered under (iii) below.

(ii) Taxpayer access to information on tax liabilities and administrative procedures.

3.68 Taxpayers have easy access to comprehensive, user friendly and up-to-date information on tax liabilities and administrative procedures for the major taxes. Information about taxes is passed on to the taxpayers as part of the annual budget speech and through the various tax notifications for the relevant taxes issued by the FBR (see http://www.cbr.gov.pk/). However, the computation of tax is a difficult task for the taxpayers as tax rates and conditions vary frequently. Information dissemination could be assisted by additional taxpayer education programs.

(iii) Existence and functioning of a tax appeals mechanism.

3.69 Taxpayers have easy access to administrative procedures for tax appeals for the major taxes. In order to ensure fairness, transparency and effectiveness of the procedures, tax appeals system has recently been re-engineered by introducing the Alternate Dispute Resolution (ADR) mechanism, and improving training and availability of suitable facilities for adjudicating officers. However, the objectives of the ADR are not being fully achieved, because ADR decisions are not binding on either party and, in many cases have been challenged in superior courts. Steps have been taken by the FBR to reduce the backlog of appeals on both direct and indirect taxes.

B. Effectiveness of measures for taxpayer registration and tax assessment (PI-14)

3.70 This PI is assessed in terms of the following three dimensions: (i) Controls in the taxpayer registration system; (ii) Effectiveness of penalties for non-compliance with registration and declaration; and (iii) Planning and monitoring of tax audit and fraud investigation programs. A summary rating against these dimensions, and overall, using M2 scoring methodology, is given in the table below:

[44] At a policy level, which is outside the scope of the PEFA assessment, issues of excessive exemptions under the GST, and the location of the tax policy function in FBR rather than the MoF are being examined as part of TARP.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-14 Effectiveness of measures for taxpayer registration and tax assessment.	**B**	
(i) Controls in the taxpayer registration system	*C*	Automated taxpayers databases are maintained for all the major federal direct and indirect taxes. Taxpayers are registered in database systems but linkages with other systems are seen as inadequate. The system of registration is currently under review.
(ii) Effectiveness of penalties for non-compliance with registration and declaration	*B*	Penalties for non-compliance exist for most relevant areas, but are not always effective, mainly because of lack of capacity and inconsistent administration.
(iii) Planning and monitoring of tax audit and fraud investigation programs	*B*	There is a continuous program of tax audits and fraud investigations, with clear risk assessment criteria, but further improvement in implementation is needed.

(i) Controls in the taxpayer registration system

3.71 The registration of tax payers is effectively operational, being governed separately under the Income Tax Ordinance, 2001, the Sales Tax Act, 1990, and the Customs Act, 1969. Each tax payer has a unique tax identification number for each tax, and all tax payers are registered in a database maintained at the FBR level. Under the income tax law, every person (individual, association of persons, and corporate entities) who earned taxable income in any tax-year are required to be registered with the Revenue Administration (RA) by having a National Tax Number (NTN). The sales tax law also requires mandatory registration for all importers, wholesalers, manufacturers (excluding cottage industry), specified retailers, hoteliers, and commercial exporters, etc. Every importer and exporter is also required to be registered with customs authorities under the customs law. Linkages among taxpayer databases are nonetheless seen as inadequate and a renewed effort is to be launched under the TARP to establish a comprehensive unique tax identification number (TIN). The registration of tax payers is also controlled/enforced on the basis of regular field surveys conducted and information acquired through this RA party information system by the tax authorities.[45]

(ii) Effectiveness of penalties for non-compliance with registration and declaration.

3.72 Ensuring that taxpayers comply with their procedural obligations of taxpayer registration and tax declaration is usually encouraged by penalties that may vary with the seriousness of the fault. Penalties do indeed exist; however, their effectiveness is determined by the extent to which they are sufficiently high to have the desired impact, and are consistently and fairly administered. The system of imposing penalties is well defined, for the most part, at the level of 100% of the tax evaded by concealment of income. Its application is subject to discretion of the tax official; for instance, the assessment official may impose or may not impose the penalties by considering explanations given by the tax payer (section 190 of the Income Tax Ordinance, 2001). Possible abuses of discretionary powers in this regard can contribute to reducing effectiveness of penalties. A ‘B’ rating corresponds most closely to the system status, but evidence indicates that significant effort is required to strengthen the administration.

[45] However, there is a substantial problem of a large unregistered tax base as a consequence of the exemption of large numbers of taxpayers from the tax net. This issue (outside the scope of PEFA) is being taken up as part of an ongoing tax policy review.

(iii) Planning and monitoring of tax audit and fraud investigation programs.

3.73 Inevitable resource constraints mean that audit selection processes must be refined to identify taxpayers and taxable activities that involve the largest potential risk of non-compliance. Indicators of risk are the frequency of amendments to returns and additional tax assessed from tax audit work. The ability of the RA 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. In 2007/08, FBR data drawn from monthly field reports indicate 6600 corporate entities and 15,593 non-corporate entities were subject to audit, of which approximately 10.5 percent in each case were subject to amendment, yielding PKRs 10 billion and 1.8 billion recoveries, respectively.

3.74 With the introduction of Universal Self Assessment Scheme (USAS), every declaration submitted by the tax payers are now being accepted as it is by the RA. The law provides for persons to be selected for an audit of their income tax affairs. The RA has selected cases for audit based on Risk Based Management audit technique, as applied by the Karachi Large Taxpayer Unit (LTU). Under this technique tax-payers can be selected for the audit only where there is a risk that acceptance of the declared version of income under USAS can cause loss of revenue. The RA can also appoint a firm of chartered accountants to conduct income tax audit of selected person(s). Similarly, under the sales tax law all registered/enrolled tax payers are liable to audit by the RA at least once in a year. In some cases, a firm of chartered accountants or cost and management accountants appointed by the RA may also conduct the sales tax audit. The selection mechanism has been devolved to the lower tiers i.e. RTO's and LTU's level. Thus there is a considerable improvement in monitoring and planning of audits. There is no ambiguity regarding the assessment criteria, where the core standard is the apparent revenue loss of the returns submitted under USAS.

3.75 Full implementation of risk-based audit remains problematic, however, particularly at field level. The RA is making major efforts to improve field level assessments and implement risk-based management audit technique country-wide.

C. Effectiveness in collection of tax payments (PI-15)

3.76 This PI is assessed in terms of the following three dimensions: (i) 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; (ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration; and (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury. A summary rating against these dimensions, and overall, using M1 scoring methodology, is given in the table below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-15 Effectiveness of collection of tax payments.	**D+**	
(i) 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*	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) Effectiveness of transfer of tax collections to the Treasury by the revenue administration	*B*	An effective transfer system is in place and is being progressively computerized. Some delays in transfer have been experienced in the past, but these are largely overcome.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	*B*	A process for complete regular monthly reconciliation of revenue receipts is in place, but further strengthening of reconciliation is needed and underway, and is expected to be completed in 2009. Tax assessments and receipts are systematically compared at least quarterly throughout the year, but a complete reconciliation statement is not available.

(i) 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.

3.77 Data collection on arrears requires further strengthening. Available data, however, show that the percentage of arrears collected (net of deletions) was 41% in 2005/06, 31% in 2006/07, and 48% in 2007/8. Total arrears as a percentage of income tax revenues were 27%; 12%; and 16% for these years. These data mean that the rating on this dimension cannot be assessed above a D rating until the collection ratio is improved by the FBR.

(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.

3.78 There is now a strong system for paying revenues into the treasury through the National Bank of Pakistan (the fiscal agent of the SBP). In case of income tax and sales tax, when the taxpayer deposit the tax in the bank branch, copies of the paid tax challans are distributed to AGPR/District Accounts Offices, and FBR Treasuries, who are responsible for preparing accounts and reconciliation on the same day. The process now requires transference of government revenues collection by the designated branches of the National Bank Pakistan (NBP) to the SBP on daily basis. Thus, NBP A-category branches located in major cities like Karachi, Lahore, Islamabad, etc transfer the funds within 24 hours. B-category branches of the NBP located in small cities, however, are required to settle their accounts with SBP within 48 hours, and NBP branches located in remote areas transfer funds within 72 hours. Any deviations from the above time-lines will expose the NBP branches to penalties.

(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.

3.79 Monthly revenue reconciliation processes by the AGPR, FBR, and SBP are in place although reconciliation differences remain. The main action to improve reconciliation will be to establish an interface between FBR, SBP-NBP, and AGPR with support from the PIFRA team.

The FBR system has to be proved and stabilized before the interface can be established (anticipated completion date June-2009).

3.80 Tax assessments are systematically compared with collections throughout the year, and data is available at macro level in FBR publications. Under USAS, the income tax return once received is considered as assessed, and payment against liability is monitored throughout the year. FBR do generate information on gross tax liability and returns by category of taxpayer (corporate, association of persons, salaried individuals, and others). However, no overall statement is available showing reconciliation between assessments and receipts.

D. Predictability in the availability of funds for commitment of expenditures (PI-16)

3.81 This PI is assessed along three dimensions: (i) Extent to which cash flows are forecasted and monitored; (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment; and (iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs. The table below gives a rating on each of the dimensions and an overall PI score using M1 methodology.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-16 Predictability in the availability of funds for commitment of expenditures.	**D+**	
(i) Extent to which cash flows are forecasted and monitored	*D*	Cash flow planning and monitoring is not undertaken at present. Some elements of a system are in place and will be built up as part of the requirements under the IMF SBA.
(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment	*C*	MDAs are provided reliable information on releases for one or two months in advance, though predictability is often less in practice.
(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs	*D*	There are frequent adjustments, which are revealed only ex post.

(i) Extent to which cash flows are forecasted and monitored.

3.82 The GoP has not developed an operational system of cash-flow forecasting, largely because cash requirements within-year have been met by the SBP's accommodating financing of the fiscal deficit—essentially through SBP issuance of treasury bills to meet government cash requirements. Under the IMF SBA, however, deficit financing by the SBP will be phased out, and it will become essential to establish an effective cash forecasting and planning system including effective coordination between the MoF and SBP in preparing in-year budget plans and planning for issuance of domestic debt. Some elements of a cash forecasting system are in place, mainly through detailed information on revenue collection relative to forecasts that are prepared by the FBR on a quarterly basis and submitted to the Budget Wing. Work is now underway to establish a cash forecasting and monitoring system to meet the needs of the MoF for fiscal management and efficient financing of the deficit, and for monetary management by the SBP.

(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment.

