April 2008
IMF Country Report No. 08/129

Pakistan: Report on Observance of Standards and Codes—Fiscal Transparency Module—An Update

This update to the Report on the Observance of Standards and Codes on Fiscal Transparency for Pakistan was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on April 4, 2008. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Pakistan or the Executive Board of the IMF.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PAKISTAN

Report on the Observance of Standards and Codes (ROSC) Fiscal Transparency Module—An Update

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April 4, 2008

I. Introduction

1. The original fiscal ROSC was issued in November 2000, and was subsequently updated during Article IV consultations in 2002 and 2004. The present update was carried out in association with an FAD technical assistance mission on public financial management (PFM) issues. It focuses particularly on transparency aspects of fiscal management reforms reviewed by that mission as well as implementation of key ROSC recommendations. The government is at a relatively advanced stage in introducing a comprehensive financial management information system and strengthening the audit function[1] at the federal, provincial, and district levels; it is progressively introducing a medium-term budgeting framework (MTBF) at the federal level and initiating complementary processes in provinces.[2] It has also established a stronger legal framework for coordinating fiscal and debt management policies and improving fiscal transparency through the Fiscal Responsibility and Debt Limitation Law (FRDL), which was enacted in June 2005.

2. These reforms have the potential to achieve wide-ranging improvements in many fiscal transparency practices. However, they involve major institutional changes and many practical issues of implementation have yet to be overcome. The government recognizes the need to address these challenges if the full transparency and management benefits are to be realized. This update assesses the impact of these reforms to date against the main principles of fiscal transparency, indicates those reforms which are underway, and suggests priorities for further transparency improvements. The mission did not carry out a full reassessment of the 2000 fiscal ROSC; the original ROSC or update assessments remain unchanged except where otherwise noted below.

[1] Through the World Bank-supported *Pakistan Improvement to Accounting and Auditing* (PIFRA) project.
[2] Supported by the U.K. Department for International Development.

II. Description of Progress

A. Clarity of Roles and Responsibilities

3. **Traditional planning and budgeting responsibilities have not been fully redefined or coordinated for medium-term budgeting**. In the 2000 fiscal ROSC, the introduction of medium-term budgeting was seen as an important vehicle for addressing the long-standing lack of clarity in the linkages between the planning and budgeting processes in Pakistan. In the long term, such an impact should be achieved through the MTBF initiative underway, but as yet, limited steps have been taken to modify the separate processes, revise the regulatory environment,[3] or redefine responsibilities for preparation and execution of the development and recurrent budgets.

4. **The FRDL provides regulatory support for fiscal policy transparency and fiscal reform**. The rules-based policies embedded in the FRDL[4] and its publication requirements (see further discussion below) establish clear standards of accountability for fiscal discipline. The authorities, recognizing these requirements, are preparing statements concerning reporting compliance with the NAM chart of accounts. When fully implemented, the FRDL will thus allow the financial markets and the international community a clear picture of fiscal policy intentions and management. Effective implementation, however, requires a rigorous application of international standards of fiscal reporting and accounting to ensure that observance of rules is verifiable.

5. **The State Bank of Pakistan (SBP) has a high degree of operational autonomy in monetary policy, as noted in the 2000 ROSC**. The separation between monetary and fiscal policy, however, is still incomplete. In particular, the practice of automatic financing of the short-term liquidity needs of government may interfere with the exercise of monetary policy if the government does not carefully husband its cash resources and exercise expenditure control during the year.

6. **Steps have been taken to streamline and clarify financial relations with the state-owned enterprise sector and financial sector, and the need for further work is recognized**. Continued efforts at privatization have reduced public sector involvement in the enterprise and financial sectors, particularly the latter.[5] An overview of the

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[3] Regulatory reform was started in September 2006 with the adoption of the *System of Financial Control and Budgeting*. Further development of higher level legal framework may be required in due course.

