

**FOR  
AGENDA**

SM/00/264

November 28, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **Pakistan—Report on Observance of Standards and Codes—  
Fiscal Transparency Module**

The attached report on the observance of the standards and codes fiscal transparency module by Pakistan has been prepared in the context of the 2000 Article IV consultation with Pakistan and its request for a Stand-By Arrangement (EBS/00/230, 11/20/00), which is tentatively scheduled for discussion tomorrow, Wednesday, November 29, 2000.

It is expected that following the Board discussion, this report will be published on the Fund's external website.

Questions may be referred to Mr. Allan (ext. 38542).

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

PAKISTAN

**Report on the Observance of Standards and Codes (ROSC)  
Fiscal Transparency Module**

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November 28, 2000

**EXECUTIVE SUMMARY**

This report provides an assessment of fiscal transparency practices in Pakistan in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency—Declaration on Principles* based on the authorities' response to the IMF fiscal transparency questionnaire and other documents provided by the authorities.

Pakistan has recently made progress in improving fiscal transparency and there is an underlying tradition of public availability of information. Important steps have been taken to improve the timeliness and reliability of fiscal reporting. Many of the requirements of the fiscal transparency code are not being met, however, and sustained efforts are needed to build on progress made so far.

The staff have recommended that immediate emphasis be given to strengthening the core fiscal reporting system. In addition, a range of measures to improve fiscal transparency in the immediate future and longer term have been broadly agreed with the authorities. Proposals to widen the range and improve the quality of fiscal data include the following: proposed publication of a statement on contingent liabilities; development of a report on tax expenditures; including all donor financed expenditures in the budget and annual accounts; and incorporating quasi-fiscal activity carried out through credit funds in the State Bank of Pakistan in the budget. Support was given to development of a medium-term budget framework to identify continuing costs of government policies more clearly.

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**REPORT ON THE OBSERVANCE OF STANDARDS AND CODES  
FISCAL TRANSPARENCY MODULE: PAKISTAN**

**ACRONYMS**

|       |   |
|-------|---|
| AGPR  | Accountant General Pakistan Revenues                |
| CBR   | Central Board of Revenue                            |
| CGA   | Controller General of Accounts                      |
| DFIs  | Development Financial Institutions                  |
| FAs   | Financial Advisors                                  |
| FMC   | Fiscal Monitoring Committee                         |
| GDDS  | General Data Dissemination System                   |
| HBL   | Habib Bank Limited                                  |
| MOF   | Minister of Finance                                 |
| NBP   | National Bank of Pakistan                           |
| NFC   | National Finance Commission                         |
| NHA   | National Highways Authority                         |
| NIS   | New Item Statements                                 |
| PAC   | Public Accounts                                     |
| PAO   | Principal Accounting Officer                        |
| PIA   | Pakistan International Airlines                     |
| PIFRA | Pakistan: Improvement of Fiscal Reporting and Audit |
| PR    | Pakistan Railways                                   |
| PSDP  | Public Sector Development Programme                 |
| PSM   | Pakistan Steel Mills                                |
| PTCL  | Pakistan Telecommunications Company Limited         |
| QFA   | Quasi-fiscal Activity                               |
| SAP   | Social Action Programmes                            |
| SBP   | State Bank of Pakistan                              |
| SROs  | Statutory Regulatory Orders                         |
| UBL   | United Bank Limited                                 |
| WAPDA | Water and Power Development Authority               |

## I. INTRODUCTION<sup>1</sup>

1. This draft report provides an assessment of fiscal transparency practices in Pakistan against the requirements of the IMF *Code of Good Practices on Fiscal Transparency—Declaration on Principles*. The authorities have completed the fiscal transparency questionnaire prepared by the IMF staff. The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of the questionnaire response and additional information provided by the authorities. The second part is an IMF staff commentary on fiscal transparency in Pakistan.

## II. DESCRIPTION OF PRACTICE

### A. Clarity of Roles and Responsibilities

2. **In a legal and statistical sense, the role of general government is relatively well defined.** The Constitution of the Islamic Republic of Pakistan and *Rules of Business*<sup>2</sup> of Government define the roles and responsibilities of the federal and provincial governments, and internationally accepted statistical definitions of general government activity are applied. In practice, however, boundaries between government and the rest of the economy have become blurred and the need for improvement in governance has been widely acknowledged. The present government has placed a high priority on restoration of governance, and has begun to put specific measures in place to improve transparency and governance in the fiscal area. Redefinition of a number of public activities vis-à-vis the private sector is emerging from the privatization and market deregulation program. Within government, the boundaries between financial, commercial, and noncommercial activities of government need improvement. The roles of different levels of government are therefore currently under review.

3. **Public enterprises are extensive, provide services of a quasi-fiscal nature, and some are subject to administrative direction and regulation.** The government owns the electricity utilities, gas distribution companies, refineries, and the largest banks,<sup>3</sup> and, in addition, it has major stakes in the fertilizer industry. Pakistan Railways (PR), and the post

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<sup>1</sup> A joint FAD/STA mission was held in Islamabad over August 7–21, 2000. The staff team comprised Messrs. Allan (head), Ortiz (STA, Expert), Khan (FAD Expert), and Mokhtar (of the World Bank resident mission), with input from the staff of MED and PDR.

