

Report No. 32569-PAK

**Islamic Republic of Pakistan
Punjab Public Financial Management and Accountability
Assessment**

May 31, 2005

Financial Management Unit
South Asia Region

Document of the World Bank

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Government of the Punjab



The World Bank



European Commission



UK Department for International
Development

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ACRONYMS AND ABBREVIATIONS

ADB	-	Asian Development Bank
ADP	-	Annual Development Program
AG	-	Accountant General
AGP	-	Auditor General of Pakistan
CFAA	-	Country Financial Accountability Assessment
CGA	-	Controller General of Accounts
COA	-	Chart of Accounts
DAC	-	Departmental Accounts Committee
DAGP	-	Department of the Auditor General
DAO	-	District Accounts Officer
DCO	-	District Coordination Officer
DDO	-	Drawing and Disbursing Officer
DFID	-	Department for International Development (UK)
DG	-	Director General
EDO	-	Executive District Officer
FD	-	Finance Department
FMC	-	Fiscal Monitoring Committee
FY	-	Fiscal Year
GoP	-	Government of Pakistan
GoPj	-	Government of Punjab
LG	-	Local Government
LGO	-	Local Government Ordinance
MTBF	-	Medium Term Budget Framework
NAM	-	New Accounting Model
NBP	-	National Bank of Pakistan
NoCs	-	No Objection Certificates
O&M	-	Operations and Maintenance
P&DD	-	Planning and Development Department
PAAS	-	Pakistan Audit and Accounts Service
PAO	-	Principal Accounting Officer
PCF	-	Provincial Consolidated Fund
PFC	-	Provincial Finance Commission
PFM	-	Public Financial Management
PFMAA	-	Provincial Financial Management and Accountability Assessment
PIFRA	-	Project for Improvement in Financial Reporting and Auditing
P-PRSP	-	Provincial Poverty Reduction Strategy Paper
PRMP	-	Punjab Resource Management Program
S&GAD	-	Services and General Administration Department
SBP	-	State Bank of Pakistan
SOEs	-	State Owned Enterprises
TMA	-	Tehsil Municipal Administration
TO	-	Tehsil Officer

PUNJAB – PROVINCIAL FINANCIAL MANAGEMENT AND ACCOUNTABILITY ASSESSMENT STUDY

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Summary Assessment

1. The Country Financial Accountability Assessment – Pakistan (December 2003) concluded that there were substantial opportunities for consolidating current reforms throughout Pakistan and for introducing additional reforms to further strengthen public financial accountability. This would require sustained policy level commitment at national and provincial levels. This provincial assessment continues this theme of continuing reform. The Punjab Government’s will to reform has been evidenced by the scale and variety of actions underway under the guidance of the Finance Secretary.
2. The PFM Performance Measurement Framework provides for a four-grade rating mechanism for measuring the attributes of PFM in a government against the benchmarks provided therein. It provides a useful mechanism for charting a path towards demonstrable improved PFM. Based on that rating scheme, the review has assessed the following indicators for the GoPj at this stage. The Action Matrix shows a path towards improving PFM in Punjab that has been developed through the consultative processes in this review.

Punjab PFM Indicometer

PFM Out-turns	Budget realism	Expenditure estimation	Revenue estimation	Expenditure arrears
Comprehensiveness & Transparency	Aggregate fiscal risk oversight	Expenditure coverage		
Budget Presentation	Fiscal projections & out-turn	Classification of the budget	Identification of pro-poor expenditure	Publication and public accessibility
Medium Term Planning & Budgeting	Multi-year perspective	Orderliness & participation in process	Coordination of recurrent budget	Legislative scrutiny of budget
Budget Execution & Procurement	Cash flow and procurement	Management of debt & guarantees	Spending agencies’ performance	Transfers to spending agencies
Internal Controls and Internal Audit	Internal controls	Internal audit	Payroll controls	Procurement systems
Accounting & Reporting	Timeliness and regularity of data	In-year execution reports	Audited financial statements	
External Audit	The scope and nature of external audit	Follow up by executive or audited entity		
Legislative Scrutiny	Legislative scrutiny			

A

B

C

D

3. The study has noted that the reforms already underway are developing a strong trajectory for PFM improvement. This report sets out the continuing concerns, challenges and proposals for further reform and development. It must be recognized that some intractable reforms have been urgent for some time but resolution has been difficult because of disagreements between parties or levels of government. The report again sets down these issues for further negotiation but most issues are within the capacity of the Provincial authorities.
4. The GoPj looks at the PFMAA study as an opportunity to develop a stakeholders' consensus on a path for carefully articulated reform measures in the various areas of financial management. The donors see it also as a statement of the current capacity of the Punjab Government's fiduciary framework to support the provision of development assistance, including through increased levels of budget support. In its Vision 2020 the government has expressed a clear vision of service delivery with the highest standards of transparency and accountability covering policy management, resource mobilization, expenditure management and oversight mechanisms. The need is to build capacities to support effective reform measures and the assessment in this report provides the baseline measures against specific benchmarks to help prioritize the actions. In addition to the continued commitment to the many reform initiatives identified, the report shows that there is an urgent need to start new actions. These recommendations are given at the end of the report in the Action Matrix developed through a stakeholders workshop held in Lahore on 29-30 March 2005 where the various ratings were agreed between the stakeholders and the Bank team.
5. Areas for urgent additional reform are in the budget execution, accounting and audit areas. The budget development area has shown up well, as would be expected after the reform activity through the Medium Term Budget Framework development. Much of the future improvement in the other areas depends on the success of PIFRA and an acceleration of its introduction to all DAOs and Treasuries in Punjab is highly desirable. Along with this it would also be highly desirable for the Accountant General to have full control of DAOs as envisaged in the CGA Ordinance.
6. Specific areas for priority attention are:
 - Improvement of arrears information on expenditures and revenues through commitment accounting and memorandum accounts of tax demands outstanding.
 - More frequent monitoring of fiscal risks arising from SOEs, including contingent liabilities and government guarantees, preferably through quarterly consolidated summaries.
 - Improvement of procurement processes through implementation of the proposed new procurement law including independent complaints resolution processes and a central procurement authority.
 - Improvements in services delivery and budget execution through reductions in procedural delays and increases in community knowledge of budget information.

- Improvements in internal controls through implementation of the recommendations of the ad-hoc PAC, and subsequent audit and PAC recommendations.
- Introduction of an adequate system of internal audit based on standards promulgated by the Institute of Internal Auditors.
- Improved payroll and GPF records through development of more effective systems.
- Implementation of more competitive and open procurement processes under the control of an effective regulatory authority.
- Continued improvement in reconciliations of accounting records through the implementation of the PIFRA system in all DAOs and Treasuries.
- More frequent budget execution reports for all districts.
- Publication of the audited annual accounts of the Province and each district within 12 months of the year end through improved audit procedures and accounts finalization procedures.
- Improved follow-up of audit and PAC recommendations through expansion into the Province of the tracking system that has been purchased through PIFRA by the Department of the Auditor General.
- Improved legislative scrutiny through more assistance to the PAC.

The Department of Finance should monitor progress against the PFM performance indicator framework through regular updates on reform progress using a tracking system developed with the assistance of the Bank if desired. Further discussions should be held between the Government of Punjab and the Bank about the implementation of a suitable tracking system.