[4] The rules require, among other things (a) reducing the revenue deficit to nil by end-June 2008; (b) achieving a debt/GDP ratio below 60 percent by June 2013; (c) annual reduction of debt by 2.5 percent of GDP; (d) issuance of guarantees to be less than 2 percent of GDP each year. Objective (b) was achieved in 2005–06, and the authorities advise that rule (c) continues to apply.

[5] As of February 2007, private sector ownership of the banking and financial sector was about 86 percent and the government plans further divestment of shares in several domestic banks.

government's equity holdings and policies toward its enterprises is maintained by the Corporate Wing of the Ministry of Finance (MOF). Data on government investment in wholly owned and joint venture enterprises, and equity investments are collected, but are not currently up-to-date.[6] Though privatization of the Karachi Electricity Supply Corporation (KESC) is complete and a process of commercialization of the Water and Power Development Authority (WAPDA) is underway, the overall drain on the budget from WAPDA, and other state enterprises such as Pakistan Railways and Pakistan International Airlines remains substantial. Subsidies to KESC continue—largely as a function of regulation of electricity tariffs. Budgetary support through equity contribution and direct subsidy are recognized in the budget and summarized in the "implicit contingent liability" section of Annexure 1 of the *Economic Survey*. However, neither the budget nor the analytical annexure provide details on, for instance any performance-related contractual arrangements. Annexure 1 does not provide estimates of the long-term costs of government regulatory policies or the size of the implicit liability faced by the government for major continuing subsidies.

B. Open Budget Preparation, Execution, and Reporting

7. **The framework for macrofiscal management of the budget is being strengthened in line with the FRDL.** Establishment of the economic advisor post and the Debt Policy Coordination Office (DPCO) have provided a sharper focus for formulation and implementation of a medium-term macroeconomic framework for budget policy. The role of the economic advisor will be centered around formulation and maintenance of the medium-term framework, development of long-term (10-year horizon) strategies for economic and fiscal sustainability, and regular reviews of fiscal and debt policy as an integral part of the budget cycle. First steps have been taken to produce annual statements of fiscal policy and debt policy (as required under the FRDL) around the mid-term of the annual budget.[7] These processes provide basic elements of a comprehensive annual, medium-term, and long-term macroeconomic framework for the budget. The combination of the existing *Economic Survey*, and the recent *Fiscal Policy Statement* and *Debt Policy Statement*, in the context of a regularly updated medium-term macroeconomic framework, provides a basis for policy setting and review of the annual budget and steering of budget policy in the medium term. A 10-year macroeconomic perspective paper will provide an opportunity to examine issues of long-term fiscal sustainability. Building such a framework should greatly strengthen fiscal policy making and its implementation, but there will be a concomitant need to review the existing

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[6] Total equity in nonfinancial enterprises stood at PKR 299.6 billion as of June 2004, with an average return on equity of 22.4 percent and considerable variation among enterprises. These data are to be brought up to date for 2007.

[7] The first such statements, *Fiscal Policy Statement 2006–07* and the *Debt Policy Statement 2006–07,* were published by the government of Pakistan on January 31, 2007.

planning and budgeting arrangements. As yet, however, the medium-term macroeconomic framework has not been published. While information is available on some fiscal risks in the Annexure 1 statement of contingent liabilities, there is no formal statement of fiscal risks covering all risks that apply to the annual and medium-term budget.

8. **An MTBF process has been initiated, but crucial elements of budget integration and policy transparency have still to be put in place.** The development of an MTBF was initiated in 2003, and an MTBF process involving detailed activity costing and identification of ministry objectives and output indicators applied progressively from FY 2005–06.[8] In phase one of the MTBF implementation, emphasis was given to establishing better costing and budget preparation techniques in the line ministries. From December 2006, however, the strategy has been changed to give primary emphasis to top-down budget control—while continuing to build up management capacity in the line ministries. The current and development budgets continue to be prepared and presented in the budget document as separate elements. Three separate call circulars are sent to ministries (for current, development, and MTBF budgets). Costs of policy objectives are shown, but further work is needed to link output indicators and budget allocations. The technical and policy basis of out-year estimates are not yet sufficiently clear in the budget documents and, in practice, out-years are resubmitted rather than being rolled over as the base data for the following year's budget.