<sup>2</sup> Cabinet Secretariat, *Rules of Business, 1973*, as periodically amended. For administrative purposes these include both the State Bank of Pakistan (SBP) and the Office of the Auditor General as part of the Finance Division responsibilities, but this is not intended to diminish the policy independence of either of these organizations.

<sup>3</sup> The eight largest public enterprises, which account for 70 percent of employment in the public enterprise sector are: Water and Power Development Authority (WAPDA); PR, Pakistan Telecommunications Company Limited (PTCL), Habib Bank Limited (HBL), United Bank Limited (UBL); National Bank of Pakistan (NBP); Pakistan International Airlines (PIA); and Pakistan Steel Mills (PSM).

offices are government departments and are subject to government direction on pricing and investment decisions. PR receives regular subsidies through the budget and occasional subsidies are provided to postal services through negative revenue adjustments. Cross-subsidization between different groups of consumers is practiced by power companies and by PTCL, but is being reduced. Price controls and price equalization regulations on petroleum products are being reduced.<sup>4</sup> Some public enterprises have, in the past, received favorable tax treatment through issuance of Statutory Regulatory Orders (SROs), and it has been difficult to determine the overall impact of these exemptions on revenue. These discretionary tax exemptions are, however, being reduced (see discussion of transparency of SROs below). Reductions are also being made in tariff and other forms of protection for public enterprises (such as PSM) and domestic industry, which have, in the past, reduced the competitiveness of Pakistan's manufacturing sector. The nature of the noncommercial services provided by enterprises (employment, or products and services at less than market prices) are broadly described but not systematically analyzed as part of budget discussions, and some costs are covered from enterprise balance sheets rather than the budget.

**4. Privatization is the major vehicle for reform of the enterprise sector and reduction of quasi-fiscal activity (QFA), but progress has been uneven.** A privatization program was initiated in the 1990s, but after early success with some of the more attractive enterprises—mainly in manufacturing, but including a thermal power plant and four commercial banks, as well as partial privatization of the PTCL—progress slowed. Lengthy procedures and delays, the perceived country risk, political resolve in adjusting key prices, lack of an effective regulatory environment, and nontransparency of some past privatization practices, were among the factors contributing to the slowdown. The government has now put in place a legal framework aimed at establishing a fair and transparent mechanism for privatization.<sup>5</sup>

**5. The SBP has considerable formal independence from the government and has autonomy in monetary policy.** The SBP is required to consult with the government on the coordination of fiscal and monetary policy and determining limits of credit to the government. This task is formalized through a credit plan which is agreed after comprehensive discussions with international financial institutions, the government and the SBP, to ensure consistency with macroeconomic objectives. Subject to this, the SBP has autonomy in implementing monetary policy.<sup>6</sup> It has not recently played a major role in budgetary financing, but is not prohibited under the law from doing so. Special credit funds

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<sup>4</sup> Implicit subsidies to oil refineries are embodied in a price equalization scheme, which does not indicate the extent to which individual refineries are subsidized. As part of petroleum sector reforms, it is proposed that ex-refinery prices would reflect the basis of c.i.f. cost of products and that refineries would receive an explicit subsidy adjusted monthly on the basis of international prices.

<sup>5</sup> A program has recently been approved by Cabinet covering 49 public assets/entities to be divested by June 2002.

<sup>6</sup> In 1993/94, the State Bank of Pakistan Act, 1956 was amended to give the SBP's Board of Directors authority to implement the range of available monetary instruments and regulate the monetary and credit system.

are operated by the SBP to support provision of credit through commercial and development banks to agriculture, industry, exports, and loan guarantees. Each of these credit funds is provided with initial financing through appropriations from the profit of the SBP determined in consultation with the federal government. All, except the export credit fund, provide credit at commercial rates. Activities of each fund are reported in the *SBP Annual Report*, but their limited quasi-fiscal activities are not included in fiscal reports. Transparency could be improved by including all fiscal support for such arrangements explicitly in the budget.

6. **Public financial institution reforms have reemphasized commercial viability, but monitoring of QFAs needs to be strengthened.** Past lending activities of public commercial banks and development financial institutions (DFIs) had led to a substantial build-up of nonperforming loans that could have posed a major fiscal and macroeconomic risk. Banking and financial sector reforms introduced from 1997 have been relatively successful in reducing the number of loans in default and strengthening monitoring and supervision of defaults and loan recovery by the SBP. Nonperforming loans remain a serious issue for the DFIs and restructuring efforts are underway.

7. **No comprehensive overview of the government's public enterprise borrowing or assets and other equity holdings are maintained.** Various units of government maintain records and cover aspects of policy toward government's involvement in commercial and financial activity, but no single overview is maintained. The Ministry of Finance (MOF) manages direct fiscal transactions with nonfinancial enterprises through its Corporate Wing, which also reviews government direct equity holdings from the point of view of preparing estimates of dividend payments. Relations with the financial enterprise sector are handled by the Internal Finances Wing. Borrowing for investment purposes by major public enterprises is included in the annual *Public Sector Development Programme (PSDP)*, principally in *Part II: Corporations Programme*. This presentation includes borrowing plans of major nonbudgetary public sector corporations—which are not part of the PSDP.