3.83 Cash management and expenditure control are at present effected almost entirely through a funds release system. The funds release by the MoF is done in stages within the budget year with the aim of controlling the commitment of expenditure by the MDAs. Predictability in the availability of funds for commitment of expenditure is effected by a dual funds release process for current and development expenditures. The current expenditure in the first half of the financial year is restricted to 40% of the total budget allocation, with remaining 60% to be released in accordance with separate instructions issued by the MoF.[46] The development funds releases used to be made on an old and well established quarterly basis, till 2005, when the paradigm of quarterly releases was shifted from supply-driven to a more demand-driven system.[47] The Public Sector Development Programme (PSDP) allocation, the Cash Plan[48] approval and the Planning Commission (PC) quarterly utilization and project implementation review, drives availability of funds system for expenditure. Subsequent to the approval of PSDP by the NA, and start of the new financial year, the projects are required to submit an annual cash plan to the line ministry, indicating the quarterly budgetary requirements. The cash plan needs approval by the line ministry, PC and FA/ DFA, to become effective. Quarterly release requests are then made by Project Directors (PDs), based on the approved cash plan and utilization of funds allocated during the previous quarter. Releases for the first quarter of the financial year are made by the PAO, without approval of the FAO[49].

3.84 Thus, particularly on the development budget side, the MDAs are provided reliable information on commitment ceilings for one or two months in advance, although predictability is less in practice. PSDP funds flow study finds lead times of 48-211 days from the time of request for release of funds by PDs to the time of actual payments to contractors/consultants.[50] Furthermore, predictability could be lessened in times of financial crunch as witnessed during the 2007-08 and 2008-09. The release of development budget for 2008-09 has been restricted to 15% across-the-board in the first quarter. Such a measure means that no priorities are assigned among activities for expenditure reduction, and no account is taken of cash plans.

(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.

3.85 As already described under PI-1 and PI-2, the Constitution allows supplementary expenditure by the federal government, providing that all supplementary grants are presented to the Parliament for ex-post authorization, along with the budget proposals for the new fiscal year for approval.[51] This practice, while revealing expenditures ex-post, does not meet international standards of transparency and accountability for within-year government spending.

[46] Government of Pakistan, Finance Division, *System of Financial Control and Budgeting* (Sept 2006), pp 8
[47] The cash planning process was preceded by lump quarterly releases of 20%, 25%, 35% and 20% of the annual PSDP allocation.
[48] Since 2005.
[49] *System of Financial Control and Budgeting* (September – 2006), Finance Division
Finance Division, Islamabad, No.F.3(2)Exp.III/2006, 13th September, 2006, Para 13 (vii).
[50] The World Bank (Nov 2007), Case Study on the Review of Flow of Funds and Utilization Rate of the PSDP in Pakistan.
[51] Article 84 of the Constitution makes the following provision with regard to supplementary grants: “The Federal Government shall have power to authorize expenditure from the Federal Consolidated Fund, whether the expenditure is charged by the

E. Recording and management of cash balances, debt and guarantees (PI-17)

3.86 This indicator is assessed on three dimensions: (i) Quality of debt data recording and reporting; (ii) Extent of consolidation of the government's cash balances; and (iii) Systems for contracting loans and issuance of guarantees. The table below gives a rating on each of the dimensions and an overall PI score using M2 methodology.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-17. Recording and management of cash balances, debt and guarantees.	**B+**	
(i) Quality of debt recording and reporting	*B*	Domestic and foreign debt recording systems and policy framework have been substantially strengthened but significant problems remain, particularly in reporting and reconciliation of the National Savings Scheme (NSS) and full and timely reconciliation of external debt (particularly where third-party payments are involved).
(ii) Consolidation of the government's cash balances	*B*	Cash balances are regularly consolidated and reported but reconciliation reporting between government accounts needs to be upgraded.
(iii) Systems for contracting loans and issuance of guarantees	*A*	Overall limits on debt are clearly set by law. The DPCO sets policies under the FDRL and recording and reporting of debt is transparent. Loans are signed by the MoF (Economic Affairs Division) under ECC authority.

(i) Quality of debt data recording and reporting.

3.87 The GoP has established a Debt Policy Coordination Office (DPCO) in the MoF, to coordinate matters relating to debt and compliance with the relevant provision of the Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005. The FRDL requires compliance reporting, including: total public debt annually not exceeding a certain percentage of GDP; total public debt reduction annually as a certain percent of GDP; and issuance of guarantees within 2% of GDP in any fiscal year. The GoP is making appreciable effort to ensure that foreign and domestic debt records are complete, updated and reconciled. Problems remain, however, with the CDNS reconciliations, particularly pertaining to the banking transactions, and work is still underway to fully reconcile AGPR, SBP, and EAD external debt stock and flow records, including incorporation of third party transactions.

3.88 Domestic debt is reported on a monthly basis by MoF, and External debt quarterly by EAD. Both exhibit a 30-40 days time lag in the completion of the report. Multiple management and statistical reports, of high quality, are produced covering debt service, stock and operations including: Quarterly Status Reports and Year Books by EAD; and quarterly Update on Debt Situation, annual Debt Policy Statement, Fiscal Policy Statement and Medium Term Budgetary Framework by the MoF. The EAD and MoF official websites (www.ead.gov.pk and www.finance.gov.pk) carry these reports. Furthermore, the fact that Debt and Fiscal Policy Statements are mandatory and laid continuously before the Parliament by 31 January further enhances the transparency and integrity of debt data recording and reporting. Most of the

Constitution upon that Fund or not, and shall cause to be laid before the National Assembly a Supplementary Budget Statement or, as the case may be, an Excess Budget Statement, setting out the amount of that expenditure, and the provisions of Articles 80 to 83 shall apply to those statements as they apply to the Annual Budget Statement."

aforementioned good practices have been developed since 2003 and DPCO plans to improve the operations further through implementation of strategies, as outlined in the Debt Policy Statement, including amongst others, "establishing links with the four debt management units in the government (SBP, EAD, NSS and Budget Wing) in order to develop an updated electronic database of all components of debt on a historical basis"[52]

(ii) Extent of consolidation of the government's cash balances.

3.89 The Consolidated Fund principles established under Articles 78-81 of the Constitution provide a legal basis for comprehensive recording and reporting on all government operations (see PI-7 above). In practice, however, the operation of a fully transparent Treasury Single Account (TSA) is not met (a) because of over-use of public accounts for government transactions (through misuse of advance and deposit accounts, personal ledger accounts, and lack of prompt clearance of suspense accounts); and (b) because of special funds being set up to handle many foreign-financed transactions.

3.90 Many of these issues are being addressed through the GFMIS that is now operational under the World-Bank-supported PIFRA project. The SBP provides the cash balance position to MoF, AGP, CGA/AGPR/AGs daily, including the position of the SN government accounts. Whilst a lag of 3-4 days is evident, the Government Balance statement of SBP is consolidated by the Budget Wing of MoF for internal analysis and management reporting, up to the Minister of Finance/Advisor on Finance, including: Daily Bank Borrowing Analysis; Deficit Financing – Bank Borrowing with Cash Register; Daily Analysis of Bank Borrowing; and Summary of Fiscal Operations. SBP also provides a monthly cash balance statement that is used by AGPR for reconciliation with a time lag of about two months, in view of the longer duration required by SBP to reconcile with NBP.

(iii) Systems for contracting loans and issuance of guarantees.

3.91 As noted above, the FRDL imposes fiscal targets, requiring limits on debt and on issuance of guarantees (within 2% of GDP in any financial year). Aggregate targets on total debt have been met up until the present financial crisis, and new borrowing will be tightly controlled under the IMF SBA. The limit on issuance of guarantees has been complied with over the past three years. Operational management regarding proper approval, recording and reporting on contracting loans and issuance of guarantees is bifurcated. Foreign loans are managed by EAD and domestic by the Budget Wing of FD. All loans must be approved by the ECC of the Cabinet; actual signing and issuance of guarantees is carried out by EAD and Finance Division (both divisions of the MoF) under ECC authority.

F. Effectiveness of payroll controls (PI-18)

3.92 This PI is assessed in terms of the following four dimensions: (i) Degree of integration and reconciliation between personnel records and payroll data; (ii) Timeliness of changes to personnel records and the payroll; (iii) Internal controls over changes to personnel records and the payroll; and (iv) Existence of payroll audits to identify control weaknesses and/or ghost

[52] Government of Pakistan, Ministry of Finance, Debt Policy Coordination Office, Debt Policy Statement 2007-08, pp 24.

workers. The summary rating against these dimensions and overall score by M1 methodology is given in the table below.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-18 Effectiveness of payroll controls.	**C+**	
(i) Degree of integration and reconciliation between personnel records and payroll data	*C*	The payroll system in the GFMIS is fully functional and pensions and General Provident Fund are underway. These systems will provide the basis for a fully integrated personnel database across all of the federal government in the future.
(ii) Timeliness of changes to personnel records and the payroll	*B*	All changes to personnel records and payroll are updated monthly in time for the following month's payments in all MDAs in the GFMIS. A lesser, but NAM-compliant standard is achieved in the SAEs.
(iii) Internal controls over changes to personnel records and the payroll	*B*	Internal controls on changes in personnel record are clear and are applied; the GFMIS is increasingly giving assurance of the integrity of personnel control data.
(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers	*C*	Audits covering payroll issues are carried out and, when the system is fully automated, should be able to identify ghost workers.

3.93 The sanctioned strength for the year 2006-2007 in respect of all categories of Federal Government Employees was 419,499 while the filled in posts were 375,932 (89.1% of the sanctioned strength) as on July 1, 2008.[53]. PIFRA has made significant contributions towards automating the payroll for the Federal Government. The automated payroll is operational at the AGPR and all sub-offices including Gilgit. The AGPR Islamabad system functionality includes HR, FI, GPF and Pension Modules. Furthermore, at Islamabad about 75,000 employees are being paid through the system, GPF FI and Pension modules are functional at all sub-offices except Gilgit. All new cases are handled by the system, but completion of historical data entry for GPF and Pensions is a challenge and still underway. Some SAEs, however, remain beyond the purview of the system, although more recently there are positive indications for extension of the current GFMIS software to two SAEs (Foreign Office HQ payroll is now on the GFMIS).

(i) Degree of integration and reconciliation between personnel records and payroll data.