9. **Good progress has been made in implementing a cash basis accounting and financial management information system**. Implementation of the PIFRA project has accelerated in recent years. Full cash basis functionality has been established and the accounting and budgeting system (using SAP accounting software) is operating effectively at 59 out of the total of 133 sites required for coverage of federal, provincial, and district level budgeting and accounting. The system is now fully implemented in the North West Frontier Province, the Punjab province is expected to be fully covered by September 2007, and the Sindh Province by December 2007. The federal government will be fully covered when all sites are active. Monthly summary accounting reports[9] are prepared in a timely way (within 20 days after month-end) for all levels of government using a combination of the legacy system and SAP sites. Accounts reconciliation is being improved by monthly review through federal and provincial fiscal monitoring committees

[8] That is, with the first year in FY 2004–5 and the third out-year in FY 2007–8. An MTBF budget was presented for two ministries (Health, and Population Welfare) for FYs 2005–08. For FYs 2007–10, 15 ministries will be presented in the MTBF format, and it is intended that all ministries will be covered in the 2009–12 MTBF presentation. The first year of the MTBF budget corresponds precisely to the appropriated and charged expenditures included in the annual budget for these ministries. Out-years beyond the budget year are not appropriated.

[9] At present, at functional level only. Work is underway to prepare reports with an object-wise summary in early 2007.

and work is underway to improve some key transaction interfaces, particularly for foreign transactions. The system significantly reduces opportunities for discretion (for example, by computer-generated checks and, eventually, direct transfer to recipient bank accounts) and reduces transaction processing time.

10. **The accounting system is being progressively adjusted to include commitments and to generate GFS-compliant fiscal reports.** The accounting system is capable of recording and tracking commitments, and commitment accounting is being introduced as part of the PIFRA project. Immediate priority has rightly been given to extending coverage as rapidly as possible using the well established cash basis procedures. At present, fiscal reports published on the MOF website (http://www.finance.gov.pk/pak_fis/main.htm) are not fully GFSM 2001 compatible. Recent mapping work and further system integration should make this possible in the near future.

11. **The discrepancy between deficit recorded in the fiscal accounts and that estimated from financing records is currently being addressed by the authorities**. Fiscal reports continue to show a significant discrepancy between the deficit recorded on the fiscal accounts and that estimated from financing records. The magnitude of the discrepancy, at around 1.2 percent of GDP in 2004–05, has been of concern for some time. A rigorous mapping and analysis of the reconciliation process should resolve this issue. Splitting of responsibilities for producing the fiscal report between AGPR and the Budget Wing of the MOF, however, has meant that no organizational unit has clear responsibility for eliminating the statistical discrepancy. These problems are likely to be overcome once the interface between MOF, SBP, Economic Affairs Department (EAD) of the Ministry of Economic Affairs and Statistics, and AGPR systems is completed. Resolving this discrepancy is key to ensuring accountability under the FRDL, which depends on assurance of reliability of key fiscal indicators.

12. **Weak internal controls continue to be an issue, though significant steps are being taken to strengthen control and accountability of ministries.** Weakness in ministry internal controls is regularly noted in the audit reports of the Auditor General of Pakistan (AGP) and is well recognized by the authorities. The September 2006 *System of Financial Control and Budgeting* authorized the establishment of chief finance and accounting officers (CFAO) within each ministry.[10] However, although budgetary support was provided, implementation difficulties related to independent selection of the CFAOs by line ministries have so far prevented the completion of this important change.

[10] The budget and accounting processes of government are currently highly centralized: financial advisors (FAs) from the MOF, attached to each ministry, supervise budget preparation and execution processes; nearly all payments are pre-audited and executed through the federal and provincial Accountant Generals (AGs) and the Controller General of Accounts (CGA).