8. **Linkages between planning and budgeting and overall coverage of the budget need review and clarification.** Reform of the public enterprise sector has meant that the public sector development planning approach has, appropriately, become more concerned with general government investment than with the public sector as a whole. There appears to be a good case for making this its explicit focus and aligning planning and budgeting more closely. The PSDP needs to be much better integrated with recurrent budget processes in terms of clarity of presentation and careful appraisal of operations and maintenance requirements. Both budget and planning processes would require considerable streamlining to accommodate reforms of the overall budget system toward a medium-term framework (see further discussion below).

9. **Budget coverage needs to be more clearly defined.** Other than the Zakat Fund, there are no extrabudgetary funds,<sup>7</sup> and the consolidated fund mechanism specified in the Constitution generally works effectively to ensure comprehensive budgeting in gross terms. Inclusion or exclusion of certain corporate-like entities in the budget and the relation between so-called “plan” and “nonplan” development expenditures are the cause of some confusion, however.<sup>8</sup> An entity like the NHA, which has little nonbudget sources of revenue, is excluded from the budget. The subsidy to PR is shown in the budget as a “demand for grants,” and in addition a summary of expenditures and own revenues is included. Until recently, clear limits had not been set on PR overdraft access to the SBP account, but a firm ceiling on borrowing has now been put in place. GFS standards could be more strictly applied to determine which institutions should be included in the federal budget. In addition, to track the value of the government’s financial assets, it would be desirable to present balance sheets and cash flow statements for public enterprises, particularly those that are in receipt of substantial budgetary support (which, of course, would be included as part of budgetary grants).

10. **Further clarification of the role of provincial governments in fiscal management is required.** The role of the provinces in managing public finances is broadly defined in the Constitution and principles and procedures are very similar to those applied at the federal level. For a number of significant functions, however, such as audit and accounting and taxation, powers reside primarily at the federal level. Borrowing by provincial governments requires the consent of the Federal Government if any part of a loan from the Federal Government is outstanding (Article 167 (3) of the constitution). The Majlis-e-Shoora (National Parliament)<sup>9</sup> law prevails over provincial law in any areas where concurrent powers are exercised. Provincial governments are responsible for the bulk of public

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<sup>7</sup> However, other funds/enterprises are operated with donor support. The main such fund is the Poverty Alleviation Fund, which is sponsored by donors including the World Bank and provides credits for enterprise development and grants for community physical infrastructure activities, as well as training to communities. The government is now also setting up a micro-finance bank with initial financing from donors.

<sup>8</sup> On-lending operations carried out in favor of organizations that have historically been associated with the budget and PSDP (such as WAPDA and the National Highways Authority (NHA)) are included in the budget and PSDP as plan expenditures. Other loans negotiated on behalf of organizations that have not been provided budgetary support in the past are described as nonplan. These are included in the budget (though on one occasion some guaranteed loans were also included in the budget document). Nonplan development expenditures have not been included in analytical tables showing the budget deficit. The nonplan category also differs from the nonbudgetary public sector corporations program of the PSDP. Conventional treatment would suggest that all loans negotiated for onlending through the national budget should be included in the budget presentation. Analytically, the present GFS requires that all on-lending transactions be recorded above the line. Loan guarantees, on the other hand, should not be included in the budget, but the fiscal transparency code requires that all such guarantees be disclosed in a contingent liability statement, which should be published with the budget.

<sup>9</sup> Parliament consists of the president and two houses: the National Assembly (207 members) and the Senate (87 members).

expenditures on health, education, agriculture, and rural water supply<sup>10</sup> and they account for around 54 percent of nondefense, noninterest spending, but provincial finances are heavily dependent on federal transfers. Own revenue accounts for only around 21 percent of total provincial revenue; the remainder comes from revenue shares in accordance with the National Finance Commission (NFC) awards<sup>11</sup> and other federal grants and direct transfers.

11. **A major initiative of the present government is to establish a third tier of government at district level.** The National Reconstruction Bureau is developing a framework for the operation and financing of more than 100 directly elected district governments, with a broad aim of improving governance and allowing local communities to participate in the process of providing civic amenities. It is envisaged that this framework will involve significant tax raising powers and the creation of Provincial Finance Commissions to distribute provincial revenue sharing pools to districts on the basis of stable objective criteria. The main features of the framework have been presented to the public in May this year, and the operational details are currently under preparation. The intention is to have district governments operationalized by August 2001.

12. **The Constitution provides a clear basis for budget management.** The Constitution (Article 78) requires that all revenues and loans or loan repayments of government are to be paid into a consolidated fund and other receipts (of a trust nature) to the public account. Procedures for authorizing payments from the consolidated fund are defined in Articles 79–88. Certain expenditures are automatically charged against the consolidated fund. These include salaries of the president, supreme court judges, the Auditor General, and other designated officials; administrative expenses of certain offices including that of the Auditor General; and public debt service. Other expenditures from the consolidated fund must be presented in the form of a “demand for grants” by the federal government and authorized by the parliament. Authorities of government agencies are defined in the government *Rules of Business*. The basic system of budgeting and precise allocation of responsibilities for budget management is given in the *New System of Financial Control and Budgeting* (which updates preceding regulations and is effective from July 1, 2000) and in detailed orders and instructions from the MOF. Similar provisions apply to budget management by provinces (Articles 118–127).