3.94 As yet, a fully automated and centralized personnel database for the GoP does not exist. Personnel records are manual and decentralized, mostly maintained by individual departments, so reconciliation cannot be readily verified. NAM, which applies to both centralized accounting entities and most SAEs (except Defense and Pakistan Railways), requires regular reconciliation of all permanent records. Available evidence indicates that reconciliation of payroll and personnel records takes place within 3 months for virtually all government agencies. The payroll under the GFMIS is the only reliable centralized database, limited, as noted, by non-coverage of all SAEs. It collects, amongst other personal details, key HR data including: academic/professional qualification; date of entry in government service/appointment; place of appointment; date of adhoc/contract appointment; and functional group/ service etc. At this level, personnel data and payroll are regularly reconciled to ensure data consistency and monthly reconciliation. Flows of personnel from SAEs to rest of government, still pose problems,

[53] Government of Pakistan, Establishment Division, Pakistan Public Administration Research Centre, Management Services Wing, Annual Statistical Bulletin of Federal Government Employees 2006-07, pp X.

however. The gradual but substantial progress being achieved in the collection and validation of historical personnel data for payroll, pensions, and GPF processing across the federal government through PIFRA should, over time, lead to full integration and reconciliation of personnel and payroll data.

(ii) Timeliness of changes to personnel records and the payroll.

3.95 Records at the AGPR confirm that changes made up to the 10th of the month are incorporated in the payroll run for that month. There is a transparent and documented process for changes to the payroll, with no provision and little evidence of any retroactive corrections in GoP domain with PIFRA. Comprehensive data are unavailable for SAEs, but the NAM environment for most gives assurance that the time-lag for updating changes to payroll and personnel records would be less than three months. Overall, a B rating has been given to this dimension.

(iii) Internal controls over changes to personnel records and the payroll.

3.96 The NAM Accounting Manual 2 provides clear guidelines for changes in records and these are applied for those employees whose emoluments are automated. Manual 5 gives similar guidelines for SAEs applying NAM. While NAM applies particularly to entities on the GFMIS, the authority and procedures for change are clear in all cases. The change (F02) form requires authentication by the official concerned in the case of gazette officers (grade 17 and above), and the Drawing Disbursing Officer (DDO) in the case of others, thus resulting in an audit trail. Under the GFMIS, system controls will give a more complete assurance of the integrity of data.

(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.

3.97 The AGP conducts audits, including payroll audit. However the coverage of government may not be adequate to ensure data integrity over all units of government. In the absence of an automated system of payroll processing, for the whole of the Federal Government, the audits currently conducted give only partial coverage. Once PIFRA is rolled out (or the entity is computerized), a system-based audit by AGP should be feasible—and these are to be carried out for SAEs for the audit of 2008/9 accounts. The CGA, as a routine internal control measure, conducts an annual inspection, including payroll.

G. Competition, value for money and controls in procurement (PI-19)

3.98 This PI is assessed in terms of three dimensions: ((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); (ii) Extent of justification for use of less competitive procurement methods; and (iii) Existence and operation of a procurement complaints mechanism. The assessment and overall score by M2 methodology is given in the table below.

3.99 PI-19, however, represents only a limited view of procurement system issues. Procurement is covered in much greater detail in the Baseline Procurement Assessment of the Federal Government carried out in parallel with this PFM Performance Report. Every effort has been made to ensure that the PEFA and procurement assessment exercises are mutually consistent. Procurement reforms, however, will be based primarily on the outcome of the final OECD-DAC-BIS Assessment.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-19 Competition, value for money, and controls in procurement.	**C+**	
(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).	*B*	Available information 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.
(ii) Extent of justification for use of less competitive procurement methods	*C*	Justification of use of less competitive practices is generally weak especially where contracts are to be awarded to government-controlled agencies.
(iii) Existence and operation of a procurement complaints mechanism	*C*	A basic process exists, but the current public procurement rules do not establish an effective mechanism for addressing complaints in a timely and even-handed way.

(i) Evidence on the use of open competition for award of contracts.

3.100 The threshold set by the Federal Government for award of contracts that exceed the nationally established monetary threshold for small purchases is Rs. 100,000/- (PPR 42). It has also allowed the semi/autonomous organizations under the administrative control of the Federal Government to procure up to maximum of Rs. 500,000/- without entering into open competition (provided that the respective board of directors of the organization endorse the same). Currently, the data available with PPRA, which may not be fully accurate, estimates that a significant percentage (more than 50% but less than 75%) of contracts above the defined thresholds are open to competitive procurement methods by the procuring agencies. Discussions with several representative line ministries indicates that deviations relate generally to direct award of contracts to Government owned entities/subsidiaries like PRACS and RAILCOP (under Ministry of Railways/Pakistan Railways), NESPAK (under Ministry of Water and Power) PEPAC (under Ministry of Environment). Recent PPRA reviews of compliance to PP rules by the major procuring entities indicate a substantial reduction in all recorded deviation from PP rules from 95 % of all tenders in 2005/06 to around 23 % in 2007/08. This analysis does not specify areas of deviation, but indicates a general improvement in practice as a result of monitoring and training.

3.101 The B rating in this, and a C rating for the following dimension are broadly consistent with concerns expressed in the procurement draft (pillar III 7b) regarding the role played by subsidiary public sector contracting entities.[54]

(ii) Extent of justification for use of less competitive procurement methods.

3.102 Where less competitive procurement methods are used, two main reasons are given. First, the time and cost of an open-competitive method which requires 26-30 days for award of

[54] This OECD-DAC-BIS indicator scores relatively highly, however, because it primarily assesses private sector competitive capacity.

contract. A second reason is the immediate availability of a service provider through their own subsidiaries.[55] It is argued that in such cases they can ensure efficiency (cost and time) in carrying out the works/services or delivery of goods. Often, however, the practice of these subsidiaries is to get the contract on direct sourcing and either sub-let it to one of the private sector organizations or bring in a private company/organization as partner in the service delivery. Contrary to the PPRA Rules which are clear on the use of competitive procurement practices, these forms of discretion do apply in practice. Consequently, a C rating is assigned to this dimension.

(iii) Existence and operation of a procurement complaints mechanism.

3.103 PP Rule 48 provides the basis of a grievance redress system. The provision is not, however, comprehensive, independent and transparent. It does not provide rule/regulations based step-wise process for redressing grievances. The provision calls only for the procuring entity to set up an internal committee, rather than referring the matter to an external organization. PP Rule 49 does provide for an external arbitrator which is governed by the arbitration act. However, even this does not operate in a manner that provides for timely resolution of complaints. The World Bank together with DfID is supporting PPRA in devising an external, independent second-tier grievance complaints system. The C assessment in this area is broadly consistent with the procurement assessment (Pillar III 8b), which notes the lack of an alternate dispute resolution mechanism.[56]

H. Effectiveness of internal controls for non-salary expenditure (PI-20)

3.104 This PI is assessed in terms of three dimensions: (i) Effectiveness of expenditure commitment controls; (ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures; and (iii) Degree of compliance with rules for processing and recording transactions. The assessment and overall score by M1 methodology is given in the table below:

[55] One example is the NRSP (National Rural Support Program), a non-governmental organization which is occasionally, directly contracted by the Ministry of Rural Development. The justification given is that NRSP is the largest service provider with rich experience, in the field of rural development.

[56] Again the OECD-DAC-BIS assessment indicator is relatively high because it covers a number of dimensions of dispute resolution, most of which are met.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-20 Effectiveness of internal controls for non-salary expenditure.	**C**	
(i) Effectiveness of expenditure commitment controls	*C*	Expenditure controls exist and are effective to an extent in controlling expenditure within available cash limits. The GFMIS incorporates budget controls as part of transactions processing. Commitments, however, are not systematically recorded and reported as part of the overall system of control. Measures to implement such a system through the GFMIS are underway.
(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures	*C*	Rules are in place and widely understood. Breaches of rules are repeatedly noted in AGP reports. New measures to establish effective internal controls by appointing CFAOs are underway but not yet effective.
(iii) Degree of compliance with rules for processing and recording transactions.	*C*	Rules are in place but use of simplified/emergency procedures is an important concern.

(i) Effectiveness of expenditure commitment controls.

3.105 Weakness of internal financial management and control has long been recognized as a problem, including by the IMF Fiscal Transparency ROSC (2000), the World Bank CFAA (2004), as well as by the AGP[57]. Nonetheless, major expenditure commitments are generally controlled through the system of FA postings from the FD to line ministries. FAs are responsible for ensuring that commitments by line ministries are held firmly within cash availability limits. In that sense, the controls are generally effective, though they depend on a high degree of central MoF control over ministry management, and, in themselves, pose appreciable risks of abuse.

3.106 Efforts are underway to address these issues, including a fully functional GFMIS, accounting and internal control system that operates at federal, provincial and district levels under PIFRA. Two measures that will be important in developing a more management-oriented control system using the GFMIS are: (i) the building up of line ministry financial management through appointment of Chief Finance and Accounting Officers (CFAOs), discussed further below; and (ii) now that the functionality of commitment control through the GFMIS has been established, steps are being taken to make the commitment control system operational from July 2009. Currently, however, commitment recording and reporting are not significant elements of non-salary expenditure control.

(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures.

3.107 The GoP internal control system is largely based on General Financial Rules, Fundamental Rules (FR), Supplementary Rules (SR), Federal Treasury Rules (FTR), the more recent System of Financial Control and Budgeting (September 2006), and other regulations, instructions and orders issued by the MoF from time to time. As noted above, internal control systems are generally regarded as being weak by various authoritative sources including the AGP. These problems, however, arise from weaknesses in financial administration within line ministries rather than absence of rules or lack of understanding of the rules. The internal controls that are in place are comprehensive, clear (albeit complex and based on centralized control) and

[57] Auditor General of Pakistan, Audit Report on the Accounts of Federal Government- (Civil), Audit Year 2007-08, pp 3.

are well understood throughout the financial administration. A major effort has been initiated to address the underlying internal control issues and transfer internal management responsibilities to the line ministries through the establishment of CFAOs in 19 targeted positions/ministries, of which 14 CFAOs had been appointed as of November 2008. The latter however has not attained a fully effective internal control system, due to several shortcomings, including lack of administrative support for CFAOs by their ministries. The proposed CFAO role is primarily oriented towards strengthening financial management processes within line ministries and divisions, but also includes internal audit responsibilities (see further discussion under PI-21 below).

(iii) Degree of compliance with rules for processing and recording transactions.

3.108 Rules for recording and reporting transactions are complied in a significant majority of transactions. However, Departmental Accounts Committee responses to audit queries of non-compliance with procedures, point in a number of cases, to several applications of routine use of emergency transactions that may well be doubtful in nature. The Audit Year Reports 2005-06 and 2006-07 contain numerous audit observations that note serious internal control weaknesses.

I. Effectiveness of internal audit (PI-21)

3.109 This PI is assessed in terms of the following three dimensions: (i) Coverage and quality of the internal audit function; (ii) Frequency and distribution of reports; and (iii) Extent of management response to internal audit findings. The summary rating against these dimensions and an overall score using the M1 method is given in the table below.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-21 Effectiveness of internal audit.	**D**	
(i) Coverage and quality of the internal audit function	*D*	A general responsibility of Principal Accounting Officers, but not developed administratively in any ministry. Some steps are being taken to appoint CFAOs (see PI-20), but internal audit as a separate function is not being addressed.
(ii) Frequency and distribution of reports	*D*	As a consequence of (i), no reports are issued.
(iii) Extent of management response to internal audit findings	*D*	As a consequence of (i) and (ii), management response cannot is inexistent.