Further steps are under consideration by the government. Manuals on internal control have been prepared and training is underway at the Audit and Accounting Training Institute. These changes, together with stronger SAP system controls and reporting, and continuing audit and central agency oversight, should help strengthen ministry management and internal controls over time. Reform in this area will be crucial to implementing the MTBF as well as complementing the audit reforms discussed below.

13. **Use of Personal Ledger Accounts (PLAs) and similar mechanisms for project disbursement are being gradually replaced by more accountable mechanisms.** Weak control and accountability through the operation of PLAs or assignment accounts[11] for rapid disbursement of project funds has been a matter of continuing concern. Though opening such accounts was being discouraged at federal level, until recently, existing accounts continued to be used, while at provincial level, the use of such accounts has been growing. Despite policies to limit creation of such accounts, the volume of receipts (authority granted) to such accounts continued to grow.[12] Subsequent to the ROSC assessment in January 2007, the authorities have, from July 1, 2007, introduced regulations to replace PLAs and assignment accounts with NAM compliant procedures in the SAP system, under which booking of expenditure will take place at the time of actual spending.

14. **Federal procurement regulations have been strengthened.**[13] At the federal level, a Public Procurement Regulatory Authority (PPRA) was set up in 2002 to regulate public procurement throughout Pakistan (see http://www.ppra.org.pk/). Federal regulations (Public Procurement Rules 2004) have been promulgated, although detailed implementing procedures have yet to be developed. The regulations are well known among government agencies, although monitoring capacity is still under development. At the provincial level, Punjab, North West Frontier, and Sindh provinces are taking steps toward strengthening procurement administration and are developing their own regulations; Balochistan has adopted the federal procurement rules, but has yet to make these operational.

C. Public Availability of Information

15. **Budget and accounts documents cover most general government transactions and are accessible to the public but analytical information requires further**

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[11] These arrangements are recorded as spending when created and give direct authority for project managers to write checks against the public account. They are subject to ex post audit, but this is acknowledged to be weak.

[12] Receipts grew from PKR billion 103.3 in FY 2004–5 to PKR billion 159.0 in FY 2005–6. Payments (that is, actual expenditure) from the accounts expanded from PKR billion 110 to 143.4 over this period. Increases occurred at both federal and provincial level, albeit more in the latter.

[13] Assessment in this area is based on World Bank analysis.

strengthening. The budget and accounts documents are now fully consistent with the new chart of accounts and provide both functional and economic (object) classification. The budget documents do not include a summary analytical table giving comparisons between original budget and actual data over several immediately prior budget years. Detailed data to make such comparisons is available, however. The annual appropriation accounts, available only recently within 12 months of the budget year-end, compares actual expenditure with original and revised budget for the relevant year, indicating any variance. A detailed review of actual revenue collection versus targets is provided in the annual *Central Board of Revenue Year Book*, as well as quarterly reports in the *CBR Quarterly Review*. The SBP *Annual Report* provides tables of government fiscal data drawn from the annual budget and accounts documents in its statistical annexure.

16. **Public debt reporting has improved, but underlying data issues need further resolution**. The *Economic Survey* includes a detailed set of tables and analysis of domestic and foreign public debt, but data for the current and previous year are provisional. The SBP also reports regularly on public debt in the statistical annexure to its *Annual Report*. Some issues remain, however, on coordinating the various sources of data and the maintenance of databases on public debt. Three organizations are responsible for different elements of public debt. With regard to domestic debt, the SBP borrows in the domestic market through issuance of treasury bills and Pakistan investment bonds; the Central Directorate of National Savings is the main source of nonblank borrowing through the National Savings Scheme. External borrowing and grants are administered through the EAD and foreign economic assistance is reported on a quarterly basis (with about a two month lag), and annually in its *Year Book*. It operates the government's external debt database using its (recently enhanced) Debt Management and Financial Accounting System (DMFAS). Reconciling data from these sources and incorporating them in the government accounts is a major continuing problem which is being addressed by the federal Fiscal Monitoring Committee with assistance from the PIFRA project. A system interface between EAD and AGPR is being prepared to reconcile data related to debt, though the significant data problems with respect to both foreign and domestic debt will require additional efforts to resolve. The *Debt Policy Statement* now being produced by the DPCO will rely on available data and will provide a sharper focus for resolution of the data issues.