13. **The legal framework focuses on proper authorization and financial compliance with little emphasis on performance or broader fiscal transparency.** The framework described above is adequate in traditional line item budget control terms but does not lend itself to a clear presentation of performance in terms of economic or social objectives to be

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<sup>10</sup> These are not defined explicitly, but are residual responsibilities not included in the Federal Legislative List or the Concurrent Legislative List in the Fourth Schedule of the Constitution. In some of these areas, the federal government also allocates a significant amount of administrative resources.

<sup>11</sup> Established every five years by order of the President and establishing formula and modalities for sharing revenues between the federal and provincial government. The last NFC Award was February 1997.

achieved by specific elements of expenditure. Some elements of a performance oriented approach have been achieved through the Social Action Programmes (SAP)<sup>12</sup> and more broadly through the PSDP. While such programs are attractive vehicles for foreign assistance and contain many elements of a medium-term results-oriented approach, they are not well integrated with the recurrent budget and add to pressures on the recurrent budget for resources for maintenance and operation of assets created under these programs. The current legal framework does not make specific provision for reporting on performance or reporting to parliament or the public beyond the annual budget and annual accounts presentations.

14. **All taxes are under the authority of a law, but many opportunities for discretionary application exist.** The Income Tax Ordinance, is overcomplex and more than a third of the text is taken up by exemptions. So-called “tax whitener” schemes, which legally prevented the tax authorities from investigating income invested in specific instruments, have been eliminated by the present government. The government is also considering a complete overhaul of the ordinance with a view to eliminating exemptions, as well as establishing modern self-assessment and strengthening audit. Steps are being taken, through appointment of an ombudsman and planned computerization, to reduce concerns regarding the extensive face to face interaction between taxpayers and officials and to develop a better balance between taxpayers rights and appropriate measures to reduce tax evasion. Excessive use of exemptions using SROs has been a problem with the excise tax and customs duties, but these have now been substantially reduced in the 2000/01 budget. Information is available within Central Board of Revenue (CBR) to provide a survey of the revenue impact of tax exemptions, but this has not yet been made publicly available. Communication of changes to tax laws and general information to taxpayers, including tracking of SROs, is being improved through the internet (<http://www.cbr.gov.pk/>).

15. **Public servants are subject to a code of behavior.** Comprehensive rules are set regarding ethical conduct of public servants in *Government Servants (Conduct) Rules*, 1964. Among other things, all public servants are obliged to declare their assets each year and are prohibited from conducting business or entering into agreements that may conflict with official duties.

## B. Public Availability of Information

16. **The budget documents provide a comprehensive and detailed coverage of the federal budget and annual PSDP.** A few days prior to the budget the *Economic Survey* is released to provide parliament with a background of economic, fiscal, and monetary developments as a basis to examine the budget estimates. This document is prepared by the Economic Advisor’s Wing of the MOF. Along with the *Budget Speech* a series of

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<sup>12</sup> Aimed at improving Pakistan’s social development indicators through provision of elementary education, primary health care, social services, and rural water supplies to deprived areas. SAP I was implemented from 1993–96; SAP II is being implemented over 1997–2002.

documents<sup>13</sup> is released providing full details and summary overviews of the annual budget (incorporating PSDP expenditures). The *Budget in Brief* presents the key features of the budget in an easily readable form, but the budget deficit referred to in the Budget Speech is not shown explicitly. At the same time, the National Planning Commission releases its annual *Public Sector Development Programme* document, showing the adjusted estimates for development expenditures. Revised estimates of the preceding year and “provisional actual” for one year before the preceding year are provided (although only in a summary form in the *Annual Budget Statement*) for comparison with the estimates for the current year’s budget. As discussed further below, the timeliness and reliability of accounts data need to be improved for useful comparisons to be made with past years, as well as to provide a basis for projections of future years’ expenditures and revenues. Projections are not at present included in the budget documents.

17. **Public debt information is published but is not available in a timely and analytical format.** A full statement of public debt is not included in the budget documents but is given in the *Finance Accounts of the Federal Government*. This latter document is not available publicly in a timely way (see discussion of reporting below). The need to coordinate public debt information among different government organizations (the Economic Affairs division, SBP, and MOF) is recognized by the authorities, and a high level Debt Management Committee has been formed recently to advise on improving the debt management system. Debt information should also be better coordinated during the year through the operations of the Fiscal Monitoring Committee (FMC), which is discussed further below.