(i) Coverage and quality of the internal audit function.

3.110 The internal audit function is assigned as a responsibility of Chief Finance and Accounting Officers, but has not been developed as an administrative operating function except in AGAs and PEs (which generally operate under corporate legislation).[58] Whilst the System of

[58] The effectiveness of internal audit system within the AGAs/PEs is also questioned by the Audit Reports for 2006-07 and 2005-06, confirming non-availability of annual accounts for 29 and 46 PEs respectively, by the prescribed date for submission to the Directorate General of Commercial Audit and Evaluation. The non-availability gap varies from single to multiple years. The 2006-07 Report confirms that 10% of the 29 PEs did not submit accounts for a single year, 34% for two years and 55% for more than two years. Similarly, the 2005-06 Report finds 37% of the 46 PEs not submitting accounts for a single year, 26% for two years and 37% for more than two years.

Financial Control and Budgeting (September 2006) assigns a basic internal audit role to the CFAOs, the function is primarily in-effective for two reason, amongst others. Firstly, shortcomings in the implementation of CFAO as provided in the System of Financial Control and Budgeting (for details see PI 20). Secondly, internal audit conceptually is a stand-alone dedicated and independent internal management support function, to advise the management on the effectiveness of the internal control system and flag risk areas for the management's attention. The CFAO's current financial management cum internal audit role does not represent good practice—though it may initially be seen as a necessary first step. Pre-audit carried out by the FAs and AGPR is an external financial control, and in no way represents internal audit. The Institute of Internal Auditors defines internal audit as "an independent, objective, assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined, approach to evaluate and improve effectiveness of risk management, control, and governance processes"[59]

(ii) Frequency and distribution of reports.

3.111 A rating of 'D' is applicable to dimensions (ii) as there is no evidence suggesting that reports are issued regularly for most GoP entities.

(iii) Extent of management response to internal audit findings.

3.112 A rating of 'D' is also applicable to dimension (iii), as a residual rating. In the absence of an operational internal audit function generating management reports, follow up management actions becomes non-existent.

5. Accounting, Recording, and Reporting

A. Timeliness and regularity of accounts reconciliation (PI-22)

3.113 This PI is assessed against two dimensions: (i) Regularity of bank reconciliations; and (ii) Regularity of reconciliation and clearance of suspense accounts and advances. The summary assessment and overall score using M2 methodology is given in the table below.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-22 Timeliness and regularity of accounts reconciliation.	**C+**	
(i) Regularity of bank reconciliation	*C*	Reconciliation of accounts between ministries and AGPR and, at a transaction level, between AGPR and the banks are done regularly. An aggregate reconciliation is done quarterly by the MoF in its fiscal operations report. Problems with un-reconciled balances are being addressed under the direction of the FMC.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	*B*	Uncleared suspense balances have been problematic, as per above, but these are now cleared regularly under FMC monthly direction. More system-based and administrative verification of suspense account clearance would be desirable.

[59] International Monetary Fund (2002), The Role of Internal Audit in Government Financial Management: An International Perspective, pp6.

(i) Regularity of bank reconciliation.

3.114 Reconciliation of expenditures recorded at the AGPR, with those recorded, on memorandum basis by the line ministries occurs regularly each month. Bank scrolls are also received daily and checks issued and treasury receipts are reconciled with presented checks and deposits. The MoF provides an overall reconciliation of the fiscal accounts with the monetary balances in its quarterly reports on government fiscal operations (covering all levels of government). These are compiled around two to three months after the end of the quarter. Work is underway to carry out this reconciliation using the GFMIS. Serious issues have been experienced, however, in explaining un-reconciled balances in the MoF fiscal report but these relate to flows between government accounts (see discussion of unidentified expenditure in PI-7 above). There are also remaining problems from carry forward of un-reconciled balances from previous years. The reconciliation statements prepared by AGPR for FYs 2005/06, 2006/07, and 2007/08 show un-reconciled closing balance differences of Rs 3.85 billion, Rs 5.44 billion, and Rs 1.79 billion respectively between the AGPR books and the State Bank of Pakistan. The government auditor has also indicated substantial *unresolved differences* between the AGPR and the bank records in his report on the consolidated financial statements of the federal government for FY 2006-07.

(ii) Regularity of reconciliation and clearance of suspense accounts and advances.

3.115 Major efforts have been made recently under the direction of the federal Fiscal Monitoring Committee (FMC) chaired by the Additional Secretary Finance (Budget) to identify the major factors leading to large un-reconciled balances (unidentified expenditures). These include failure to clear suspense account balances held in the public account and non-recording of some foreign funded transactions. FMC meetings are held monthly, and minutes of the meetings indicate that suspense balances are regularly cleared. There is a need, however, to strengthen FMC scrutiny of these reports by system-generated reports and technical scrutiny by a strengthened FMC Secretariat. Most of the problems are now being successfully addressed and preliminary indications are that the level of unidentified expenditure for 2007/8 budget will be relatively low (as discussed under PI-7).

B. Availability of information on resources received by service delivery units (PI-23)

3.116 This PI assesses the collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (such as primary schools and primary health clinics) relative to the overall resources made available to the sector. Scoring is shown in the table below using the M1 method.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-23 Availability of information on resources received by service delivery units.	**B**	For the Federal government, the GFMIS and MDA records permit detailed data to be available at spending DDO level and for PRSP reports to be generated. Transactions in kind are not recorded, but limited at the federal level.

3.117 Most service delivery functions are carried out by provincial and lower level governments; the federal government has limited direct responsibilities (for instance for higher education, and federally managed hospitals, clinics, and schools in the Islamabad capital territories). For these units, service delivery information is available on the system at DDO level, which corresponds generally to service units. The federal government, however, has an overall responsibility for oversight of service delivery as part of the PRSP. The GFMIS can provide detailed reports at spending DDO level and currently generates PRSP progress reports covering all PRSP sectors, which are posted quarterly (about 6 months after quarter-end).[60] The PRSP Secretariat has conducted one Poverty and Social Impact Analysis on micro-financing (in 2005) and plans to carry out regular service delivery assessments in the future.

3.118 The problems, however, are more complicated at provincial and lower levels of government. The key sector departments (education and health) have in place a well functioning tracking mechanism, reported regularly, on resources received and deployed across their respective sectors, but a DDO may have multiple service units. Provinces also continue to use PLAs and imprest arrangements which means that expenditure is recorded when transfers are made rather than at the time of actual expenditure. The use of such arrangements is being actively discouraged.

3.119 The system does not record transactions in kind, but these are relatively minor, particularly at the federal level.

C. Quality and timeliness of in-year budget reports (PI-24)

3.120 This PI is assessed in three dimensions: (i) Scope of reports in terms of coverage and compatibility with budget estimates; (ii) Timeliness of the issue of reports; and (iii) Quality of information. The ratings and overall score using the M1 method are shown below.

Indicator	Score	Brief Explanation of status as at the reporting period
PI-24 Quality and timeliness of in-year budget reports.	**C+**	
(i) Scope of reports in terms of coverage and compatibility with budget estimates	*C*	Only payments or receipts data (budget vs. actual) are covered but no commitments are included in BERs.
(ii) Timeliness of the issue of reports	*A*	BERs, including SAEs, are produced monthly and within 3 weeks of month-end. Quarterly consolidated government reports are made available on the MoF website.
(iii) Quality of information.	*B*	Until the GFMIS is fully stabilized, there will be some problems with data quality; but these will be resolved through use of the system and routine remedial measures.

(i) Scope of reports in terms of coverage and compatibility with budget estimates.

3.121 A Budget Expenditure Report (BER) for all line ministries is now prepared monthly by the AGPR within 15-21 days of the end of the month. SAEs produce their own internal management reports, and the AGPR consolidates all accounting entity reports each month. A consolidated federal government BER, showing budget and actual expenditures at major/minor object heads by ministry/division and by function is currently available from AGPR. The BERs

[60] See http://www.finance.gov.pk/poverty/poverty_PRSP_progress.aspx. These reports should be available more quickly once data verification by the PRSP Secretariat is completed.

for PAOs provide detailed and summary reports comparing budget against actual, showing object-wise spending by administrative, functional and economic classifications. Expenditure is captured at payment stage as commitment accounting is not yet in place. Relative to the reports produced prior to the introduction of the GFMIS, coverage and compatibility with budget estimates have improved enormously in recent years. The proposed introduction of commitment accounting, which is to be introduced by AGPR with the 2009/10 budget, will enable a large improvement in this rating.

(ii) Timeliness of the issue of reports.

3.122 BERs are produced monthly within two weeks of month-end. These can be produced at any level, from spending units to ministries to consolidated government reports. Currently, they have only recently become available within government and the data quality needs to be stabilized before they could be made available publicly. A summary of quarterly 'Consolidated Federal and Provincial Budgetary Operations' are posted on the Ministry of Finance website based on the monthly Civil Accounts from the AGPR. Presently these reports are made available with a time lag of almost two months after the end of the quarter. The GFMIS should allow such reports to be made available much more rapidly after the end of the quarter—and, in principle, could be produced more frequently than quarterly.

(iii) Quality of information.

3.123 The GFMIS is relatively recently in place and there have been temporary concerns about some aspects of data entry. However, these will be settled over time and high data quality standards can be expected as the system is used and routine corrective measures are used to address data quality issues as they arise. The present data issues do not compromise the overall consistency or usefulness of the reports.

D. Quality and timeliness of annual financial statements (PI-25)

3.124 This PI is assessed against three dimensions: (i) Completeness of the financial statements; (ii) Timeliness of submission of the financial statements; and (iii) Accounting standards used. The summary assessment and overall score using M1 scoring method are given in the table below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-25 Quality and timeliness of annual financial statements.	**B+**	
(i) Completeness of the financial statements	*B*	Complete records of revenue, expenditure, and bank balances are presented, with some issues of reconciliation. A brief statement on financial assets and liabilities is included.
(ii) Timeliness of submission of the financial statements	*A*	Under the GFMIS, accounts from 2007/08 are presented within 6 months of year-end
(iii) Accounting standards used	*B*	NAM standards are applied fully. Cash-flow reporting complies with IPSAS.

(i) Completeness of the financial statements.