17. **Tax expenditure reporting has been established but could be further strengthened.** Tax expenditures are now reported regularly in the *Economic Survey* (Annexure 2 of the budget) and these estimates are being used by the Central Board of Revenue in its consideration of tax policy changes. However, not all exemptions are considered to be tax expenditures. For instance, exemptions designed to encourage foreign investment are not included in the tax expenditure report and absence of this data limits the possibilities for a comprehensive review of tax policy.

D. Assurances of Integrity

18. **The quality of fiscal data presented to the public needs further strengthening**. As noted above, data comparing original budget with actual outcomes is not readily available on a timely basis. Available data[14] indicates that, in recent years, revenue and grants have substantially outperformed the original budget forecasts, which has permitted increases in spending, through supplementary appropriations during the year. An underlying factor cited by the authorities, has been the "soft budget constraint" strategy used to manage budget demands. Lack of reliable forecasts reduces the transparency of government fiscal policy and the resulting uncertainties will make the implementation of an effective MTBF more difficult.

19. **Significant improvements in scope, timeliness, and quality of external audit are underway**. Under the PIFRA project, the Auditor General of Pakistan (AGP) has introduced modern, risk- and system-based audit methodology and is applying this to all levels of government (including state-owned enterprises) under AGP jurisdiction.[15] A financial audit manual has been produced and distributed and some 370 staff have been trained. The program is on track to apply these techniques to the finance and appropriation accounts for federal and provincial governments FY 2005–06 (during audit year 2006–07), and for district and self-accounting entities in audit year 2007–08). Risk and system-based, as opposed to transactions-based techniques will improve audit efficiency, effectiveness and quality. Modern audit identifies high risk areas for audit and focuses on systemic issues rather than individual transaction irregularities (though these will continue to be part of audit observations as needed).[16] An examination of the effectiveness of agency systems of internal controls (see discussion above) will be given a particular emphasis. Strengthening of controls at this level will, in turn, improve transaction-level controls and allow the AGP to focus more on systemic issues. Considerable work remains for these objectives to be achieved fully, and progress in achieving quality improvements will be monitored under the PIFRA project.

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[14] Data compiled from IMF staff reports show that both tax and nontax revenue increased substantially over budget in 2003–04 and 2004–05 (most significantly in nontax receipts, by about 22.9 percent and 58.9 percent in the respective years). These increases were then taken up by increases in both current and development spending.

[15] Total staff strength of the AGP as of November 2006 stood at 5251, of which, 1919 are at a senior level of B-16 and above. Some 1302 staff have professional qualifications, 372 at degree level. Of the total, some 2162 are in the Provincial and District Audit Wing of AGP, which had to be substantially strengthened following implementation of the government's decentralization strategy and the need for AGP functions to be carried out at district level.

[16] A system audit of the National Highway Authority was completed successfully in June 2006 to demonstrate the application of the methodology to the AGP. This will be included in the AGP report to the parliament and serves as a model for more general application.

20. **Timeliness of presentation of audit findings is being improved**. Audit of the federal, provincial, and district accounts for FY2005–06 is targeted for completion by June 2007. A significant improvement over the previous year is thus expected; the 2004–05 accounts have just been presented to the president. Due dates for submission of accounts by the respective AGs is not set in legislation or in regulations, but is prescribed by the AGP. Some slippage in meeting the due date for federal accounts has occurred, but the authorities consider that the target will be met, and that presentation of audited accounts to the national and provincial assemblies within 12 months or less will become standard.