18. **General government information is available but actual data is provided with a long time lag.** Grants to provinces are included in the federal budget, but details of provincial receipts and spending are presented only to the provincial assemblies. An overview of federal and provincial budgets in the preceding three years is provided in the *Economic Survey* (again noting difficulties in timeliness and reliability of actual data). The SBP also provides information on the combined federal and provincial budgets in its *Annual Report* (presented at end-December) drawn from relevant budget documents and SBP bank data. The Controller General of Accounts (CGA) prepares *Combined Finance and Revenue Accounts for the Federal and Provincial Governments of Pakistan* from audited accounts of each level of government, but lack of timeliness and unreliability of some of the data has made this document of limited usefulness. It is now intended to improve reconciliation processes and to complete the compilation within six months of each financial year-end. The

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<sup>13</sup> These are: *Annual Budget Statement* and the *Budget in Brief*, which provide a summary overview; *Explanatory Memorandum on Federal Receipts*, providing estimates and brief notes on revenue and capital receipts (including foreign grants and loans); *Estimates of Foreign Assistance*, providing more detailed estimates of foreign grant and loan assistance by project; *Demands for Grants and Appropriations*, which provides details by vote for each grant as well as all expenditures charged on the consolidated fund; and *Details of Demands for Grants and Appropriations* (pink books), which provide much more detail of items of expenditure for budgetary control purposes (two volumes are produced: Current Expenditure: Volume I, and Development Expenditure: Volume II).

government has recently started publishing all available financial and economic data each month on its website (<http://www.finance.gov.pk>).

19. **No information on contingent liabilities, tax expenditures, or quasi-fiscal activities is provided with the budget documents.** Each of these aspects is of significance for fiscal decision-making in Pakistan and some relevant information is already available within the government.<sup>14</sup>

20. **Formal commitments for more regular publication of fiscal data have not yet been made.** The lack of timeliness of fiscal data has not allowed much progress to be made toward meeting IMF General Data Dissemination System (GDDS) standards, and no advance release date calendar for fiscal statistics publication has been produced. Recent developments to improve fiscal reporting (see discussion below) may make production of a monthly fiscal bulletin an attainable objective in the near- to medium-term future. The CBR data is already available on a monthly basis. Provisional civil account expenditure data will be published on a monthly basis from September, 2000.

### C. Open Budget Preparation, Execution, and Reporting

21. **The annual budget presentation of the federal government focuses primarily on central government and the current financial year.** The main concern of the budget presentation is with the provision of details of charged and voted expenditures to the parliament as required under the Constitution. The budget speech focuses on the main changes to revenue receipts and borrowing and a description of expected benefits from any increases in demand for grants and appropriation. Little emphasis is given to the size or sustainability of the budget deficit. A more analytical presentation is provided in the *Economic Survey*, which discusses the sustainability of the debt position and shows both overall and primary budget deficits. Budget policies are determined on a year-by-year basis. Development expenditures are aligned with gross borrowing, but there is no formal “golden rule” (requiring that borrowing should be limited to investment expenditure) and development spending cannot be directly equated to public investment. Detailed projections of possible future trends are not given. The main focus of provincial budgeting is also on parliamentary authorization and financial compliance, following the constitutional provisions in this regard. The Punjab Province, however, has begun experimenting with performance-oriented budgeting, though this exercise is still confined to an annual budget timeframe.

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<sup>14</sup> Relatively complete information is available within government on guarantees issued by the government with respect to guarantees for external loans by enterprises and domestic loan guarantees issued. Contingent liabilities that arise as a result of guarantees issued in relation to private sector financing arrangements could also, in principle, be systematically catalogued. Similarly, tax exemptions could be surveyed and published to provide a broader picture of fiscal activity during budget discussions. Quasi-fiscal activities of financial and nonfinancial public enterprises could also be usefully surveyed, though this may take considerably more research.

22. **The basis of budget and planning forecasts needs further improvement.** Five-year forecasts for the NFC incorporate assumed revenue policy changes which may not be realized. The underlying economic basis for forecasts is not made explicit, and risks of variation to the estimates are, therefore not always taken into account. The MOF, however, has begun preparation of rolling three year revenue forecasts for internal use in budget preparation. These forecasts are being prepared under the assumption of no policy changes to help determine trends and needs for new resource initiatives.

23. **No analysis of sensitivity of the estimates to changes in economic variables is published and there is no statement of fiscal risks.** Macroeconomic factors affecting the budget estimates are described in broad terms in the *Economic Survey* but these are not formalized nor put in the context of the estimates for the forthcoming budget. No assessment is made of risks arising from changes to macroeconomic assumptions or from specific contingencies.

24. **Estimates of ongoing costs of government policies are clearly distinguished in budget preparation, but not in the budget documents.** Initial estimates of current expenditure are prepared in terms of “permanent” expenditures and New Item Statements (NIS). NISs are further distinguished as “new” or “temporary” (covering new expenditures for a period of five years before they are categorized as permanent). These distinctions are not, however, retained in the budget documents. They are, however, used as a baseline for future budget estimates, and so provide a basis for forward projections of the continuing costs of government. Ongoing and new projects are distinguished in the PSDP.