3.125 A consolidated government statement is prepared annually; information on revenue, expenditure and financial assets and liabilities is included. The financial assets statement is summary, and does not include all government equity (see PI-6, and also reporting on PEs under PI-9). Reconciliation issues covered under PI-7 do not directly impact the financial statements, but relate mainly to distinguishing expenditure flows to and from the overall government accounts from flows between consolidated fund, the public account, and donor fund accounts. Further work is required to address the issue of carry forward of previously un-reconciled balances (PI-22).

(ii) Timeliness of submission of the financial statements.

3.126 The financial statements have generally been provided to audit 7-10 months after the end of the year in the recent past. The introduction of the GFMIS allowed presentation of the financial statements to AGP within 6 months of year-end for the 2007/08 accounts.

(iii) Accounting standards used.

3.127 The government consolidated financial statements are prepared by the AGPR under CGA (Appointment, Function, and Powers) Ordinance, 2001 and in compliance with the NAM that is fully aligned with international best practices using IPSAS cash basis format. The cash basis of accounting recognizes transactions and events only when cash is received or paid by the entity. However, it is expected that commitment accounting practices will be implemented from July 1, 2009. The audit of these financial statements is conducted by the Office of Auditor General of Pakistan (AGP) in accordance with the requirements of Article 169 of the Constitution and under the provisions of the Auditor's General's (Functions, Powers and Terms & Conditions of Service) Ordinance, 2001. The operational standards are in the process of substantial improvement through PIFRA as far as financial reporting and disclosure requirements are concerned and for their continuous alignment with International Public Sector Accounting Standards.

6. External Scrutiny and Audit

A. Scope, nature and follow-up of external audit (PI-26)

3.128 This PI is assessed on the following three dimensions: (i) Scope/nature of audit performed (including adherence to auditing standards); (ii) Timeliness of submission of audit reports to legislature; and (iii) Evidence of follow up on audit recommendations. The summary rating against these dimensions and overall rating by scoring method M1 is given in the table below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-26 Scope, nature, and follow-up of external audit.	**C+**	
(i) Scope/nature of audit performed (including adherence to auditing standards)	*B*	The AGP, with the use of risk based audit methodology under the FAM that is consistent with modern auditing practice, audits at least 75% of central government expenditures annually. With the new audit approach, there is increased focus on risk-prone and systemic areas.
(ii) Timeliness of submission of audit reports to legislature	*C*	The latest Audit reports (FY 2006/07) that have been submitted to the legislature were submitted within 9 months of the date of receipt, by the AGP, of the draft accounts from the AGPR. The FY 2007/08 accounts have been audited and certified by the AGP after 3 months of receipt from the AGPR, but submission to the legislature has yet to happen. .
(iii) Evidence of follow up on audit recommendations	*C*	Some formal responses are made, but little evidence exists on effective follow-up. Action to improve is underway.

(i) Scope/nature of audit performed (including adherence to auditing standards)

3.129 The AGP is empowered under Articles 168 to 171 of the Constitution to ensure public accountability. The AGP Ordinance 2001 describes the powers of the AGP, which include the following functions: inspection of any accounts office or treasury of the Federation, Province or District; requisition accounts, books, papers and other documents for audit; and enquire or make such observations considered necessary for audit. PIFRA has a Capacity Building and Upgrading of OAGP component, with an objective to adopt modernized government audit procedures and internationally accepting auditing standards that will contribute to enhancing program oversights and improving evaluation capabilities.

3.130 A rating of ‘B’ is applicable to dimension (i) as the central government entities representing at least 75% expenditure for FYs 2005/06-2007/08 have been audited annually by Federal Audit. The audit covers expenditure through a wide range of certification and regulatory audit and some aspects of performance audit. The AGP has since approved the new Financial Audit Manual (FAM), which follows the modern risk-based certification audit approach and the Manual has since 2006/07 been implemented at the Federal level.[61] Staff have been trained to produce FAM compliant audit plans for all Field Audit Offices and audits for the year that ended June 30, 2008 have been completed according to the audit plans. Going forward, however, there is the urgent need to synchronize the financial statements audit with the regularity/compliance audits, in a form of concurrent audits, so as to expand coverage and achieve improved timeliness of audit completion and certification.

(ii) Timeliness of submission of audit reports to legislature.

3.131 The audited financial statements of the federal government (as well as of the four provincial governments) for FY 2007/08 have been certified by the Auditor General during March 2009 (within 3 months after receipt of the reports from the AGPR). However the, reports have yet to be submitted to the legislature. For the latest report that was submitted to the

[61] The World Bank (May 2007), Pakistan, Public Sector Accounting and Auditing, A Comparison to International Standards, pp xii**.**

legislature – i.e. FY 2006/07 – the draft accounts were submitted for audit to the AGP by the AGPR in February 2008 and audit and certification were completed in July 2008. However, the reports were submitted to the legislature only in November 2008 (about 9 months after receipt of draft accounts by the AGP). Based on the time-lag of 9 months between the date of receipt of the draft accounts (FY 2007/08) by the AGP and the date of submission of the certified accounts to the legislature, this dimension scores a rating of 'C'. The AGP currently has a concise strategic plan in place that provides for the certification of accounts for FY2008/09 as well as the submission of these accounts, along with the reports, to the legislature within 4 months of their receipt from the AGPR.

(iii) Evidence of follow up on audit recommendations.

3.132 Formal response is made to audit observations, though delayed, but there is little evidence to support effective and timely follow up. The records show few follow up actions, in some cases on recommendations dating back to 1987-88. Departmental Accounts Committees (DACs) continue to be weak in following up and settling audit paragraphs. Systematic analysis of departmental and DAC follow-up of audit paragraphs being carried out in the Education sectors in Punjab and Sindh should help identify ways of strengthening follow-up actions across sectors at the federal level. Strengthening of the activities of the PAC (see PI-28(iii)) should also provide incentives for more prompt and effective action on this aspect.

B. Legislative scrutiny of the annual budget law (PI-27)

3.133 This PI is assessed on the following four dimensions: (i) Scope of the legislature's scrutiny; (ii) Extent to which the legislature's procedures are well-established and respected; (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)*; and (iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature. The summary rating against these dimensions, and overall rating by scoring method M1 is given in the table below:

Indicator	Score	Brief Explanation of status as at the reporting period
PI-27 Legislative scrutiny of the annual budget law.	**D+**	
(i) Scope of the legislature's scrutiny	*B*	The budget presentation covers fiscal policies (only in broad terms) and aggregates for the coming year as well as detailed estimates of expenditure and revenue.
(ii) Extent to which the legislature's procedures are well-established and respected	*C*	The National Assembly's procedures are well established and respected, but cannot be effectively implemented because of administrative and time constraints
(iii) Adequacy of time for the legislature to provide a response to budget proposals	*D*	The time for National Assembly review of the budget law is significantly less than one month.
(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature	*C*	Rules exist, but they allow extensive administrative re-allocation and expansion of total expenditure.

(i) Scope of the legislature's scrutiny.

3.134 The Parliament's review of the budget is quite extensive in terms of amount of material presented, but depth of consideration is constrained; proposals are presented at a late stage in the decision-making process—and the time for legislative review is limited (see (ii) and (iii) below). The budget documentation is quite extensive and is being continually technically improved. The budget presentation briefly covers fiscal policies and aggregates for the coming year (through the Medium Term Budget Framework paper—see PI-12) as well as detailed estimates of expenditure and revenue, but, as yet, no detailed examination of the medium-term fiscal framework (MTFF) is taking place. The budget package provided to the legislators comprise: a Budget Speech; Demands for Grants and Appropriations; Supplementary Demands for Grants and Appropriations; Annual Budget Statement; Federal Budget in Brief; Explanatory Memorandum on Federal Receipts; Estimates of Foreign Assistance; Economic Survey; and (a brief) Medium Term Budgetary Framework Paper. As a FRDL compliance measure, the GoP also separately submits a Fiscal Policy Statement and a Debt Policy Statement to the Parliament by 31st January.

(ii) Extent to which the legislature's procedures are well-established and respected.

3.135 Rules for budget review by the Parliament are well established and respected, but full implementation of the rules is limited by time and resource constraints. Articles 82-88 of the Constitution of the Islamic Republic of Pakistan 1973[62] specifically deal with budget related matters including: procedure relating to Annual Budget Statement; authentication of Schedule of Authorized Expenditure; Supplementary and Excess Grants; Votes on Account; and Powers to Authorize Expenditure when Assembly Stands Dissolved. Furthermore, the Rules of Procedure and Conduct of Business in the National Assembly 2007, elaborates internal organizational arrangements and procedures in financial matters through Rules 182-197. Additionally, Rules 198-245 elaborates procedures on specialized review through Standing Committees. None of these rules, however, sufficiently address the question of sequencing of parliamentary consideration of fiscal policy framework and detailed estimates review. Committee procedures will also need to be developed to address recent and coming changes in the budget process. The new Finance and Revenue Committee comprises of a Chairwoman and seventeen members. It is empowered to take up budget related issues during the year and has already met a few times. Proposals that the budget be submitted to the Committee for scrutiny before submission to the NA have not yet been resolved.

(iii) Adequacy of time for the legislature to provide a response to budget proposals.

3.136 The period for Parliament's review is less than one month. The National Assembly's past budget review trend (Table 3.8) shows a range of 12-18 days from the date of submission of the budget proposal to the Assembly to the date of approval of the budget. The budget proposal is submitted to the Senate at the same time. The Senate makes recommendations to the National Assembly within seven days, albeit, of a non-binding nature. The Senate, like the National Assembly, has a Standing Committee on Finance, Revenue, Economic Affairs and Statistics that reviews the recommendations made before submission to the National Assembly.

[62] As modified up to 31st July 2004

Table 9: Actual time of National Assembly Budget Proposal Review

Financial Year	Date of Budget Submission	Date of Budget Approval by Assembly	Legislative Review
2005-06	06-Jun-05	17-Jun-05	12 days
2006-07	05-Jun-06	22-Jun-06	18 days
2007-08	09-Jun-07	23-Jun-07	15 days

Source: Ministry of Finance

(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.

3.137 Clear rules, based on the Constitution, exist for in-year amendments of the budget without prior approval of the legislature, but they allow extensive administrative reallocation as well as expansion of total expenditure. The findings of PI-1, 2, and 16 indicate the impact of the current framework. No strict limits are set on the extent, the nature, or the timing of amendments for in-year budget amendments by the Executive. The record shows that in-year budget adjustments in the form of Supplementary Grants generally occur from the first month of the financial year. All appropriations so made are submitted ex post as Supplementary Grants to the legislature with the following year's budget proposal, and voted separately by the legislature.

C. Legislative scrutiny of external audit reports (PI-28)

3.138 This PI is assessed on the following three dimensions: (i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years); (ii) Extent of hearings on key findings undertaken by the legislature; and (iii) Issuance of recommended actions by the legislature and implementation by the executive. The summary rating against these dimensions, and overall rating by scoring method M1 is given in the table below.