Chapter 1: Introduction

1. This document reports on the conduct by the World Bank (the Bank), with the active cooperation and support of the Government of Punjab (GoPj) and also of other donors (EU, DFID, ADB) of a Public Financial Management and Accountability Assessment (PFMAA) for Punjab by describing the existing financial systems briefly, identifying the issues and related reforms trajectory, and finally by providing time-bound recommendations for actions. The study has been conducted with the assistance of a draft Public Financial Management Performance Measurement Framework (PFM Framework). The framework identifies the six critical PFM objectives of budget realism, a comprehensive policy-based budget, responsive management of the fiscal position, adequate information, effective control of public funds and appropriate scrutiny arrangements for accountability and transparency. The framework provides a set of high-level PFM indicators to rate performance against those objectives but the task team has made some adaptations for the particular circumstances of Punjab and has also used other sources of evaluative criteria. The report identifies these when used.
2. This review has assessed PFM in Punjab against each of the indicators for the PFM objectives, describing the processes related to the indicator, identifying issues and recommendations, and providing an assessment against a four level rating for the indicator - a, b, c, or d. These ratings and the criteria for achieving a specific rating for each indicator are set out in the Bank document footnoted and are briefly explained in each section. A rating of 'a' would be international best practice and a rating of 'b' would be a good achievement. Whatever the rating, ways to improve performance have been discussed in the report for consideration by a GoPj workshop, but of course improvement is higher priority for areas rated as 'c' or 'd'. Lastly, the report summarizes the critical recommendations in the form of an Action Matrix and these concentrate on the areas of priority.
3. This document has been prepared after distribution of a draft to members of the Steering Committee and examination of that draft during a workshop held in Lahore on 29-30 March 2005. Comments provided by the Finance Department on a draft have been used to assist the preparation of this report. It will be used as a foundation for the GoPj's commitment for programs of institutional reorganization and legal reforms and to assist the implementation of the devolution of financial functions under the local government program. As the financial management structures and systems have their basis in the law (The Constitution, laws, rules, and regulations), a legal reform strategy will be required to realign the legislative framework to support the new systems.
4. A Steering Committee was formed comprising the Secretary Finance (Chairman), Secretary, Public Accounts Committee, Accountant General, Punjab, Director General Provincial Audit, Punjab, Deputy Secretary (Budget), Chief Foreign Aid, Planning and Development Department, Punjab. The study started with an inaugural Steering Committee meeting in the Finance Department on November 26, 2004, followed by meetings of members of the task team with stakeholders'. The study has been done in close coordination with the European Commission and DFID and in consultation with the ADB so that the Government of Punjab may arrive at a unified set of reform measures in the area of public financial management duly supported by the various

donors. DFID's concurrent Fiduciary Risk Assessment mission included participation from the Bank and ADB.

5. The Bank's PFMAA task team comprised Ismaila B. Ceesay, Senior Financial Management Specialist/Task Leader, Furqan Ahmad Saleem, Consultant, Michael Jacobs, International Consultant, Hanid Mukhtar, Senior Economist and Asif Ali, Senior Procurement Specialist. The peer reviewers included Mr. Andy Wynne, Head of Public Sector Technical Issues, U.K. Association of Chartered Certified Accountants (ACCA), Ms. Mireille Perrin Decorzent (EC), Robert J. Saum, Manager, SAR Financial Management, Abid Hasan, Operations Advisor, Riyaz Bokhari, Ex Auditor General of Pakistan, Jackie Charlton (DFID) and Doug Porter and Kathleen Moktan (ADB). Ms. Safia Aftab from ADB and Ms. Mireille Perrin Decorzent from EC were sources of invaluable inputs during the field study.
6. The work has been carried out through a combination of field study in specific areas, review of existing studies and on going self-assessment reports of the government, desk research, and extensive discussion and dialogue with concerned stakeholders in the government, private sector, legislature, media, civil society and donors. The PFMAA team gratefully acknowledges the cooperation extended by government counterparts, donors, civil society representatives and the support received from other sector units within the Bank.

Chapter 2: Background Information and Government Reform Process

7. Annexes A, B and C contain descriptions of Punjab, its decentralization programs and its fiscal processes. For ease of understanding of the assessment, relevant details of the Province's institutional framework for financial management are contained in the specific chapters in this report that assess the relevant element of the budget and financial management cycle.
8. The district level political and administrative structures and their interrelationships are quite distinctive from systems in place at the provincial and federal levels. The Local Government Ordinance 2001 (LGO) sets out a structure and balance among the institutions giving way to direction, supervision and vertical monitoring by the Local Councils. The overall system can be characterized by performance and quality assurance, strategic planning coordination, responsiveness, participation, regularity, transparency, horizontal monitoring, forums for complaint and grievance redress and dispute resolution and accountability. The new and comprehensive Local Government system has been established to evolve effective governance systems proximate to the citizenry. However, the very scale and comprehensiveness of change has brought problems over powers, roles, functions and relationships, and severe capacity constraints. Annex B briefly explain the governance systems and structures under the LGO.
9. The Tehsil/Town Municipal Administrations (TMAs) have been an important exclusion from the provincial financial management system. The devolution process has transferred a significant proportion of the Provincial Government's functional and expenditure responsibility to the district and Tehsil/town governments and while internal budgetary controls and financial management system are being put in place for the district governments, TMAs are more autonomous. All of the monies they collect and expenditure they incur remains outside the provincial budgeting and accounting systems.
10. The GoPj has initiated a process to assess the financial and operational viability of selected public sector organizations and to devise strategies for their future direction, which may include privatization, liquidation, corporate restructuring or institutional development. Punjab Seed Corporation, Punjab Provincial Cooperatives Bank Limited, Punjab Small Industries Corporation, Punjab Tourism Development Corporation and Government Printing Press are the major provincial entities under review.
11. In its 2004 Punjab Economic Report the Government of the Punjab has indicated the main elements of its economic strategy. This strategy rests on five pillars: (i) improving governance; (ii) strengthening fiscal and financial structures; (iii) creating a more supportive environment for private sector-led growth; (iv) reforming the delivery of public services; and (v) addressing the provincial economy's vulnerability to shocks. Taken together, these elements add up to a strategy that is occupied not only with increases in output, but also encompasses items such as education, health, improved governance, and protection of the environment. The overriding concern is to provide a better life for the province's citizens.

12. The following reform programs demonstrate the steps being taken to improve PFM in Punjab:
- Punjab Resource Management Program (PRMP) and the use of a Medium Term Budget Framework
 - Punjab Provincial Poverty Reduction Paper as a policy document to guide the annual budget process
 - abolition of redundant posts
 - debt restructuring
 - a pilot budgetary initiative by publishing for 2000-01 a performance-based budget (PBB) for seven departments
 - reduction of number of taxes from 36 separate and individual taxes to 9
 - harmonization of rates with other provinces
 - introduction of income-based agriculture income tax
 - expansion of the base of urban immovable property tax
 - commitment to decentralization through the Decentralization Support Program (DSP) helping to devolve functions to local government level and improve the governance at all levels
 - the Government's plans to hire and train 250 professionals in the areas of accounting and internal audit
 - Project to Improve Financial Reporting and Audit (PIFRA) in which a computer-based Financial Accounting and Budgeting System based on a new chart of accounts and a modified cash accounting model (called the New Accounting Model) is being implemented at the provincial and district government level.

Chapter 3: Assessment of Public Financial Management Out-turns

Aggregate fiscal deficit compared to the original approved budget

– rating ‘a’

13. This measure provides an assurance whether the PFM system is delivering effective fiscal discipline and responsive to changes in macro-economic situations in accordance with budget intentions. The following are figures relating to budgeted and actual fiscal deficits/surpluses in the last three years. To rate very well according to the PFM Framework, in no more than one out of the last three years should the actual deficit have exceeded the budgeted deficit by an amount equivalent to more than 2% of total budgeted expenditure, and in that one year the excess should have been less than 5% of total budgeted expenditure. The figures indicate that in each year the actual deficit did not exceed the planned budget deficit so the Government of Punjab (GoPj) met this expectation:

Rs. In Millions

	2001/02		2002/03		2003/04	
Primary Fiscal Deficit	Amount	% of Budgeted Expenditures	Amount	% of Budgeted Expenditures	Amount	% of Budgeted Expenditures
Budgeted	(2,764)	-2.17%	(4,571)	-3.32%	(1,959)	-1.23%
Actual	(172)	-0.13%	6,524	4.73%	5,679	1.10%
Difference	2,592	2.04% less	11,095	8.05% less	3,720	2.33% less