21. **Public access and follow-up to audit findings has been improved and the need to address the backlog of audit reports with the Public Accounts Committee (PAC) of parliament is recognized.** After completion of audit and certification of the federal accounts, the AGP presents the certified accounts to the president, as required by the constitution. The president then places the audited accounts before parliament for consideration by the assembly and its PAC. Immediately upon tabling in parliament, the audited accounts become public documents. PAC meetings to discuss audit findings with principal accounting officers are open to the public. The AGP has advised that, as a consequence, audit findings are now given considerable weight and the AGP has enhanced authority to ensure follow-up of PAC directives. Because PACs were not operational for two years from 2000, however, a number of audit reports from previous years have still to be reviewed—and, as a consequence, action on directives from immediately previous years cannot be listed in the current audit reports. The AGP has suggested that priority be given to the most recent reports, but action on this proposal is the prerogative of the PAC chairperson. Subcommittees have been set up within the PAC to take action on all audit reports now tabled for PAC review.[17]

22. **The legal framework for audit restricts certain activities from audit by the AGP.** Under the Auditor General's Ordinance,[18] the AGP is prevented from auditing government bodies or authorities if their own ordinance requires audit by bodies other than the AGP. This provision has limited scope of audit in such agencies as the National Highways Authority. Some operational factors have also limited the scope of audit in the past. Because of differences in approach to valuation of liabilities between AGPR and the EAD, the AGP has not, in the past, audited the stock of debt, but has only audited borrowing and repayment flow data. The AGP is currently, however, examining measures that can be taken to remedy the situation.

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[17] Provincial audit reports for FY 2001–02 are currently being discussed in relevant Provincial Assemblies of all four provinces. The audits of FY 2002–03 and FY 2003–04 of all provinces have been completed and submitted to relevant governors. In case of districts, audit reports for FY 2002–03 of only three districts of Punjab have been submitted, no other district audit reports have been prepared.

[18] Auditor General's (Function, Power and Terms and Conditions of Services) Ordinance, 2001, Section 11 (2).

III. IMF Staff Commentary[19]

23. **PFM reforms have resulted in significant improvements against each of the four main fiscal transparency code principles since the 2004 ROSC update.** The continuing process of PFM reforms is giving tangible transparency and management benefits. The FRDL is starting to make a strong contribution to *clarifying fiscal management roles* and establishing a regulatory basis for fiscal policy accountability. This framework, together with the progress made in implementing the new accounting model and computerized accounting under the PIFRA project are helping to make *budget preparation, execution and reporting processes* more open. As the MTBF implementation proceeds, it will further help strengthen budget process transparency. In turn, these measures have had an impact on the quality of budget documents and *information made available to the public*. Notable improvements are the statements on fiscal policy and debt policy now being produced under the FRDL and the regular reports on tax expenditures and contingent liabilities annexed to the *Economic Survey*. The AGP is strengthening the quality and timeliness of external audit with the support of the PIFRA project. The application of risk- and systems-based audit promises to be an effective way of providing *assurance of the integrity* of the PFM system.

24. **Significant weaknesses remain and are being progressively addressed, but it will take sustained effort and clearly directed institutional change to realize the full benefits of reforms.** The preceding assessment notes significant remaining weaknesses against each of the four main code principles alongside the improvements noted above. Three main areas of weakness appear to impede the pace and impact of the PFM reforms. First, and as acknowledged by the authorities, internal controls and management capacity within line ministries is weak. Achieving a satisfactory standard in this area is a recommended good practice of the fiscal transparency code. It is also a prerequisite to a satisfactory level of performance in budget preparation, execution, and external audit. Second, the inherited systems of planning, budgeting, and reporting, which are little changed, need to be progressively modified in line with the requirements of the MTBF, the FRDL, and international standards of accounting and fiscal reporting. Third, and related to the previous point, cooperation among the main stakeholders in implementing PFM reforms, while improving, has been limited so far. Improvement in this last area will have the most immediate impact, and will be an essential foundation for sustained reform. More detailed suggestions for immediate and longer-term priorities for reform are given below.