Indicator	Score	Brief Explanation of status as at the reporting period
PI- 28 Legislative scrutiny of external audit reports.	**D+**	
(i) Timeliness of examination of audit reports by the legislature	*D*	For the past three years, PAC scrutiny of audit reports has taken longer than 12 months. Recent improvements in submission by AGP and increased PAC activity should lead to an improvement in the future.
(ii) Extent of hearings on key findings undertaken by the legislature	*C*	In-depth hearings with responsible officers took place occasionally over the years 2005/06-2007/08. Improvements are expected under the present PAC.
(iii) Issuance of recommended actions by the legislature and implementation by the executive	*C*	Recommendations are made by the legislature, but, until very recent years, action has been limited and slow

(i) Timeliness of examination of audit reports by the legislature.

3.139 The examination of the audit reports by the legislature has historically taken much more than 12 months to complete. The PAC at the federal level has a long history of back logs and sometimes non-functionality. Currently, the pendency of audit reports goes back to 1989-90, with the audit reports for 2001-2002 to 2004-05 having been lying untouched till the formation of the current PAC.

3.140 The newly formed PAC, after the 2008 elections, is demonstrating a vigorous departure from the historical trend of PACs. Some of the key initial actions include, appointment of Chairman of the PAC from the Opposition, only the second time in Pakistan's history, and continuous sessions (evenings) even when the National Assembly is in session. The Main Committee has started working on a last-in-first-out (LIFO) basis and considering the latest Audit Year Report, and formed two Sub-Committees to deal with the 1989-90 and 1990-91 pending reports on a first-in-first-out (FIFO) basis. There is possibility of formation of two additional sub committees to deal more effectively with the backlog. Furthermore, PAC has initiated a new practice of taking current issues as reported in the press for consideration.

(ii) Extent of hearings on key findings undertaken by the legislature.

3.141 When the PAC is active, it holds in-depth hearings with responsible officers. The PAC's recent emphasis on most recent audit reports increases the likelihood that responsible officers will still be in service at the time of the hearing. Vigilance will be required to maintain this approach.

(iii) Issuance of recommended actions by the legislature and implementation by the executive.

3.142 Excepting the newly formed PAC, actions have been recommended, but rarely acted upon by the Executive. It is observed that the non-compliance with the recommended actions is in more than 50% of cases and ranges as high as more than 70%. The new PAC has, however, amongst other actions, reversed this trend. The PAC monitors action by the Executive on the recommendations.

7. Donor Practices

A. Predictability of Direct Budget Support (D-1)

3.143 This PI is assessed on the following two dimensions: (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); (ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates). The summary rating against these dimensions and overall rating by scoring method M1 is given in the table below.

Indicator	Score	Brief Explanation of status as at the reporting period
D-1 Predictability of Direct Budget Support.	**A**	
(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*	Budget support is forecasted in a timely way; the forecast is reliable.
(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)	*A*	Actual disbursement delays have not exceeded 25% in two of the last three years.

(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).

3.144 The reporting period records show that direct budget support outturns have not fallen short of the forecast by more than 5% in any of the three years. Budget support forecasts are timely, predictable, and honored by donors. For the past three years, budget support, relative to forecast, have been: 2005/06, excess of 13 percent; 2006/07, shortfall of 0.47 percent; and 2007/08, excess of 35 percent.

(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates.

3.145 The disbursement agreements have been agreed with donors before the beginning of the fiscal year and the actual disbursement delays have not exceeded 25% in two of the last three years. IDA- IBRD (WB), ADB, IDB, DFID and EU contribute the overwhelming share of the donor funds mostly in the form of budget support without any delays in disbursement. The 2007-08 quarterly disbursements showed an excess of 20.5 % in first quarter, 12.5% in the second, 59.7% in the third and 48.5% in the fourth; a similar disbursement pattern was followed during 2005-06 and 2006-07.

B. Financial information provided by donors for budgeting and reporting on project and program aid (D-2)

3.146 This PI is assessed on the following two dimensions: (i) Completeness and timeliness of budget estimates by donors for project support; (ii) Frequency and coverage of reporting by donors on actual donor flows for project management. The summary rating against these dimensions and overall rating by scoring method M1 is given in the table below.

Indicator	Score	Brief Explanation of status as at the reporting period
D-2 Financial information provided by donors for budgeting and reporting on project and program aid.	**C+**	
(i) Completeness and timeliness of budget estimates by donors for project support	*A*	Donors follow the government's budget calendar and, in most cases, the breakdown is in broad consistency with government's budget classification.
(ii) Frequency and coverage of reporting by donors on actual donor flows for project management	*C*	EAD receives expenditure information from project authorities and SBP, not from the donors.

(i) Completeness and timeliness of budget estimates by donors for project support.

3.147 The budget estimates are forecasted by the donors and project authorities, and annual inputs consolidated by EAD after the Priorities Committee meeting between the project authorities, FD and EAD. Most pledged and committed donor project funds are received according to schedule and factored in the government's budget. The consolidated position is submitted to the NA as a separate publication of the budget proposal titled, "Estimates of Foreign Assistance". 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. However, the donor aid funds are included in the government budget using the government's chart of accounts classification and based essentially on the projects' PC-1s (the government-own feasibility/appraisal study document). Not all of these projects have been disaggregated at object-level, but this weakness is being rectified.

(ii) Frequency and coverage of reporting by donors on actual donor flows for project management.

3.148 Mostly, EAD does not receive regular monthly or quarterly reports directly from donors but gets the information from project implementing authorities and SBP. Some donors (with the World Bank in particular) provide 'client connection' facilities to project implementing agencies as well as to EAD at the Federal level, which serve to inform on the status of donor disbursements against each individual project. Such information, however, is not provided on the basis of government's chart of accounts classification.

C. Proportion of aid that is managed by use of national procedures (D-3)

3.149 This PI is assessed on a single dimension: (i) Overall proportion of aid funds to central government that are managed through national procedures The summary rating by scoring under the M1 methodology, is given in the table below.

Indicator	Score	Brief Explanation of status as at the reporting period
D-3 Proportion of aid that is managed by use of national procedures.	**C**	An increasing amount of aid goes through the national system as budget support; 50-75% of aid funds are managed through national procedures.

3.150 The aid funds received by GoP through budget support are managed through national procedures; project support is managed through the donor's preferred management systems, though some elements of the later may also be using national procedures including procurement etc. Annual disbursements on donor-funded projects (investment projects using donor-preferred systems) constitute less than 50% of all donor aid to the government. Thus much of donor assistance is dove-tailed into the national budget management system. The trajectory of change is positive towards use of national procedures during the reporting period with continuous shift from 41% during 2005-06 to 64% during 2007-08. Furthermore, efforts are also underway to mainstream foreign aided development projects using the country systems under the GFMIS platform.

Chapter 4: The Government PFM Reform Process

4.1 The GoP has a continuing agenda of PFM reform. Current programs are focused on areas of weakness in PFM administration that have been identified by the GoP and development partners. Major efforts are well underway to: (1) establish an effective system for financial management, reporting and audit; (2) implement a medium-term budget framework; (3) strengthen the capacity of the public sector in key areas (including aspects of PFM; (4) reform tax administration and strengthen the FBR; and (5) consolidate and strengthen the country's public procurement system. In addition, a number of steps have been taken to strengthen the capacity of the legislature to oversee the government's PFM activities; other activities provide support to local government below the district level (tehsil municipal administrations (TMAs) and union councils). Coordination among different elements of the reform program has grown over time, but as yet these efforts are not guided by an integrated overall PFM reform plan.

Financial Management, Reporting, and Audit

4.2 As described in Chapter 3, the World Bank-supported PIFRA project has successfully established a core GFMIS that serves federal, provincial, and district levels of government. This project is being implemented in two phases, with the second phase due for completion in December 2010. The PIFRA I project was approved in 1997, following earlier diagnostic studies by the IMF and the World Bank. It addressed a number of key weaknesses in financial and fiscal reporting, most notably the need for separation of auditing and accounting functions (then both administered by the AGP), as well as an out-dated chart of accounts, and lack of timeliness, comprehensiveness, and analytical content of the financial reports and year-end financial statements. PIFRA I aimed to facilitate the needed institutional changes, to design and implement a computerized GFMIS, and to establish modern systems and risk-based audit practices to all levels of government. Both the separation of audit and accounting and the introduction of a modern chart of accounts proved more difficult and took more time than anticipated. As a consequence of these institutional change delays, by the completion of PIFRA I (May 2005), the computerized system had been established only in 2 pilot and 28 roll-out sites. However, the major achievements of establishing the NAM, incorporating a GFS-compliant CoA, and of separating the accounting function (now under the CGA as an attached department of the MoF) from auditing (under the AGP), were accomplished. Full implementation of a functional GFMIS was taken up by PIFRA II, which became effective in November 2005.

4.3 The full roll-out of a functional GFMIS to core accounting and budget sites as well to some MDAs of the three tiers of government was achieved by January 2009. While some aspects relating to use of available system functionality (such as commitment accounting and fixed asset accounting) have not yet been achieved, these elements should be substantially in place by project completion date in December 2010. Major efforts are also being made to ensure that PFM outcomes envisaged in the project design will be achieved—and in many cases exceeded. These outcomes include full reconciliation of accounts, effective and timely BERs, effective and timely aggregate fiscal reports, effective steps to establish internal financial management controls in line ministries, the application of modern audit methodology throughout government, and timely completion and publication of audit reports.

4.4 PIFRA II thus is very likely to meet all of its major goals. However, it must be emphasized that much more needs to be done to make full use of the GFMIS. A key point highlighted in Chapter 3 is that, while core accounting sites included in the system benefit from timely reporting and payroll functionality, SAEs that are not yet part of the GFMIS are presently excluded from many of these benefits. The GFMIS will also contribute substantially to the implementation of the MTBF, which is discussed in the following section. Maintenance and further development of the GFMIS will thus provide a critical platform for the GoP's long-term PFM reform strategy. Continuing development of the audit component of PIFRA will also play a crucial role in addressing the weaknesses of the legislative oversight function that is highlighted in the PEFA assessment of Chapter 3. The new audit methodology is currently fully applied in the audits of the federal and provincial accounts and the roll-out to district governments has begun.