14. The regulatory and institutional arrangements encourage the effective financial management and accountability and almost all components of good governance can be identified. The Country Financial Accountability Assessment 2003 (CFAA) highlights significant initiatives on all fronts to improve public financial management and accountability including Medium Term Budgetary Framework (MTBF), improved debt management, poverty reduction expenditures tracking, revenue reforms, and the Project for Improvement in Financial Reporting and Auditing (PIFRA). The CFAA includes recommendations relating to the adoption of International Public Sector Accounting Standards (IPSAS), improved internal controls, the establishment of functional internal audit units and capacity development through training line management staff in budget execution.
15. The budget shows continuing budgeted deficits. This report takes into account the reforms initiated by the Punjab Government. The Finance Department advised that in any case the provincial government cannot take on huge budget deficits, as the provincial government does not have tools of monetary policy. The GoPj has adopted a strategy to expand fiscal resources for meeting its growing development and service needs through increasing provincial revenues, reducing debt and debt servicing expenditure, reallocation of provincial expenditures, disinvesting from non-essential activities, improving the budgetary, financial management and procurement procedures and strengthening audit arrangements within a medium term budgetary framework. Important reforms include reduction of number of taxes from 36 separate and individual taxes to only 9, harmonization of rates with other provinces, introduction of income-based agriculture income tax, expansion of the base of urban immovable property tax, commitment to decentralization, performance-based budgeting in pilot departments and

districts, improved internal accountability, rightsizing and institutional reforms of public enterprises, abolition of redundant posts, and debt restructuring. These reforms are being undertaken in accordance with the Government's own efforts and with support also from the ADB funded Punjab Resource Management Program (PRMP) and Decentralization Support Program (DSP). The government plans to hire 250 professionals in the areas of accounting and internal audit to strengthen the implementation of the PFM reforms. Donor-supported Federal Government initiatives, Bank-funded PIFRA, and DFID's support to CGA, strengthen the provincial interventions.

16. GoPj looks at this PFMAA study as an opportunity to develop a stakeholders' consensus on carefully articulated reform measures in the areas of financial management. The government has a clear vision of service delivery with the highest standards of transparency and accountability. Therefore, a holistic approach to PFM reforms intends to cover policy management, resource mobilization, expenditure management and oversight mechanisms. The need is to build capacities to support effective reform measures, whereas PFMAA will provide baseline measures against specific benchmarks and will help prioritize the actions.

Composition of budget expenditure out-turn compared to the original approved budget

– rating 'b'

17. Budget realism is a measure to assess the estimation process and the effectiveness of budgetary controls during execution. To meet the PFM Framework's highest criterion, the composition of expenditures needs to be close to budget – an average of no more than 10 percent variance at administrative or functional level in at least two of the three years (excluding interest on debt), and no more than 10 percent variance on an economic basis in at least two of the last three years.
18. The percentage variances from budget as shown below indicate that budget realism did improve markedly for 2002/2003 and 2003/04 but performance over the three years did not quite meet the PFM Framework criterion for an 'a' rating. Performance did however meet the second level rating – 'b' of the framework – as the variance exceeded 15% in only one of the three years.
19. It may, however, be worth mentioning that in this particular situation where the provinces can borrow only from, or with the consent of, the federal government, shortfalls in expenditures from their budget targets, at least at the aggregate level, may not necessarily imply poor financial management on the part of provincial government. The Finance Department advised that the Punjab had developed its debt profile indicating clearly the space available for acquiring future debt. More appropriate from the provincial perspective perhaps is the sectoral composition of this expenditure shortfall. The following is a comparison of expenditures compared to the original approved budget by functions/sectors. The burden of expenditure adjustment (necessitated mainly by revenue shortfall) is relatively widespread but had fallen more heavily on development expenditure and on social and economic services, whereas general administration and law and order functions of the government has not witnessed any major adjustment.

Rs. In Millions

	2001/02	2001/02	2002/03	2002/03	2003/04	2003/04
	Budget	Actual	Budget	Actual	Budget	Actual
Total Expenditure	127,270	107,899	137,850	125,875	159,695	141,243
Current Expenditure	108,140	96,290	117,101	108,913	129,195	119,935
General Administration	13,559	14,043	16,120	15,789	15,321	13,970
Law & Order	9,906	10,347	12,188	12,919	15,777	13,965
Community Services	3,705	3,730	5,528	5,040	1,950	1,670
Social Services	39,652	34,857	41,644	40,867	10,889	8,763
Economic Services	11,196	9,446	13,545	10,556	10,613	8,899
Subsidies	5,000	2,505	3,000	3,000	1,920	2,000
Debt Servicing	16,058	15,605	16,131	15,317	14,782	12,970
Grants	9,065	5,759	8,960	5,426	57,943	57,698
Development Expenditure	19,130	11,609	20,750	16,962	30,500	21,308

	2001/02	2002/03	2003/04	3 Years
	Variance	Variance	Variance	Average
Total Expenditure	-15.22%	-8.69%	-11.55%	
Current Expenditure	-10.96%	-6.99%	-7.17%	
General Administration	3.57%	-2.05%	-8.82%	-2.43%
Law & Order	4.45%	6.00%	-11.49%	-0.35%
Community Services	0.67%	-8.83%	-14.36%	-7.51%
Social Services	-12.09%	-1.87%	-19.52%	-11.16%
Economic Services	-15.63%	-22.07%	-16.15%	-17.95%
Subsidies	-49.90%	0.00%	4.17%	-15.24%
Debt Servicing	-2.82%	-5.05%	-12.26%	-6.71%
Grants	-36.47%	-39.44%	-0.42%	-25.44%
Development Expenditure	-39.32%	-18.26%	-30.14%	-29.24%
Average Variance (exc. debt servicing)	20%	12%	13%	

20. The Punjab Provincial Poverty Reduction Strategy Paper (P-PRSP) earmarks allocations to priority sectors including housing, rural development, education, health, population welfare and water and sanitation. Outcomes in these areas are monitored through the indicators specified for measuring development in each. P-PRSP feed into the MTBF and therefore guides the annual budget process of GoPj. The Annual Development Program (ADP) has expanded over the period shown in the table at a faster rate than the expenditures on General Administration and Law and Order.
21. The tables show there has been substantial under-spending compared with planned budgets in important service delivery functions. The variance in the development expenditure is decreasing. The variance in General Administration and Law and Order has been less as salaries take up a larger proportion of expenditure under this head than in other heads and salaries are budgeted more realistically. The Auditor Generals most recent audit reports for the districts found major underutilization of CCB and

development funds and recommended that District Governments should accelerate their efforts for the full utilization of the development funds so that socio-economic infrastructure may be developed.

22. Where the under-spending has been due to procedural and systemic hurdles which lead to delays and eventually under-spending on the part of the executive, improved systems are needed. The procedural problems can be resolved by increased automation, elimination of duplicate and redundant controls, improved processes of record handling, file movement and decision-making. In addition, setting, making public, and implementing service standards for financial transactions (separately for line departments, P&DD, FD and AG office) would also help in removing/reducing procedural delays.

The supplementary budget book clearly indicates that a large number of expenditures are not taken into account at the time of the normal budgeting process. The use of Supplementary Estimates /Appropriations is largely due to changes in priorities and reflect continuous policy making through the year rather than unforeseen requirements¹. More consideration needs to be given to making provisions for contingent liabilities and extra-ordinary items.

23. The institutions responsible for public financial management are often seen as having little efficacy, but as a source of holding sanctions, disbursements etc. This reflects that an expectation and knowledge gap persists between the executive and PFM institutions, which sometimes lead to non-compliance with regulations and controls on the part of the executive and overuse of authority by PFM institutions. To assist improvements in budget variances there is a continuing need for building FM and accounting capacity in the line departments and local governments in addition to streamlining the systems of public financial management, which may require re-orientation of roles and responsibilities. It is also necessary to emphasize the need for proper training of PFM staff at all levels if these gaps are to be reduced.
24. Under the two-phase PIFRA project, the Financial Accounting and Budgeting System (FABS) based on New Accounting Model (NAM) is being implemented at the provincial government level. In Punjab, the implementation will cover budgeting and accounting sites at the provincial level as well as in all 34 districts. Training is being provided to 460 staff members at DAO offices and 10,000 Drawing and Disbursing Officers (DDOs) in Punjab. The district functionality will also be implemented at the DAO sites. Punjab is fully embracing PIFRA and its positive outcomes for the accountability framework. However, with the very slow pace of the project's implementation, reliance on the existing system for financial accounting and reporting will continue to form the basis of the accountability system in Punjab in the immediate and short run.
25. To allow for the provincial government budget for FY2005/06 to be prepared on the basis of the new Chart of Accounts (COA), DDO and DAO training was provided under PIFRA. The District Government budgets are expected to be prepared on the new basis as of FY 2006/07. For 2004/05, Punjab has prepared its provincial government budget on both the Old Chart of Classification (CIC) and the COA although the budget was

¹ Genuine unforeseen and urgent requirements are generally the legitimate purpose of supplementary grants

submitted to the Provincial Assembly for approval only on the basis of the CIC, and budget execution is being rendered on that basis.