25. **Recurrent expenditures are controlled within budget authority, but control against aggregate deficit targets has been inadequate.** Weaknesses in revenue estimation and collection (noted above) have contributed to unrealistic budget estimates at both federal and provincial level, necessitating cutbacks during the year. Budget cuts have particularly affected the PSDP but have also been applied to discretionary elements of recurrent spending. Through its cadre of Financial Advisors (FAs), the MOF exercises control over commitment of expenditures and monitors progress against budget authorization. FAs are assigned to Ministries/Divisions by the MOF to assist the Principal Accounting Officer (PAO) of that agency in budget management. They are administratively responsible to and part of the budget of the MOF and report to the Secretary, MOF.<sup>15</sup> All expenditure commitments must be approved by the FA and an annual report is submitted to the MOF by the FA through the Secretary of the Department/Division to which the FA is assigned. Specific issues may also be referred to the MOF as these arise. More timely fiscal reports will improve the government’s capacity to respond to revenue downturns.

26. **The federal government has adopted measures to address a significant breakdown of the processes of accounts reconciliation and fiscal reporting.** Though basic

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<sup>15</sup> Duties of FAs are given in *Revised System of Financial Control and Budgeting*.

processes of accounting and reconciliation are in place, these had been allowed to lapse through a "cycle of neglect" caused by several factors: a delayed Public Accounts (PAC) mechanism; lack of timeliness and therefore usefulness of accounting reports from the Accountant General Pakistan Revenues (AGPR); and a lack of pressure on PAOs to produce timely reconciled reports to the AGPR. The MOF as a result relied on a variety of data sources other than AGPR to monitor fiscal developments. However, there was inadequate cross-checking of data among the central agencies of government, and this system was found recently by the government to have significantly underreported budget financing through the National Savings Schemes as well as giving rise to a number of other fiscal data discrepancies. In response, the government took immediate and effective steps to begin reestablishing accounts reconciliation and fiscal reporting processes based on AGPR data (see Box 1) and is accelerating efforts to establish a computerized accounting system. Similar deficiencies apply to the reconciliation and reporting processes at provincial level and further action is underway to address the issues at that level.

**27. Measures are being taken to include statements of accounting policy in the budget and final accounts documents.** Accounting is on a cash basis and accounting procedures are set out in detail in accounting manuals. The budget and accounts data are classified in a way that is broadly compatible with GFS fiscal reporting requirements. The accounting system does not generate standard reports on accounts due for payment, but accounts-based data on arrears can be obtained from the ministries and FAs. The government has, in principle, agreed to adopt a revised chart of accounts and a new accounting model that are compatible with the eventual implementation of accrual accounting and reporting.<sup>16</sup> It is envisaged that the cash basis of reporting on government activities will be used for some time to come and that commitment and accrual recording and reporting will be introduced in a phased manner. Software is currently being selected for computerization of the new system. It is currently envisaged that the new chart of accounts will be implemented on a pilot basis at both federal and provincial level during 2001/2 and will be rolled out to the whole of government commencing 2002/3. These changes need to be supported by strengthening and professionalization of the accounting staff in field offices.

**28. Internal control procedures are in place, but observation of these procedures needs improvement.** The lapse in reporting practices has, as a counterpart, contributed to weakening the internal control system. Internal audit processes are generally recognized as being weak at federal level, and even more so in the provinces. Procurement regulations are in place, but the regulations are not issued under the umbrella of a procurement law, are not always strictly observed in practice, and administrative mechanisms to ensure compliance are inadequate. The government has initiated action to set up a Public Procurement Regulatory Authority, which will report to the highest level of government, to develop a procurement law and oversee its implementation. Administration of the civil service establishment and

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<sup>16</sup> This is being done as part of a World Bank-financed project: Pakistan: Improvement of Fiscal Reporting and Audit (PIFRA).

sanctioned staff strength is in need of major reform, with a fragmented and antiquated payroll administration and only manual cross-checking of authorized and established posts.

29. **Steps are being taken to improve the quality of fiscal reports and final accounts reports, but substantial difficulties remain.** For the reasons outlined above, fiscal reporting for management purposes has been inadequate and year-end accounts have not been finalized in a timely way. No monthly budget report is produced. The classification of accounts is an amalgamation of a functional and an economic classification and insufficient detail of economic categories is produced in fiscal reports. As outlined in Box 1, however, the FMC will oversee production of a reliable and timely monthly report, which could eventually become the basis of a monthly fiscal bulletin. The AGPR prepares *Appropriation Accounts (Civil)*<sup>17</sup> within 9 months of year-end, which are then submitted by the Auditor General to the president for transmission to the parliament. Reconciliation of accounts at this stage was not satisfactory. Final approved accounts were not made publicly available in a timely way because of prolonged delays in PAC consideration of the accounts. A similar situation prevailed at the provincial level. A comprehensive statement of the end-year accounts of the federal government, *Finance Accounts of the Federal Government*, covering all accounts and balances of assets and liabilities, is produced by the AGPR at the same time for the executive branch of government.<sup>18</sup>

30. **Defense expenditures are included in the budget but detailed budgeting and accounting are separate from the civil accounts.** As noted, defense expenditures and accounts are departmentalized accounts maintained by the Military Accountant General. Audit is performed by the Director General, Defense Audit. Defense appropriation accounts are provided to the PAC, as noted above, but circulation of these accounts is restricted for security reasons. Defense pension obligations, however, from FY 2000/2001, have been included in the civil budget.