The Medium Term Budget Framework

4.5 Broadly in parallel with the development of the GFMIS, the GoP, with support from DfID, has initiated reforms of its budget process by moving from an incremental dual (development and non-development) budget process toward a more integrated multi-year approach. These reforms were started in 2003, rather later than the PIFRA reforms; and they too have faced major challenges of institutional change. At first, the strategy was aimed primarily at establishing "bottom-up" planning and management capability in line ministries. The MTBF in this form was piloted first in the ministries of Health and of Population Welfare in 2005/06 and then rolled out to another three ministries in 2006/07 (Food and Agriculture, Education, and Women Development). At this point, however, there were concerns that insufficient attention was being paid to aggregate control and very limited progress had been made in integrating the development budget (whose investments were largely determined by the Planning Commission), and the non-development budget, under the direction of the Finance Division.

4.6 The MTBF strategy was reviewed in 2007 and it was determined that the approach would combine top-down setting of a macro-economic framework and of line ministry budget ceilings, together with a continuation of the development of line ministry bottom-up planning and management capacity. Over the period 2007/08 and 2008/09 a further 20 MTBF ministries were added (of the then total of 43). The MTBF will be rolled out to all federal ministries other than Defense for FY 2009/10. It has also been agreed that the GFMIS will be used as the software platform for implementation of the MTBF. Use of the CoA program classification facility will provide a mechanism for more effective integration of development and recurrent budgets within the MTBF framework.

4.7 Many issues remain to be resolved in implementing a fully integrated, medium term, output-oriented budget framework. The decision to move firmly ahead with this approach and to integrate the accounting and budgeting reforms should, however, help overcome the remaining difficulties over time.

Public Sector Capacity Building

4.8 To help address public sector capacity weaknesses, including aspects of PFM, the GoP contracted a $55 million IDA credit in 2004 for the Pakistan Public Sector Capacity Building Project (PSCBP). A Civil Service Reform Unit (CSRU) was created in the Establishment

Division to oversee and catalyze the implementation of a wide range of reforms across the public sector, including professional development, recruitment and promotion reform, pay and pension reforms, and coordination. The reforms, though, have yet to be deepened, and their impact, if any, is not yet visible.

4.9 The PFM reform components of the PSCBP included coverage of the following areas:

- Debt management: strengthening the DPCO's capacity to monitor Pakistan's debt situation and develop its debt strategy – although project funds have yet to be utilized to support this activity, and as such, no effective implementation has been done so far.
- PFM regulatory framework: support for the MoF to revise the General Financial Rules (GFR) and other supplementary rules for consistency with the new and improved financial management regime.
- Corporate finance (CF), banking, and investment: strengthening the CF Wing's capacity to: evaluate performance and progress of key PEs; review the privatization process, especially of the state-owned private banks; and facilitate private sector participation in strategic areas – little investment in this activity has so far been made under the project.
- Tax administration: in support of the larger Tax Administration Reform Project (TARP—see below); the PSCBP provided bridging support for the reform initiative, including initial work for setting up the LTU and MTU, customs reform, universal self-assessment scheme, and dispute resolution centers.
- Procurement: strengthening the capacity of the Public Procurement Regulatory Authority (PPRA) to monitor and regulate public procurement by developing a modern, transparent, and cost-effective public procurement system.

4.10 As indicated in Chapter 3, these reforms have made a contribution to strengthening PEFA scores in the relevant PIs. However, significant underlying issues remain to be addressed fully; there has been little progress in civil service restructuring, and wage decompression and pension reforms have proved difficult to implement. Continuing support for broader civil service reform is needed, particularly to tackle some of these deep-seated and structural issues.

Tax Administration Reform

4.11 Weaknesses in tax administration are long-standing and are seen as a significant contributing factor to the low tax-to -GDP ratio in Pakistan relative to international experience and to other countries in the region. Reform efforts in this area have been particularly emphasized in recent years. The World Bank-supported TARP, with financial support from an IBRD loan, an IDA credit, and a DfID grant, totaling $125.9 million, was initiated in November 2004 to be implemented over a 5 year period. The project's overall aim is to fundamentally reform the FBR (formerly Central Board of Revenue (CBR)) and establish a more efficient and effective tax administration system. Specifically, it aimed to achieve the following:

- Strengthening the independence, transparency, and efficiency of the FBR by reorganizing it along functional lines, encouraging self-assessment, and modernizing tax operations.

- Promoting compliance through strengthened audit and enforcement capacity, particularly through adoption of a risk-based audit system. Voluntary compliance was also to be promoted through an intensive taxpayer education and facilitation program and re-engineering and re-orientation of the FBR's business processes and operational culture.
- Reforming and modernizing customs procedures: the introduction of simplified modern risk-based import and export clearance procedures (CARP) that are in line with international standards was aimed at facilitating trade and reducing port wait times.
- Improving integrity and fairness of tax administration by implementing a comprehensive anti-corruption strategy, including the creation of an internal audit and internal affairs unit, establishing taxpayer and staff feedback surveys, and establishing a new code of conduct.

4.12 These measures have strengthened some aspects of the relevant PIs (PI-13-15) discussed in Chapter 3, but it is also evident that there is considerable scope for further improvement after the completion of the present TARP. Under the IMF SBA, the GoP has agreed to further action to strengthen tax policy and tax administration, including the integration of the income tax and sales tax departments and the replacement of the current general sales tax with a broad-based Value-Added Tax (VAT).

Procurement Reform

4.13 In 1999/2000, the World Bank led an assessment of Pakistan's procurement system.[63] The recommendations from this assessment included the establishment of a public procurement regulatory authority. The PPRA was subsequently created through a Presidential Ordinance in 2002 with the task of developing a legal, regulatory, and administrative framework for the federal public sector. With ADB assistance, the PPRA prepared draft rules for public procurement in 2004, designated as Public Procurement Rules 2004 (PPR). The 'review and re-engineering of procurement procedures in line with PPR 2004 has been carried out for 14 out of 24 large procuring entities of the federal government.[64] The PPRA is working to complete this initiative for the remaining 10 large procuring entities. The PPRA has issued a first set of 6 implementing regulations to the PPR 2004. Implementing regulation no. 4 makes it mandatory for procuring entities to use the standard bidding documents prescribed by Pakistan Engineering Council (PEC), for procurement of works.

Oversight and Governance

4.14 Sustainable reform in Pakistan will depend on establishing effective legislative oversight at all levels of government. Effective public and parliamentary oversight are critical to ensure that administrative governance standards are effectively met and maintained. Several reform programs are aimed at strengthening the capacity of the legislatures at each level of government.

[63] *Pakistan: Country Procurement Assessment Report*, Report No. 22000.
[64] Including National Highways Authority, Pakistan Railways, Pakistan Steel Mills, Pakistan International Airlines, Utilities Stores of Pakistan, Telephone Industries of Pakistan, Civil Aviation Authority.

4.15 The USAID-supported Partnership for Democracy and Governance aims to strengthen Pakistan's parliamentary institutions, improve electoral processes, and advance the devolution process.[65] As at June 2008, $84 million had been provided by USAID since 2003 in the following areas:

- The Pakistan Legislative Strengthening Project, which aims to enhance the effectiveness of the National Assembly, the Senate, and all four provincial assemblies. The project has focused on training of rules of procedure, the committee system, law drafting and budget review. The project has provided assistance and equipment to key committees, and its support has helped improve conduct of public hearings and increased the focus on substantive issues.
- The Pakistan Election Support Program, which is implemented by the International Foundation for Electoral Systems (IFES) helped establish capacity to implement the national elections in February 2008. Further assistance through the Asia Foundation supports domestic election monitoring efforts.
- The "Districts That Work" project operates in 30 focus districts and supports the GoP's efforts to devolve decision-making and resource management skills to the grassroots level. This project also provides in-kind assistance to district and tehsil governments through the District Support Fund.

4.16 There are continuing efforts by the GoP, assisted by other DPs, to improve PFM capacity at district and sub-district levels. The PIFRA project will have established NAM-compliant PFM systems in 133 TMAs, and a basis for modern audit practices in all districts by project completion in December 2010. Other DP projects directly support delivery of services by sub-national governments, often in cooperation with the relevant provincial governments (such as the ADB-financed Devolved Social Services Program in Sindh Province).

[65] See http://www.usaid.gov/pk/governance/index.htm

Annex 1 Summary of PEFA PFM Performance Scores

PEFA PERFORMANCE INDICATORS		Scoring Method	Dimension Ratings				Over-all Score
A. PFM-OUT-TURNS: Credibility of the budget			i	ii	Iii	iv	
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	D				D
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	B				B
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	A				A
PI-4	Stock and monitoring of expenditure payment arrears	M1	NS	D			NS
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency							
PI-5	Classification of the budget	M1	A				A
PI-6	Comprehensiveness of information included in budget documentation	M1	B				B
PI-7	Extent of unreported government operations	M1	A	D			D+
PI-8	Transparency of inter-governmental fiscal relations	M2	A	A	A		A
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	M1	C	A			C+
PI-10	Public access to key fiscal information	M1	C				C
C. BUDGET CYCLE							
C(i) Policy-Based Budgeting							
PI-11	Orderliness and participation in the annual budget process	M2	A	C	A		B+
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	C	B	B	C	C+
C(ii) Predictability and Control in Budget Execution							
PI-13	Transparency of taxpayer obligations and liabilities	M2	C	B	B		B
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	C	B	B		B
PI-15	Effectiveness in collection of tax payments	M1	D	B	B		D+
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	D	C	D		D+
PI-17	Recording and management of cash balances, debt and guarantees	M2	B	B	A		B+
PI-18	Effectiveness of payroll controls	M1	C	B	B	C	C+
PI-19	Competition, value for money and controls in procurement	M2	B	C	C		C+
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	C	C	C		C
PI-21	Effectiveness of internal audit	M1	D	D	D		D

C(iii) Accounting, Recording and Reporting							
PI-22	Timeliness and regularity of accounts reconciliation	**M2**	**C**	**B**			**C+**
PI-23	Availability of information on resources received by service delivery units	**M1**	**B**				**B**
PI-24	Quality and timeliness of in-year budget reports	**M1**	**C**	**A**	**B**		**C+**
PI-25	Quality and timeliness of annual financial statements	**M1**	**B**	**A**	**B**		**B+**
C(iv) External Scrutiny and Audit							
PI-26	Scope, nature and follow-up of external audit	**M1**	**B**	**C**	**C**		**C+**
PI-27	Legislative scrutiny of the annual budget law	**M1**	**B**	**C**	**D**	**C**	**D+**
PI-28	Legislative scrutiny of external audit reports	**M1**	**D**	**C**	**C**		**D+**
D. DONOR PRACTICES							
D-1	Predictability of Direct Budget Support	**M1**	**A**	**A**			**A**
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	**M1**	**A**	**C**			**C+**
D-3	Proportion of aid that is managed by use of national procedures	**M1**	**C**				**C**