26. GoPj has clear plans, for which approval has already been secured, to recruit 250 accounting and finance staff to support the provincial accounting units as well as service the districts and support the accounting processes. There have been concerns by the AGP about how these staff relate to the Pakistan Accounts and Audit Service and any remaining doubts about provincial and federal cadres need to be resolved. The Finance Secretary, is currently evaluating bids by private accountancy firms to recruit the requisite staff for the purpose of enhancing the FM capacities at the provincial and district levels. The current standard of uneven accounting skills and capacity at the provincial and district levels will be improved upon with the recruitment, training and deployment of adequate personnel to support the Provincial and District Accounts Officers as well as the Executive District Officers (EDOs - Finance and Planning). Out of the total recruitment of 250 staff, 34 will be trained and assigned to the internal audit function to service the needs of each district. This move is in itself a fundamental good step forward to meeting the human resources requirement in the accounting, finance and internal audit areas, within the context of the devolution program.
27. Procedural delays are significant reasons for under-spending and cuts in spending occur disproportionately in the delivery of particular services that are important to poverty reduction. These delays need to be dealt with. The recruitment and allocation of the more expert staff is expected to assist through greater concern with service delivery but there is a need for more training of line staff in budget execution. The program of internal audit should include assessment of budget execution processes in the key departments. In some cases, the inclusion of un-approved schemes in ADP results in under spending of development budget.

Aggregate revenue out-turn compared to the original approved budget

– rating ‘b’

28. Accurate forecasting of domestic revenue is a critical factor in determining budget performance, since budgeted expenditure allocations are based upon it. A comparison of budgeted and actual revenue provides an overall indication of the quality of forecasting and revenue administration. To meet the PFM Framework’s criterion, the domestic revenue out-turn should have been, in no more than one out of the last three years, below 95% of total budgeted domestic revenues. The following table shows a comparison of forecasted and actual receipts under various receipt heads of GoPj. It indicates that the criterion was met in 2002-2003 but not in the two previous years so performance at the overall revenue level is rated as ‘c’ according to the PFM Framework scales because in these two years revenue was less than 92% of budget.
29. Evaluating budgetary performance on basis of aggregate revenue out-turns is important from a broader perspective of overall credibility of budgetary estimates. However, awarding a low rating solely by looking at the aggregate revenue outcomes perhaps “penalizes” the provincial government for no particular fault of its own. A closer look at revenue performance indicates that while aggregate revenue performance deserves a rating of “c”, this is only because federal transfers fell below the budget levels by significant amounts. This is more a failure of federal budgetary processes than provincial. The provincial own-revenue was in fact higher than the budget targets for each of the three years. The figures in the table show that the actual figures during

2000-01 were 8.39% higher than the budgeted provincial revenues, and those in 2002-03 were 34.6% higher. The provincial revenue performance would merit a ranking “a” if the PFM Framework’s criterion is applied solely to provincial own revenue. It may be highlighted however that such high levels of budgetary underestimation are as much indicative of poor forecasting. With the actual figures falling below 95% of budgeted revenues, a rating of ‘b’ is justified.

Rs. In Millions

	2001/02	2001/02	2002/03	2002/03	2003/04	2003/04
	Budget	Actual	Budget	Actual	Budget	Actual
Total Resources	124,506	107,727	133,279	132,399	157736	143004
Total Revenues	120,313	103,981	130,726	124,139	149347	132554
Total Revenue as a % of budget	86%		95%		89%	
Tax and Non-Tax Transfers	99,978	83,354	109,752	95,904	120688	107345
Provincial Revenues	20,336	20,627	20,974	28,235	28659	25209
Tax Revenues	11,771	10,562	12,033	13,190	14087	16090
Non-Tax Revenues	8,565	8,202	8,940	8,424	14572	9119
Provincial Revenue as a % of budget	101%		135%		88%	
Development Grants	4,193	3,746	2,553	8,260	8389	10450
From the Federal Government	4,000	3,746	2,201	8,260	8389	
From Donors	193	-	352	-		
Others		1,862		6,621		

30. GoPj has abolished the majority of low-yielding taxes and limited the number of taxes having promising revenue potential. The taxation reforms also include expansion and clearer definition of tax bases and improvements in tax administration. Similarly, in order to better regulate the demand for public services and enhance provincial non-tax revenue, user charges on provincially delivered services are being rationalized.
31. Tax revenues of the Government of Punjab principally consist of taxes collected and levied on 'assets and properties' located in the province, such as Stamp Duty, Mutation fee, Urban Immovable Property Tax and Motor Vehicle Tax. Other sources include taxes levied on 'income' generated in the province, other than those collected by the Federal Government, such as Agriculture Income Tax (AIT). Also, provinces are also allowed to levy 'Provincial Excises'. The overall resource management reforms are in the right direction. The PRMP study of revenue administration indicted that an effective tax administration necessarily requires (a) minimal discretion, (b) least interaction between taxpayers and tax collectors and (c) self-assessment with effective audit. It found that in respect of all taxes major reforms are required in improvement of 'Business Processes'.

32. There is an intention to develop a more scientific assessment of resource bases/potential². Currently, forecasting is on an incremental basis. The tax proposals need to be more methodologically based on empirical computations, keeping in view the multi-faceted impacts.
33. Performance at the Federal level has improved through major programs of reform of the CBR. The PRMP has reviewed tax and revenue administration in Punjab and reforms arising out of that process should improve performance. As referenced in the next section the systems for reporting and acting on revenue arrears and uncollected taxes are insufficient.

Stock of expenditure arrears; accumulation of new arrears over past year

– rating ‘d’

34. The existing government accounting system and basis does not differentiate between a current expenditure or payment of arrears under a particular economic head. Therefore the stock or total payment of arrears in a particular period cannot be arrived at. In the absence of such information, a number of different problems such as inadequate commitment controls, cash rationing, inadequate budgeting for contracts, under-budgeting of specific items and non-transparent financing, would persist. The PFM Framework criterion looks for very few or no expenditure arrears, but in the absence of any information the PFM Framework rating scores assign a rating of ‘d’.
35. These weaknesses could be resolved after the full implementation of the NAM that accounts for commitments of significant value and also allows for memorandum accounts of tax demands outstanding. The Finance Department noted that the proposed commitment budgeting is a part of PIFRA to which the Punjab is giving its fullest cooperation and ownership.
36. The conversion of DAOs to the computer-based SAP accounting system through the second phase of PIFRA starting during 2005 should be accelerated so that all DAOs are completed at the earliest possible stage. Systems should be developed for monitoring revenue arrears and uncollected taxes by the agencies responsible for them.

² PRMP's planned activities include the conduct of revenue potential survey for the provincial government. Revenue potential of local governments is being commissioned through DSP.