#### D. Independent Assurances of Integrity

31. **The Auditor General is established under the Constitution to provide independent assurance on the public finances to both the executive and legislative branches.** The Auditor General of Pakistan at present carries out both auditing and accounting functions for the government and reports directly to the president. Accounting has been interpreted in the past as an external control function, but its executive role is increasingly being recognized. A process of separation of the accounting and audit function, initially within the Auditor General's office, has been initiated. These functions have been

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<sup>17</sup> Accountant generals of nine departmentalized accounting departments, including Defense Services, Public Works Department, PR, and National Savings Organization, each produce their own *Appropriation Accounts* volume and these are presented at the same time by the Auditor General.

<sup>18</sup> It can be noted that accounting for interest payments on a cash basis presents particular difficulties in Pakistan because many of the debt instruments exhibit balloon type interest profiles. An accrual basis account would provide a more accurate picture of the fiscal position

### **Box 1. Fiscal Monitoring and Reconciliation**

As with many countries, the government accounting function in Pakistan has been focused mainly on its roles of assuring financial regularity and reporting on use of appropriations to parliament, much less on providing within-year management information to the executive branch. Weakness in the PAC mechanism and lack of executive use of within-year data led to some lapse in even these basic functions. Alternative sources of information were used for fiscal management, but this led to the emergence of significant data discrepancies in a number of areas, particularly in relation to National Savings Schemes.

In response to the discovery of these discrepancies, the government set up a FMC to monitor the general government balance monthly, using reconciled data from the AGPR with respect to federal government spending. The FMC, which is chaired by the MOF and includes senior staff from AGPR, the SBP, and the CBR. Strong directions were issued to all Principal Accounting Officers to prepare reconciled reports each month. The creation of the FMC—and its strong support by the government—has had two important effects. First, it has had an immediate effect on improving the quality of data used for monitoring budget performance within year and has established a stronger management role for the accounting cadre. Second, it has strengthened the processes of internal reconciliation and control that are vital to effective governance and accountability. Some of the main features of the FMC process to date are as follows.

- The procedures for reconciliation have been strengthened to give greater assurance of data reliability for fiscal monitoring.
- The degree of reconciliation has been improved from 40 percent in December to 70 percent in April. Full reconciliation is expected to be achieved in July.
- The principles that AGPR data should be the primary source for fiscal reports and the AGPR should be fully involved in aggregate fiscal monitoring have been established.
- Reconciliation processes for National Savings Schemes have been improved and are now fully up to date.

In the longer term, these processes will be computerized. Implementation delays with the PIFRA project have been largely overcome. It is expected that a new chart of accounts will be introduced on a pilot basis in 2001/2 and a computerized system will be rolled out to both federal and provincial governments from 2002/3. In the meantime, the FMC will firmly apply existing regulations. Extension of similar processes to the provinces and measures to strengthen the PAC mechanism will be examined.

separately departmentalized under the Auditor General. Accounting is now coordinated through the CGA. The Constitution, however, appears to constrain the extent to which the CGA can be delegated accounting powers (signing the federal and provincial Appropriation and Finance Accounts) by the Auditor General and a high level committee is considering this aspect and the need for a constitutional amendment in this respect. The issue of the extent to which accounting powers can be delegated to the provinces is also being considered by this committee.

32. **Strengthening of audit capacity and PAC mechanisms is required at all levels.** A major aim of the PIFRA project is to develop the office of the Auditor General as a Supreme Audit Institution, with all the characteristics of independence required for such institutions. Technical capacity and approach to audit are also being strengthened under this project. Techniques of audit have been improved with less emphasis on detailed propriety audit and a sharper focus on key performance related issues and improved communication of key issues. A major weakness in the system, however, has been the prolonged delays and relative ineffectiveness of the PAC mechanism. Provincial assemblies appear to be particularly weak in this respect. The need to improve this mechanism is being given attention at the highest level.

33. **Macroeconomic models and assumptions are not open to external scrutiny.** As noted, these are not formalized in the public domain and, therefore, not open to technical assessment by independent experts.

34. **The national statistics office is given legislative assurance of independence.** The *Statistical Act, 1974* provides clear authority for the Federal Bureau of Statistics to collect information for statistical purposes.

### III. IMF STAFF COMMENTARY

35. **Pakistan has recently made progress in improving fiscal transparency.** Effective improvements in fiscal reporting, continuing progress in deregulating the public enterprise sector, and a tradition of public availability of budget information provide a solid basis for establishing a transparent and effective fiscal management system. Many of the requirements of the IMF Fiscal Transparency Code have yet to be met, however. A sustained commitment at the highest level plus strong administrative efforts are required to build on the progress that has been made. The immediate aim should be to establish a threshold level of fiscal transparency that can become self-sustaining. Efforts toward this end could focus on three broad areas: (1) strengthening the core fiscal accounting and reporting processes; (2) widening and deepening fiscal information provided in the budget process; and (3) defining more clearly the roles of different levels of government and the relationship between government and commercial activities. While some immediate emphasis is needed on the first of these, all are interrelated and some action can and should be taken on all three fronts. By and large, the government is already committed to improvement in these areas; the following comments serve to highlight activities of particular importance.