[19] Measures proposed by FAD staff in this update have been developed in consultation with other development partners and are dealt with in more detail in the main text of the IMF technical assistance report.

Immediate and short-term measures

25. **Staff support the high priority being given to ensuring that fully GFS-compliant reports are generated by the SAP system.** The staff technical review of the new accounting model chart of accounts indicates that, while its economic (object) classification is broadly in line with GFS concepts, there are significant differences in treatment. These differences are not of major concern for budget management, but it is critical that fiscal reports used for internal review of fiscal policy, in international consultations, or in FRDL-compliance reports are fully compliant with international standards. Immediate steps should therefore be taken to map the chart of accounts classification against GFSM 2001.[20] In the medium term, efforts should be made to develop a comprehensive manual that specifies application of the economic (object) classification code to elements of expenditures. A well-trained unit within CGA/AGPR should be responsible for review of classification and advice and training to federal and provincial accounting staff. It would be highly desirable for full responsibility for production of fiscal reports to be given to a single organization. As SAP becomes fully established, the operational fiscal reporting function could most easily be carried out by CGA/AGPR with a continuing review function in the MOF.

26. **High priority should also be given to incorporating economic (object) classifications fully in the monthly Civil Accounts.** As a first step towards achieving this, the new budget execution reports which are available on a ministry by ministry basis for those on SAP, already include full breakdown by economic (object) classification. Consolidated detailed monthly reports is being emphasized in the PIFRA rollout and data are being entered by all spending units. Both SAP and legacy system data will be incorporated in SAP for the reports to be generated. The format of the monthly Civil Accounts is being changed in consultation with the AGP, CGA, and AGPR, with the assistance of the PIFRA project.

27. **Improved fiscal reporting should be supported by strengthening reporting on off-budget activity and fiscal risks.** The present contingent liability and tax expenditure reports annexed to the Economic Survey should be more comprehensive and embodied more explicitly in the budget policy process. The following steps are recommended:

a. In addition to the currently defined tax expenditures, other exemptions for specific activities (such as industry-specific exemptions to encourage investment) should also be identified and estimates of revenue foregone provided. These could be separately identified under the title of "structural

[20] The staff technical review provides guidance on key areas where objects and functional mapping is required.

exemptions," but it is important that some estimate of cost be indicated and considered openly as part of policy.

b. In the contingent liabilities annexure[21] the estimates of cost of implicit contingent liabilities should be extended to cover the full cost of the quasi-fiscal activity for which the subsidy is given.[22]

c. Government holdings of equity and policies toward its enterprises should be made more explicit, and an up-to-date data on government holdings included as part of the *Economic Survey*.

28. **A fiscal risk statement should be issued as part of the budget papers**. Elements of fiscal risk are covered in the present budget documents, but no summary overview of potential risks to the government's fiscal position is provided. As well as risks arising from explicit and implicit contingent liabilities, such a risk statement should cover macroeconomic risks arising from changes to key macroeconomic parameters, such as price, interest, or exchange rate. It could also provide an analysis of control risks, based on an examination of original budget estimates versus actual budget outcomes.[23]

29. **PLAs and assignment accounts should be completely replaced with NAM compliant alternatives as soon as possible**. The regulations to replace PLAs and assignment accounts should be implemented as soon as possible to strengthen reporting and control.

Medium- and long-term measures

30. **A program classification, based on subdetail functions, covering all ministries should be developed as part of the full MTBF rollout.** The MTBF implementation is following an ambitious rollout plan. A unified classification derived from the existing COA will build on the present system and support the top-down allocation process. FAD staff suggest that the present budget classification permits evolution to a more focused program approach which will help to address a number of critical long-term change issues. Operational "programs" so defined would incorporate both development and recurrent budgets relevant to that function element. Starting from an across-the-board classification within the existing chart of accounts would contribute to several important transparency and management objectives. It would help to:

[21] Or possibly as an element of the 10-year medium-term economic framework paper.
[22] For instance, the full cost of energy subsidies could be estimated from the discounted value of the price differential between controlled and market prices (incorporating different policy assumptions in the analysis).
[23] See *Manual on Fiscal Transparency*, IMF 2001 (Box 16, p. 44) for an illustration of a statement on fiscal risks.