Chapter 4: Assessment of Comprehensiveness and Transparency

Comprehensiveness of aggregate fiscal risk oversight

– rating ‘c’

37. The provincial government should monitor and manage fiscal risks arising from its own activities, and fiscal risks that arise from activities of state-owned enterprises (SOEs). The Government of Punjab owns many public enterprises. Various departments of GoPj have been assigned the responsibility of monitoring the operations of commercial and financial activity by the public enterprises, but no single overview is maintained. Generally, the governing bodies/boards of such enterprises are given significant autonomy, yet there are requirements of pre-approvals and NoCs by the responsible government departments in addition to annual review of financial statements and annual audit requirements that apply to public enterprises. In fact, due to granting of financial and administrative autonomy to teaching hospitals and some educational institutions, the number and the volume of financial transactions of provincial autonomous bodies have, in fact, increased. While some of these are financed solely from the budget, some are totally or partly self-financing. Although small in relative magnitude, the financial transactions of these latter types of public autonomous entities adversely affect the comprehensiveness of provincial budget. The PFM Framework criterion looks for well-established procedures for monitoring SOEs on a quarterly basis, and the annual reports on the full aggregate fiscal position. Where Procedures are in place for monitoring SOEs on an annual basis and these are largely complied with, the PFM Framework scoring assigns a rating of ‘c’, and this would probably apply for Punjab.
38. The record of contingent liabilities and guarantees given in respect of provincial public enterprises cannot be found at one place³. Borrowing for investment purposes by major public enterprises is included in the Annual Development Program (ADP). This presentation does not include borrowing plans of major public sector corporations.
39. Moreover, by seeking (and getting) provincial government’s guarantees for their borrowings, some of these enterprises are responsible for the bulk of the provincial government’s contingent liabilities.
40. Section 120 of the Punjab Local Government Ordinance, 2001 prohibits the local governments from borrowing. However, in the absence of good fiscal discipline at that level there is a tendency to over commit future resources of the local governments beyond the reasonable fiscal space. The Local Government Commission has been entrusted with the responsibility of monitoring the affairs of local governments and for conducting annual and special inspections, and reporting to the Chief Executive of the Province.
41. A long known and persistent issue relates to the duality of control on DAO’s staff and related provincialisation of accounts. The Controller General of Accounts and the Provincial Government both have counter claims. The issue also impacts on the smooth

³ Punjab Vision 2020 identifies Pensions and GP Funds as major contingent liabilities and outlines a phase-out strategy.

implementation of PIFRA and should be resolved either way. The Auditor General's most recently reported reviews of district accounts found that this duality of control was impacting on the preparation of proper accounts and recommended that all the DAOs should be under the administrative control of Accountant General, so that effective accountability and control be ensured under the overall control of the Controller General of Accounts.

42. There is a shortage of technical staff in finance and planning disciplines, particularly in local government finance and planning offices. There are a large number of vacant positions in various offices. Persons with appropriate skills are short in numbers. GoPj is responding to the situation by providing suitable demand driven training and retraining programs and hiring and training of 250 personnel in financial management.
43. More comprehensive and frequent information on SOE fiscal risks is needed. Progress in forming the Local Government Commission and the risks of local governments developing over-commitments need to be monitored..

Extent to which budget reports include all significant expenditures on provincial government activities, including those funded by donors

– rating 'b'

44. As extra-budgetary funds weaken the provincial budget as a resource allocation tool and as a tool of fiscal management, effective budgeting requires that the budget process does in fact control all revenues, expenditures and financing of the provincial government. The PFM Framework considers that budget reports (annual budget documentation, year end financial statements and other fiscal reports for the public) should cover all budgetary and extra-budgetary activities. While, the provincial budget laws, rules and procedures are designed to ensure this comprehensiveness of the budget, the system still leaves open the possibility of a significant amount of government expenditures to be incurred outside the budget and accounting systems. Major improvements have been made in the budget and accounting process in recent years, and efforts are underway for further improvements. Yet, certain monies, funds and operations of the government have remained outside these systems, and in certain areas have accentuated, due to the large demand put on the system by the devolution process and due to the government policy of giving increased administrative and financial autonomy to certain education and health institutions. The PFM Framework looks for fiscal reports to include complete information on all expenditures on government activities and for all major donor-funded expenditures on government activities to be captured in annual budget documents. Because there is not complete information, this element of PFM is rated 'b'.
45. Despite some improvements, accounting and reporting of foreign aid presents a number of problems, mostly from the fact that a variety of systems are operating for disbursement of foreign project assistance. Some of these systems allow disbursements to be made, utilized and accounted outside the provincial budgeting and accounting systems. Significant disbursements/reimbursements, albeit much less than before, continue to be made by donors directly into assignment accounts established for the implementation of foreign-assisted projects. Expenditures financed from assignment accounts are therefore recorded by the public accounting system if, and when, the project entities inform the Accountant General of these expenditures. The Circular on the procedures for operation and maintenance of revolving fund accounts issued by the MoF (25 November 2002) and adopted by the FD would, when complied with, ensure

that foreign aid resources will be captured in the budgets, and expenditures accounted for and reported as part of the GoPunjab's overall expenditures. In order to establish the consistent accounting and reporting procedures for foreign aid the Finance Department mentioned a wish to switch to budgetary support. Programme loans, it seems, are the most suited in the areas where the aim is to impact a social sector devolved to the local governments. The Punjab Education Sector Reform Program is a recent example.

46. Although not strictly an infringement from the comprehensiveness aspect of the budget, non-clearance of suspense balances and the personal ledger accounts are a main source of discrepancies that arise in budgetary expenditure and its financing, thus adversely affecting the government's accounting and budgetary systems and compromising transparency of the provincial budget.
47. The Constitution of Pakistan, 1973 prescribes fund management through separate accounting of the Consolidated Fund and the Public Accounts. The former includes all the revenue and expenditure as well as flows of loans and repayments and other sources of budget financing. The latter registers stocks of assets and mainly liabilities of the provincial government and is sub-divided into a large number of funds and deposits. While most of these funds are small, the General Provident Fund (GP Fund) is large, but has been financing budgetary expenditure for a long time, leading to an uncertain degree of unfunded liabilities to be met from future budgets. The Government is intending to eliminate use of the GP Fund, in 2004-2005, for deficit financing and development expenditure. This not only circumvents the hard budget constraint; it clouds the transparency of the budget and builds up a large stock of deferred liabilities for future governments.
48. The government is taking steps to capitalize the General Provident Fund and is considering to make it a separate account and have it professionally managed. The overall adequacy, through actuarial valuations, of the present balance of the GP Fund should be considered and plans should be developed to set down for targets for increased funding of the existing and future liabilities.

Chapter 5: Assessment of Budget Presentation

Adequacy of information on fiscal projections, budget and out-turn provided in budget documentation

– rating ‘b’

49. The PFM Framework looks for annual budget documentation to include complete information on debt and financial assets, some information on contingent liabilities, and comparable information on prior year out-turns and future year projections. In 2000-01, the Government of Punjab embarked on a new budgetary initiative by publishing a performance-based budget (PBB) for seven departments. This provided very valuable information regarding the performance targets set for different services and, if continued thereafter, could become a reasonable tool for monitoring performance against set budgets. Another intervention for PBB was started in Faisalabad and Multan Districts with a focus on pilot sectors. The budget documentation includes the policy papers⁴, budget speech, annual budget statement and detailed statements of receipts, current expenditures and the annual development program. In addition, a “White Paper”, presenting explanation of budgetary allocations and budgetary trends also forms a part of budget documents. These documents provide information relating to receipts and expenditures from both consolidated fund and public account managed through government account # 1. Information is also provided in respect of operation of government account # 2 relating to trading. Revised estimates of the preceding year are provided for comparison with the estimates for the current year’s budget. Three years’ forecasts for receipts and expenditures after the budget year are shown as part of the MTBF. A statement of public debt is included as part of the White Paper, which also gives a brief account of interest payment made to date on these loans. However, no information is provided on the amount of mark-up payable on these debts in future and any maturity groupings. As no information is provided on contingent liabilities, a rating of ‘b’ is applicable on the PFM Framework scoring scale. More information on contingent liabilities, financial assets, tax expenditures, or quasi-fiscal activities should desirably be provided in the budget documents.
50. The devolution process has added another degree of complication to the budgetary process. To further fiscal devolution, the Government of Punjab announced an Interim PFC Award in June 2002, which specified that the Provincial Allocable or local government share of the PCF was 38.72 percent. This was revised in mid-October to 39.80 percent. The provincial government budget does reflect the total development and current budgetary transfers to be made to the local government. Beyond this it is not possible to give the detailed appropriation of these monies as these are made by the local councils. However, the Finance Department will collate both provincial and local data, with effect from FY 2005-06.
51. Nazim has been mandated to present the annual budget to the local council for approval under the Local Government Ordinance, 2001. Zila Nazim is assisted by EDO(F&P) [or TO(Finance) in case of TMA] for preparation of the budget. After approval from the council, the Nazim authenticates the budget and allocates expenditure budget to each

⁴ Punjab’s Vision 2020 and Punjab Provincial Poverty Reduction Paper are the policy documents providing guidance to the annual budget process.

office. As yet the financial management capacity of the local governments is uneven and any success stories for medium-term budgeting are yet to be noted. There are certain initiatives to support the capacity development of local governments⁵..