36. **Immediate priority should be given to consolidating improvements in fiscal reporting and re-establishing control processes.** Improved timeliness and reliability of reports on federal government fiscal activity creates an environment whereby government can react more quickly and flexibly to changes in the economic environment. In order to sustain and develop the improvements achieved, the following actions should be considered.

- When a satisfactory standard of reliability and timeliness of monthly fiscal reports has been attained, the MOF should make a quarterly (and eventually monthly) fiscal

bulletins available to the public showing the status of the budget relative to the original estimates.

- Similar processes should be promoted at provincial level in consultation with provincial authorities.
- Internal audit and control processes should be improved with particular emphasis on control of staff strength, establishment of effective internal audit, and development of a general procurement law and an effective administration to oversee compliance with procurement.
- Establishing effective and timely PAC processes by both federal and provincial legislatures should be given priority at the highest level.
- Accounting training, development of improved government accounting standards, and developing explicit accounting policies (e.g., policy on disclosure of contingent liabilities) should be particularly emphasized as part of the PIFRA project implementation. The PIFRA project should be strongly supported by immediate action to strengthen accounting processes and staff quality in field offices.

**37. The range and quality of information provided in budget and accounts documents should be progressively improved.** A considerable amount of information relevant to budget decision-making is already available within government and could relatively easily be included in the budget documents. Other aspects, such as extending the budget timeframe, will take time to put fully in place, but it is nonetheless important to initiate some action in the near future. The following actions are suggested:

- publish a statement covering all federal government explicit contingent liabilities showing the size and nature of the liability and including government guarantees for domestic loans or commodity support schemes, and external loans; contingencies associated with privatization processes; and guarantees associated with private sector financing of infrastructure. Any invoked guarantees or contingencies that have become actual liabilities should also be disclosed;
- as part of tax reform, review tax exemptions and estimate the extent of revenue foregone through such exemptions. A schedule of tax expenditures could be published as part of the budget documentation;
- account more clearly for quasi-fiscal activities carried out by public enterprises, ideally incorporating such activities (for instance SBP credit funds) formally in the budget;
- report all extrabudgetary funds financed by donor funds as annexes to the budget and annual accounts documents;

- provide an explicit description of the main economic assumptions used in making budget forecasts and indicate the estimated effects of changes in key economic parameters (such as GDP growth rate, interest rate, or rate of inflation);
- initiate a process of establishing a medium-term budget framework by establishing a rolling process for costing the existing policies of government for at least two years beyond the budget year. The following steps could be undertaken in the near future:
  - develop the MOF revenue forecasts as a baseline forecast assuming no change in revenue policies;
  - request all ministries to extend their “permanent” (including so-called “temporary”) budget forecasts beyond the budget year by two years and including (separately) identified additional costs that arise from implemented development projects. Current wage and price assumptions should be used and any parameter changes applied on an aggregate basis by the MOF;
  - initiate a formal review process to improve efficiency and/or reduce permanent budget costs;
  - strengthen coordination with the National Planning Commission to establish an integrated process for examining and setting priorities among all forms of new expenditure;
- initiate a detailed review of long-term sustainability of fiscal policy with particular emphasis on the ratio of debt-to-GDP and an examination of all future liabilities (including future pension liabilities to both civil and defense personnel) and contingent liabilities; and
- Initiate a review of budget documentation, with a view to streamlining the presentation and supplementing the *Economic Survey* with a more specific forward-looking analysis of the budget. The possibility of including forward “existing policy” estimates in the budget in the near future should be considered.<sup>19</sup>

38. **Continuing emphasis needs to be placed on clarifying roles and responsibilities of government vis-à-vis other sectors.** The MOF is one of the key agencies involved in this process and its organization and legal framework may need to be modified in due course to reflect these responsibilities. Major elements that need to be addressed include the following.

- A clear definition of revenue authority and expenditure responsibilities at each level of government.

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<sup>19</sup> It should be emphasized that these estimates would be a statement of government policy and not a “demand for grants.” Provision of this information to the parliament (as is done in other countries with similar constitutional requirements) should thus pose no problems with regard to the current legal framework.

- A clearer distinction between general government activities and those of the nonfinancial and financial public sector. A fiscal analysis framework based on identification of a general government balance as well as the borrowing requirement of nonfinancial public enterprise sector could be appropriate bases for fiscal policy analysis. This possibility would require some consolidation of government's capacity for public enterprise policy analysis (including assessment of the extent of quasi-fiscal activity) and should be located in the MOF. This possibility needs detailed review.
- The possibility could be considered in due course of developing a Public Finance Act, based on the provisions of the Constitution, but defining more explicitly the role of the MOF in fiscal management and giving explicit emphasis to performance and fiscal transparency.
- As the capacity of the Auditor General's Office is developed, consideration could be given to broadening the mandate of the Auditor General to give more emphasis to performance audit and, more generally, to act as an independent watchdog to monitor the extent to which good fiscal transparency practices are being observed.