- Unify the development and recurrent budget processes—"new proposal submissions" for programs should be evaluated in a similar way to development projects, but cover both capital and recurrent spending;

- Eliminate crossover problems when the development phase of a project is complete and recurrent costs are transferred to the revenue budget;

- Provide a framework that applies to all ministries, allowing a more phased approach to establishment of effective budget management by line ministries;

- Provide a framework that applies to all levels of government, helping to coordinate cross-government programs, particularly those included in the PRSP[24]; and

- Set a basis for redefinition and harmonization of the roles of the Planning and Development Division (PDD)[25] and the Budget Wing of the MOF.

31. **Actual outcomes as well as forward estimates should be included in the MTBF presentation.** Given the expected improvement in availability of data, it should be possible in the near future to meet the fiscal transparency code requirement that the budget and MTBF estimates should (in addition to the MTBF out-years) show actual outcomes for two years previous and provisional data for one year previous to the budget year. Allied to this, the budget documents should include summary tables showing original budget versus actual outcomes over several years.

32. **The methodology for preparing MTBF out-year estimates should be clearly specified.** Clear technical specifications for calculation of out-years will both improve the efficiency of budget preparation and improve transparency and accountability of the budget. Specification of technical parameters (such as price) and policy for the estimates will permit an analysis of factors causing changes in the estimates in the following year—most importantly, separating price changes from introduction of new policies. In turn, this will limit the need for data entry to establish baseline ceilings for following years' budgets, since the first out-year can be automatically entered as data for the next budget year in the roll-over process.

33. **A road-map for organizational change associated with the major reforms should be prepared and its implementation monitored at a high level.** A number of

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[24] *Accelerating Economic Growth and Reducing Poverty: The Road Ahead,* Government of Pakistan, December 2003.

[25] The current appraisal, monitoring, and evaluation roles of the PDD, for instance, could be applied to projects redefined in terms of operational programs.

significant changes in organizational roles and responsibilities for fiscal management, both among central agencies and within line ministries, is clearly required over the medium to long term. These changes include a redefinition of the roles of the PDD and the MOF, discussed above, development of closer coordination between the Budget and Expenditure Wings of the MOF, and changes in responsibilities between the central agencies and line ministries as the MTBF and effective internal controls are put in place. Specific plans for these developments need to be developed internally, recognized at a high level of government, and modified as circumstances change.

34. **Action on filling internal control posts should be accelerated, and clear appointment authority given to PAOs.** The initiative to establish effective internal control and financial management systems in line ministries will take time to implement but is central to long-term reforms. Implementation of the CFAO or equivalent positions in ministries and provision of budget support are extremely important first steps to establishing management capacity in line ministries. Remaining ambiguities on the relationship of the CFAO to central agencies should be resolved quickly, and clearly conveyed to the line ministries to expedite recruitment of these key posts. FAD staff favor giving full responsibility for selection of the appointees directly to the PAOs, subject to appropriate qualifications. Beyond this, however, a long-term commitment to training and capacity building in the line ministries will pay dividends through more effective implementation of both the PIFRA project and the MTBF.

35. **Efforts to strengthen procurement practices should be maintained and linked to the present PFM reforms.** Some further efforts are needed to promote reform of procurement practice at all levels of government and implement the regulations now in place at the federal level. The AGP already identifies procurement as an area of high risk. To help monitor procurement, SAP provides a platform that can be linked to contract-tracking software.

36. **The staff encourage the AGP to amend the legal framework for audit to permit all areas of risk to the public finances to be audited under the AGP's direction.** As noted, current audit practices are under review, with the expectation that regulatory changes will be introduced to extend the AGP oversight to all areas of government operations.