52. The government has recently moved towards MTBF (see below), which will later be developed to cover performance.

Administrative, economic, functional and programmatic classification of the budget – rating ‘b’

53. The PFM Framework looks for the classification system to allow the tracking of spending on the following dimensions: administrative unit, economic, functional and program, using standard international classification practices where available. The existing "Chart of Classification" of Provincial Government Receipts and Disbursements constitute Appendix 2 of the Account Code, Vol. I, and has been issued by the Auditor-General of Pakistan, with the approval of the President, under Article 170 of the Constitution of Islamic Republic of Pakistan, 1973, forming part of the Provisional Constitution Order, 1981. There is function-cum-object classification for recording expenditures whereas separate heads are given for the receipts and public account transactions. Budget documents also use the same Chart of Classification with an addition of grant number and scheme number in case of ADP. The present accounting regime provides a basis for classifying information by administrative units, economic/object heads, functions and programs⁶ and based on the PFM Framework's scoring system, the rating is ‘b’. Inherent limitations of the Chart of Classification will hopefully be addressed with the complete implementation of NAM Chart of Accounts (COA) at the provincial government level as of budget year 2005/06. It is anticipated that implementation of NAM COA will be rolled-out to all 34 districts of the province as of budget year 2006/07 to complete the classification requirements for the entire province. The new NAM COA is more compliant with the UN-supported Classification of Functions of Government (COFOG) and IMF's GFS.

Identification of poverty related expenditure in the budget – rating ‘b’

54. The PFM Framework looks for the systematic identification and tracking of poverty-reducing spending through appropriate budget codes. To identify and track these pro-poor expenditures, GoPj is following the same format and coding scheme as adopted by the federal government. This helps the provincial authorities to provide timely and verifiable information to the federal PRSP secretariat to compile and report this information on quarterly basis. Moreover, the provincial government is pursuing a policy to rationalize and improve public accountability of spending for pro-poor public service delivery and high priority areas. P&D and FD are rationalizing portfolio of ongoing development projects, including abandoning low priority projects and allocating sufficient funding to accelerate completion of viable on-going schemes. Government has also enhanced and protected provisions for high priority social

⁵ Faisalabad District is getting support from DFID for management development, DSP is conducting trainings in Planning and Budgeting at DG and TMA level, ADB Southern Urban Punjab Development Project plans for the capacity building of TMAs for effective resource management, DFID supported Faisalabad and Multan District Governments in performance budgeting, Orientation trainings by NRB and MPDD for local government officials, Trainings of lady councillors by W3P etc.

⁶ In case of development schemes only.

expenditures as identified in P-PRSP and maintenance of existing infrastructure in good working condition.

55. P-PRSP set the sectoral allocations of poverty related expenditures, which are taken in the annual budget process through MTBF. The white paper itself also briefs about how the government has taken up the issue of poverty and which are the areas where specific measures for poverty reduction have been taken. The classification of expenditures in social services, community services, economic services and subsidies indicates the total volume of expenditures directly or indirectly related to poverty reduction. As there is prior identification of poverty reducing expenditure items in the budget, even if at a general level, and there is reporting on those items but without the addition of a special code to the classification of expenditures, the rating on the PFM Framework scale of scores is 'b'.

Publication and public accessibility of key fiscal information, procurement information and audit reports

– rating 'b'

56. The PFM Framework looks for comprehensive, timely publication of key fiscal information and external audit reports, that are readily accessible to the general public, and are provided in a clear, readable format. No specific targets are given by the PFM Framework for timeliness. Provisional information on budget execution is available through monthly Civil Accounts of the province – an Accountant General's publication which gives complete account of provincial revenue, expenditure and financing as well as the stock position of provincial cash balances on monthly and progressive⁷ basis. As per set standards, the Civil Accounts are available after the second week of succeeding month. The "provisional actual" budgetary outcomes are available after three months of the close of every fiscal year⁸. The actual out-turn data, however, are provided but with a long time lag. A brief overview of the provincial budget in the preceding three years is provided in the Economic Survey and SBP Annual Report (presented at end-December). Only the annual accounts compiled by the Accountant General are made public, and only after having been audited by the Auditor General of Pakistan and laid before the Provincial Assembly through the Governor. The Constitution or any other law does not provide any time limit for rendering accounts before the legislature/public. Only provisional figures are available as part of the budget documents or published on the MoF website.
57. Similarly, Audit reports are made available with a significant time lag. There are no within year budget execution reports accessible to public⁹. Finally the understandability and appropriateness of layout of detailed budget documents and finance accounts require considerable improvements.

⁷ That is, accumulative for the given fiscal year.

⁸ These are presented in the revised Civil Accounts for June (called the June Final Accounts), which present the reconciled budgetary accounts.

⁹ The "Civil Accounts" are made available to the Finance, P&D and every line department of the provincial government. This information, though, does not flow automatically to the provincial Cabinet or the Legislature, but could be provided on demand.

On the basis of the PFM Framework's scoring, a tentative rating of 'b' is assessed because timeliness could be much improved. The ad hoc PAC (Punjab) made recommendations¹⁰ on these issues and the Finance Department needs to respond to the current PAC reporting on progress in responding to these ad hoc PAC recommendations.

58. There is little public access to procurement related information. Tender notices, other than those coming under international competitive bidding (ICB), are either not advertised in widely circulated newspapers, or the time allowed is too short to elicit a healthy response. Similarly, there is no access to information about the final award in tender exercises or the final disposal of appeals. All procurement notices, award information and complaints and appeals information should, as a matter of policy, be available to the general public on a website. The recommendation report of Consultant to the PRMP recommended the establishment of a separate procurement authority through legislation. The report is being considered in FD which is supportive to the idea.

¹⁰ Ad hoc PAC (Punjab) Digest of Reports, 1985-86 to 1997-98

Chapter 6: Assessment of Medium Term Planning and Budget Formulation

Extent of multi-year perspective in fiscal planning, expenditure policy-making and budgeting

– rating ‘b’

59. The PFM Framework looks for multi-year aggregate fiscal forecasts and forward expenditure estimates (based on economic and sectoral breakdown) to be prepared on a rolling annual basis, with costed statements of national and major sector strategies, and strong direction in the budget circular regarding the multi-year forecasts to be adhered to in budget submissions. In 2004/05, the Punjab government presented its medium-term vision. *The Punjab Vision 2020* foresees a fully literate, fully employed, highly educated, skilled, talented, tolerant, culturally sophisticated, internationally connected, and a reasonably well off healthy society. It suggests a switch of focus from a production strategy of self sufficiency in food production, to a strategy where one can fully exploit the potential of high value added agricultural products and livestock development while maintaining strategic reserves of essential food grains. In the medium term the government has decided to focus on poverty reduction as a prime goal. The overarching objective is to improve the lives of people by improving their incomes and improving the delivery of public services. The provincial Medium-Term Budget Framework (MTBF) attempts to put the *Punjab Vision* in budgetary framework by costing out the government’s initiatives and focusing on three-year slices in a rolling format. As the MTBF is still being developed¹¹, and the costings are not yet complete, a rating of ‘b’ is assessed.
60. P-PRSP provides for the policy priorities for which costing could not be done due to resource limitations¹². These policy priorities are set out in a rolling medium term budgetary framework. The budget circular now has MTBF orientation that makes a link between the provincial strategy, multi-year forecasts and annual budget. P&DD and FD are responsible for the multi-year perspective in fiscal planning, expenditure policy-making and budgeting whereas it may be desirable to submit these proposals to Cabinet for their endorsement.
61. The budget preparation process clearly distinguishes between the permanent expenditures and new items. New items of recurrent expenditures become permanent after five years of their currency. This typically supports the incremental budgeting where permanent expenditures are subject to a lower degree of review and scrutiny.
62. The Interim Award of PFC Punjab indicates 39.8 percent as the local governments’ share in the provincial consolidated fund minus the obligatory expenditures¹³. This allocable amount funded non-salary recurrent and development expenditures. Salaries are reimbursed outside of the allocable, which are calculated as incremental increases on

¹¹ This is being undertaken under the Punjab Resource Management Program supported by the Asian Development Bank.