* NS = No Score

Annex 2 Budget Data, Persons Consulted and Documents Reviewed

Budget Expenditure Data

Federal Government: Budget and Actual Expenditure Data 2005/06 to 2007/08

(Rupees in million)

	Financial Year	**2005/06**		**2006/07**		**2007/08**	
		Budget	Actuals	Budget	Actuals	Budget	Actuals
01	General Public Services	368,868	479,845	472,899	452,831	485,236	524,122
02	Defense Affairs & Services	223,501	245,672	250,285	257,090	275,612	287,883
03	Public Order & Safety Services	21,953	23,399	25,783	26,554	28,950	31,245
04	Economic Affairs	107,577	124,332	142,213	178,231	199,589	398,677
05	Environment Protection	175	155	299	418	182	178
06	Housing and Community amenities	4,762	4,406	9,621	4,561	5,520	7,066
07	Health	13,124	12,162	15,910	14,100	19,904	16,737
08	Recreational, culture and religion	3,017	3,509	3,074	3,495	3,823	4,198
09	Education Affairs & Services	21,524	22,265	25,541	28,252	48,990	41,248
10	Social Protection	3,306	3,205	2,535	3,206	4,630	4,346
Total		**767,807**	**918,950**	**948,160**	**968,738**	**1,072,436**	**1,315,700**
Debt and interest payments (excluded)		2,465,537	2,325,182	2,093,220	2,628,522	2,514,571	2,591,216
Totals (as per ABS and AGPR)		**3,233,344**	**3,244,132**	**3,041,380**	**3,597,260**	**3,587,007**	**3,906,916**

Sources:
Budget - Annual Budget Statement, net-of recoveries. Actuals - AGPR work-sheets modified as per functional heads and audited financial statements for FYs 2005/06 and 2006/07. Financial statements for FY 2007/08 submitted to auditors.

Persons Met

Name	Designation	Department
Mr. Asif Bajwa	AFS - External Finance *(Chair, PEFA Steering Committee)*	Finance Division
Mr. M. Ayub Tarin	AFS - Budget	Finance Division
Mr. Khalid Idrees	AFS - Expenditure	Finance Division
Dr. Ashfaq Khan	DG - External Debt	Finance Division
Mr. M. Razi Abbas	AFS- Public Finance	Finance Division
Mr. Rana Asad Amin	Joint Secretary External Finance *(Deputy Chair/Coordinator PEFA Steering Committee)*	Finance Division
Mr. Zafar ul Hassan	Deputy Economic Adviser	Finance Division
[mentionend above]	Joint Secretary	
Mr. Shamroz	CFAO	Finance Division
[above]	Additional Secretary (CF Wing)	Finance Division
Mr. Hussain Ahmad	Joint Secretary - Expenditure	Finance Division
Mr. Talib M. Baloch	Joint Secretary - Budget	Finance Division
Mr. Umair Farooqi	Deputy Secretary - Budget	Finance Division
Mr. Ubaid Ur Rehman	Deputy Secretary - Expenditure	Finance Division
Mr. Malik Afaq	Manager Computer - External Debt	Finance Division
Mr. Mian Muhammad Yunis	Joint Secretary	Finance Division
Mr. Idrees Ahmed	Additional Secretary (Expenditure)	Finance Division
Mr. Ahmed Hussain	Joint Secretary	Finance Division
Mr. Zafar Iqbal Malik	Chief	Economic Affairs Division
Mr. Afaq Malik	DMFUS Incharge	Economic Affairs Division
Mr. Muhammad Shahid	Director-General, Projects Wing (Member, PEFA Steering	Planning and Development Division

Name	Designation	Department
	Committee)	
Mr. Haque Nawaz	Director General	AGPR
Mr. Masood Sherwani	Additional Director General	AGPR
Mr. Umar Waheed	Secretary – FRS *(Member PEFA Steering Committee)*	FBR
Mr. Waseem Bajwa	2nd Secretary - Direct Taxes	FBR
Mr. M. Azher Lateef	Director General (Accounts) *(Member PEFA Steering Committee)*	CGA
Mr Masood Sherwani	Accountant General	AGPR
Mr. Haque Nawaz	Director General-DM&E	AGPR
Mr, Shehzad Hasan	Director, (FABS) PIFRA *(Member PEFA Steering Committee)*	Auditor General of Pakistan
Mr. Noaman Ali	PIFRA	AGPR
Mr. Javed	Senior Accountant	AGPR
Mr. John Gray	Team Leader	MTBF
Mr. Nohman Ishtiaq	Financial Consultant	MTBF
Mr. Akmal Minallah	Director General	Auditor General of Pakistan
Mr. Saqib Latif	Audit Expert	Auditor General of Pakistan
Mr. Syed Waseem Kazmi	Senior Audit Specialist	Auditor General of Pakistan
Mr. Abdul Jabbar	Coordinator	FMC
Mr. Raja Amin	Secretary	Senate

Documents Reviewed

Budget-related Documents

Budget Speech 2005/06, 2006/07, 2007/08
Federal Budget in Brief 2005/06, 2006/07, 2007/08
Annual Budget Statement 2005/06, 2006/07, 2007/08
Demands for Grants and Appropriations 2005/06, 2006/07, 2007/08
Explanatory Memorandum on Federal Receipts 2005/06, 2006/07, 2007/08
Estimates of Foreign Assistance 2005/06, 2006/07, 2007/08
Economic Survey 2005/06, 2006/07, 2007/08

Debt Policy Statement 2007/08, DPCO
Fiscal Policy Statement 2007/08, DPCO

The Fiscal Responsibility and Debt Limitation Act 2005
System of Financial Control and Budgeting (September – 2006), Finance Division

Accounting and Audit Documents

Audit Report on the Accounts of Federal Government (Civil) for Audit Years 2004/05, 2005/06, 2006/07 and 2007/08
Financial Statements of the Federal Government 2007/08

Economic Planning and Poverty Reduction

Poverty Reduction Strategy Paper (PRSP II), Government of Pakistan, Finance Division, February 2009.
Mid Term Review of Medium Term Development Framework 2005-10, May 2008, Planning Commission
Planning Commission – A Synoptic View (2008) Planning Commission

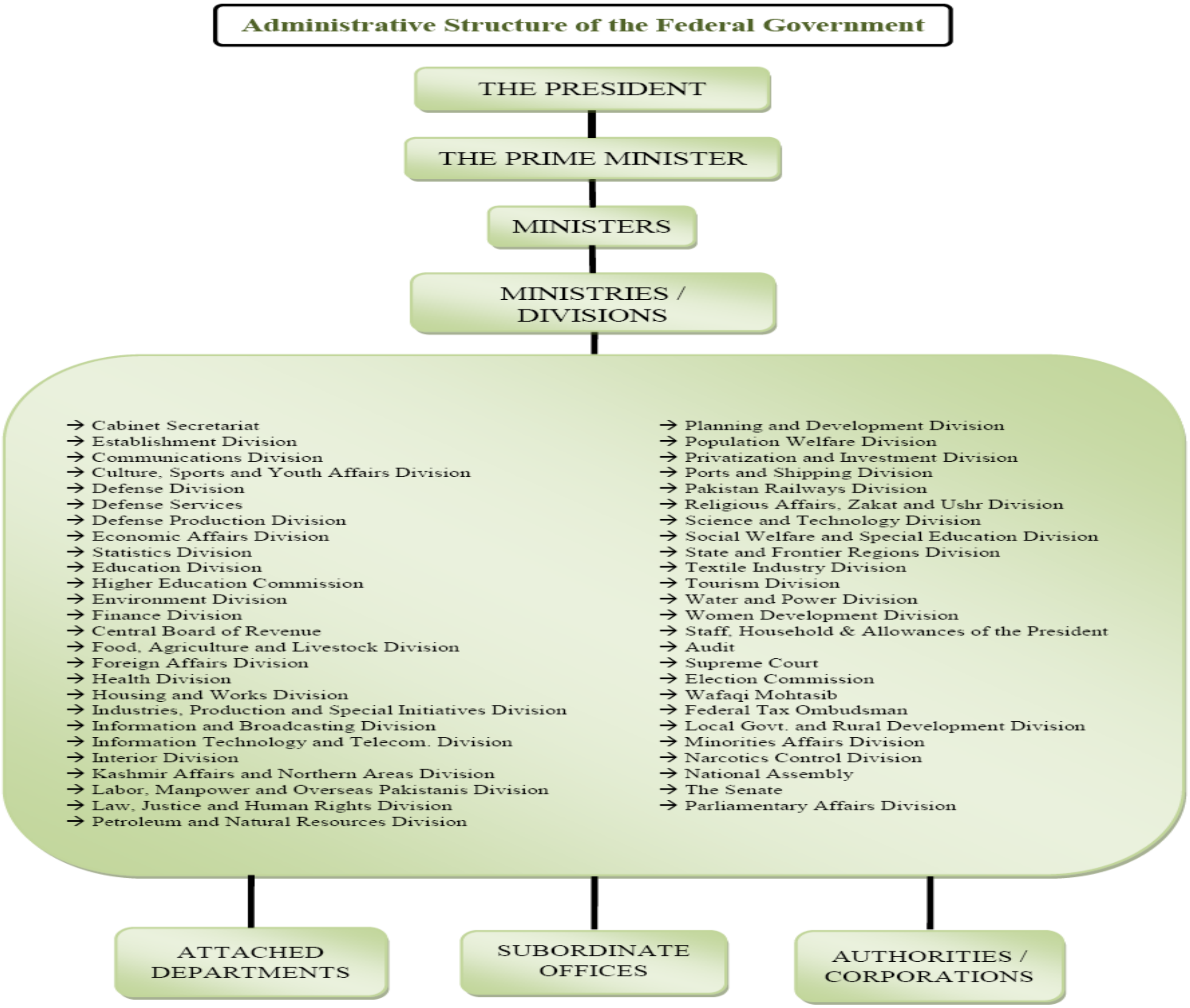
Other Reports

The World Bank (November 2007), *Case Study on the Review of Flow of Funds and Utilization Rate of the PSDP in Pakistan*
Pakistan: *Request for Stand-By Arrangement—Staff Report*, December 2008, IMF Country Report No. 08/364
Pakistan: 2009 *Article IV Consultation and First Review Under the Stand-By Arrangement—Staff Report*, April 2009, IMF Country Report No. 09/123

Key Websites

MoF: http://www.finance.gov.pk/
FBR: http://www.cbr.gov.pk/
Planning Commission: http://www.pakistan.gov.pk/ministries/planninganddevelopment-ministry/index.htm
PIFRA: http://www.pifra.gov.pk/1/nam.html

Annex 3 Key Elements of PFM Administrative Structure



Source: *Financial Statements of the Federal Government 2007/08*