¹² The federal government has already commissioned research studies to obtain not only the anticipated costs but also the requisite tools and techniques to continue costing of estimates in future as well. These studies will serve the purpose of costing the social sector strategies for both the federal government as well as provincial governments.

¹³ It includes debt servicing, pension, subsidies, and charged expenditure.

the 2001 baseline. Population and backwardness are the only two variables used for distribution of development funds among districts with respective weights of 67 and 33 percents.

63. These funds are further distributed in the ratio of 75 and 25 percents in the district government and TMAs in each district. A three-year award in complete accordance with the LGO 2001 is yet to be announced. The interim awards made are not in themselves LGO compliant due to lack of data in respect of fiscal capacity, fiscal effort and performance of local governments as well as insufficient capacity in the PFC.

Orderliness and participation in the budget formulation process

– rating ‘a’

64. The PFM Framework looks for a system whereby spending ministries are given clear guidance for the preparation of budget submissions, including indicative ceilings that are informed by specific agreement at the political level on the relative spending priorities across sectors. Provincial departments should adhere to the budget calendar and be generally able to fulfill the requirements of the budget calendar, including ceilings and data submissions. Negotiations with departments of finance should be open and transparent and line departments should know their final allocation at the conclusion of such negotiations. The Constitution itself sets the basis of budget formulation by defining the provincial consolidated fund, public account, charged expenditures and other provisions relating to financial management. The Punjab Budget Manual describes the detailed process of budget formulation by the provincial government whereas the Budget Rules, 2003 have been issued for local governments.
65. The Punjab Development Forum which settles development priorities of the government before a budget, is now a regular feature. Similarly the Resource Mobilisation Committee finalises tax and revenue proposals for a budget. This ministerial committee has now been replaced by a Permanent Committee on Resource Management (again a Ministerial Committee where related departments are represented). The practice followed by the provincial government involves formulation of development and recurrent budgets by the line departments. These are then negotiated between the finance, P&D and line departments on the basis of available resource envelope and competing demand on the financial resources. The process, which continues for at least a couple months and involves several iterations, gives the heads (secretaries) of line departments to argue and defend adequate provision of financial resources to their respective departments. The draft budget formulated through this process is then presented to the provincial cabinet for final and higher level negotiations. The Cabinet finalizes the budget to be put before the Provincial Assembly for approval. Based on this system the PFM Framework rating is assessed as ‘a’.
66. Ideally the budgetary process should be integrated top-down through formulation of policy priorities and communication of these through line agencies to spending units and then a bottom-up process of demands for grants. The formulation of policy priorities needs greater consultations at the cabinet level resulting into broad expenditure, revenue

and financing targets consistent with sustainable fiscal policy. These need to be clearly indicated in the budget circular with parameters to be used for performance costing and monitoring the budget. Similarly, the bottom-up proposals should be more innovative and meaningful.

67. It appears that the budget negotiations at the time of compilation of budget are held at the FD and each line department separately. The recurrent budget is adjusted based on these consultations, whereas approved schemes are taken or dropped based on the resources available for the year. The budget negotiations on allocations need to be made more transparent and systematic within the overall policy priorities of the government.
68. The adjusted budget, after the negotiation, is not disaggregated by DDOs. The line departments are given the authority to do the adjustments in their budget proposals within the agreed ceilings. These adjusted figures are not finalized and conveyed to DDOs¹⁴ before the fiscal year begins. This hampers their ability to plan and spend as financial managers, taking whole year as the planning cycle.

Coordination of the budgeting of recurrent and investment expenditures

– rating ‘b’

69. The PFM Framework looks for a single budget process, based on a single calendar and circular, that fully coordinates the budgeting for investment and recurrent expenditures at the central, department/agency and sub functional/program levels, and for the recurrent implications of investment decisions to be budgeted. The proposals of development projects are evaluated at the competent forum through P&DD and approval is conveyed to the line agency and Finance Department. The 2005-06 Budget Call Circular calls for DDOs to use the MTBF both for current and development budget estimates. Based on the PFM Framework, a rating of ‘a’ is assessed. However co-ordination needs to be supported by adequate budget flexibility to plan realistically to meet program priorities, and the lack of fiscal space caused by committed expenditures has limited this flexibility.
70. Although, the PC forms¹⁵ do get the information on how the project will be operated and maintained in the long-run including the expected cost recoveries and the dependence on annual recurrent budget, yet these figures are not directly taken into the medium term budgeting. So the total call on the future budgets due to already approved and in-progress development projects is not always known. The annual recurrent budget proposals only take account of statement of new expenditures (SNEs) for near to completion or completed projects. Because of these limitations, an assessment of ‘b’ is given.
71. This separation and lack of control between budgeting of expenditures that are of recurring nature and budgeting for multi-year investment projects on the macro frame put extra constraints on the annual budgeting process. There is lack of flexibility in budgeting, which already is constrained by a considerably high proportion of fixed expenditures on salaries. In summary, there is a limited scope for the executives to plan for the desired service delivery outcomes.

¹⁴ DDOs are the implementation managers vested with the PFM responsibility at various levels.

¹⁵ This refers to a series of forms (PC-I to PC-VI) designed by the federal Planning Commission for programming, budgeting, approval, monitoring and evaluation of development projects.

72. GoPj is following a strategy to focus on the social sectors and operation and maintenance of completed schemes rather than developing new infrastructure as a priority. The recent policy announced at the federal level is to fill all vacant posts on a priority basis. It is likely that the provincial governments will adopt the same.

Legislative scrutiny of the annual budget law

–rating ‘b’

73. The PFM Framework looks for legislative scrutiny to be comprehensive, well-informed by summary and detailed information, and involved in-depth review by specialized committee; and for the budget to be passed before the financial year commences. Before the Punjab budget is presented in the assembly, it is laid before the cabinet where it is discussed and finalized. The Minister of Finance presents the budget documents along with a speech in the assembly. After the budget speech, a rest day is given after which discussion starts for about five days. This legislative scrutiny and debate involves review of the fiscal policies and medium term fiscal framework and also the review of details of expenditure and revenue. A rating of ‘b’ is assessed in the absence of scrutiny by a specialist committee in the legislature.
74. The charged expenditures under the Constitution are only subject to discussion in the house and all other estimates of expenditures and revenues are voted in the provincial assembly. Each demand for grant is then discussed and passed by the assembly during the session lasting for many days. Since the ruling party is represented both in the cabinet as well as in majority in the assembly, the budget presented in the assembly is passed as it is or with some minor changes, as is often the case in other countries. The budget is passed before the beginning of the financial year.

Chapter 7: Assessment of Budget Execution and Procurement

Effectiveness of cash flow and procurement planning, management and monitoring

– rating ‘b’

75. The PFM Framework looks for daily calculation and consolidation of all the government’s cash balances; forecasts of all cash inflows and outflows to be prepared for the fiscal year and updated monthly, based on revenue forecasts, budget implementation and procurement plans; and borrowing plans on the basis of cash flow forecasts. Cash balances of the provincial and district governments are generally consolidated into a daily report but some special accounts, public enterprises accounts, some commercial accounts and Zakat accounts are not included.
76. FD receives the daily cash balance report from the SBP in respect of both Account # 1 for the provincial government and Account # 4 for district governments. Account # 1 holds the receipts and payments in respect to both provincial consolidated fund and public accounts. The cash balance in the government assignment accounts, donor’s special accounts and personal ledger accounts etc. are not consolidated for the calculation of an overall cash balance since these funds are reserved for specific purposes. There are reconciliation delays for the provincial revenues collected in the districts but these amount to a relatively small portion of the overall revenues; mostly coming from the federal transfers. At the date examined by the review the relevant cash balance reconciliations of the district collections portion with the SBP were 60%. More than 75% of the total provincial resource comes from the federal government; the transfers are regularly reconciled with the federal government as well as in the State Bank.
77. The Resource Wing of the Finance Department is responsible for the preparation of a statement of the resource position of Provincial Government’s Running Accounts with SBP - Head Office on a daily basis. The Resource Wing prepares a daily comparison of balances and identifies any large and unusual items. Copies of daily reconciliation are sent to concerned higher officials for cash management and decision making purposes. The business process flow has been attached at the end of this section. The review carried as part of the PRMP for Finance Department strengthening found that in theory, the Resources Wing is responsible for resource planning but in practice, its role is restricted to preparing the resource position and comparing it to the bank balances, and the Wing is presently not equipped with the processes, tools and expertise to forecast revenue projections. The Resource Wing carries out relatively informal assessments of likely future revenues through the year.
78. There is no evidence of an overall procurement strategy and formal procurement planning by the major departments. There is a need to enact a procurement law supported by rules, which will carry legislative strength. Current proposals for the Procurement Authority are in preparation and are supported by the Department of Finance.
79. Account # 2 represents the receipts and payments in respect of trading activities of the provincial government in respect of food grains, sugar, medical stores¹⁶ and coal.

¹⁶ The trading of medical stores has now been discontinued.

Receipts and payments in respect of loans from the commercial banks are also accounted for in the same account. Subsidy from the government, if any, is also taken in Account # 2. This account is closed to balance each year. Proper profit and loss statements and running accounts statement to indicate the net annual activity are not being prepared. There is a need to keep accounting/costing records of stock and incidentals separately. The net activity in this account is included in the annual budget of the provincial government and therefore provides an indirect disclosure of profit/loss of the trading activity.

80. Account # 3 is for receipts and payments of Zakat fund. These funds are received from the federal government and disbursed by responsible Zakat committees and as such not made part of the budget documents as these are outside the Provincial Consolidated Fund.
81. Account # 4 has sub accounts for each district government. These are operated by the District Accounts Offices on the authorization of district government authorities but count towards the cash balance of the provincial government for the calculation of the ways and means position against which the provincial government can overdraw from the SBP.
82. GoPj holds investments in the form of loans to the public enterprises, shares of companies and real estate including the evacuee properties held. The Punjab Privatization Board has been made more effective to look after privatization and sale of assets. The Punjab Government is estimating that it would be able to fetch Rs. 2,948.499 million from privatization proceeds in 2004-05¹⁷.
83. The Finance Department intends to improve its projections of its cash flow position and this will improve its capacity to more tightly manage its cash position. On the basis of the PFM Framework's scoring system a rating of 'b' is currently appropriate.

Procedures for managing and recording debt and guarantees

– rating 'b'

84. The PFM Framework looks for a system whereby domestic and foreign debt records are maintained on a single computerized debt management system to produce comprehensive reports for government routinely, and whereby debt sustainability analysis is undertaken regularly. It looks for the issue of government guarantees to be made against transparent criteria and fiscal targets, and approved by the Department of Finance. Manual recording of debts from various sources exists in Punjab and a spreadsheet is maintained listing repayments. The White Paper consists of a list of all loans. GoPj has developed a debt management strategy to repay expensive loans from federal government. Based on the PFM Framework's scorings, a rating of 'b' is assessed.
85. The Finance Department has amortization schedules of each and every debt it has incurred from the federal government or the donors; and, of all the debts it has advanced, on Microsoft Excel. Funds to manage Pension and General Provident Fund have also been notified and legislation is being drafted to govern their operation. The

¹⁷ White paper also suggests that there were serious difficulties in pursuing the privatisation targets last year.

legislation is expected to be in place by the next financial year. The amount of mark up payable on debts would also be given in the White Paper accompanying the budget for the next financial year. Debt sustainability analysis appears to be undertaken on occasion. A Debt Management Cell has been established. There appears to be a manual system of issuing and recording guarantees and no framework as such of reporting guarantees separately and consistently exists.

86. Pensions of government employees constitute a major liability of the government. GoPj has initiated a funded pension scheme where, each year, an amount is deposited and the fund would be self-sustainable in seven years.
87. GP Fund represents the deferred liability of the Provincial Government due to government employees. Every year, the contributions of the employees towards the Provident Fund increase due to increases in the number of employees and due to the increase in contributions of the existing employees. This is one of the major public account heads (trust funds) with the government, which was in the past used either to cover deficits in the current budget or to finance development expenditures at a very high rate. To avoid this kind of practice the government is taking steps to capitalize the GP Fund as a separately managed fund.

Extent to which spending departments and agencies are able to plan and commit expenditures in accordance with original/revised budgets

– rating ‘b’

88. The PFM Framework looks for spending departments and agencies to commit expenditures in an orderly manner throughout the year, broadly in accordance with cash flow forecasts agreed with finance department and with the budget. Adjustment to the allocations should take place only once during the year and be done in a predictable, transparent way. The spending departments have considerable autonomy in planning and committing expenditures in accordance with the original budget when viewed at the level of Principal Accounting Officer/Administrative Secretary. Under the New System of Financial Control and Budgeting the whole year’s budget in case of recurrent expenditures are released by the FD and similarly 40% to 50% of the annual development program (only approved schemes) is released at the start of the fiscal year. It is then at the discretion of the PAOs to release their respective budgets to their subordinate formations/spending units. A rating of ‘b’ is assessed.
89. The departments have sufficient powers of re-appropriation, thus providing management flexibility. During the year, adjustments to allocations in the light of unanticipated events affecting the revenues or expenditures are informed to the spending departments. If there is no crisis situation the expenditure may not be linked to cash flow forecasts. The departments should be free to execute the budgeted expenditure while the Finance Department would keep track of the cash flows. Timely submission of statements of Excess and Surrender is being ensured in order to improve adjustments of expenditure. At the same time the Planning and Development Department is trying to decrease the number of unapproved schemes in the ADP.

Evidence available that budgeted resources reach spending units in a timely and transparent manner

– rating ‘c’

90. The PFM Framework looks for reliable accounting and/or survey information that demonstrates that service delivery units obtain the vast majority of resources intended, in a timely manner; and that communities have routine access to information about resources received by local service units. There are significant procedural delays in the system in general that hamper the spending capacity of the executive. These include a lengthy procurement process, establishment of committees, which slow down decision-making, lack of incentive for taking timely decisions, duplicate controls through pre-audit processes. There is no information provision system to provide the community with budget information and to ensure the local community contributes to decision-making. Based on the lack of information to local communities, a rating of ‘c’ is assessed.
91. The provincial budget is approved with allocations by functions. In general, the practice is for the Administrative Secretaries or independent budget controlling officers to release 80% of their current budget to the spending units/DDOs and hold 20% as undistributed or as part of their own budget. Therefore, substantial amount of non-salary budget is held and released in parts throughout the year. This practice may prevent the line managers from planning and may mean that funds are available at the wrong time in the fiscal cycle and therefore left unspent.
92. Monthly transfers are mandated under Provincial Finance Award from Account # 1 to Account # 4. This makes up the cash balance of district funds. The Local Government Budget Rules, 2003 provide for preparation of budgets by DDOs, and every DDO has the knowledge of sanctioned limits for the whole year. Since district governments cannot incur debt in accordance with the LGO 2001, any delay in the availability of funds constrains their spending capacity because of resource availability.
93. There is a need to improve the focus of spending units on service delivery and to enhance the provision of information to local communities. The most recent Auditor Generals report on district audits found that activities of the District Governments were not focused towards achieving specific/quantifiable targets. As such, the control mechanism could not be used for effective monitoring and ensuring achievement of targets.

Chapter 8: Assessment of Internal Controls and Internal Audit

Effectiveness of internal controls

– rating ‘c’

94. The PFM Framework looks for an internal control system that is relevant, incorporates a comprehensive and generally cost effective set of controls, which are widely understood. It looks for the rate at which rules are not complied with to be very low (no more than 3% error rate in routine financial procedures, as demonstrated by audit), the controls to be only rarely bypassed, and a top management that takes clear and full responsibility for the effective operation of the system. Internal audit is treated separately in the Framework because of its importance – see next indicator.
95. The observations and recommendations of the ad hoc PAC (Punjab) in paragraphs 12 and 13 of its Digest of Reports, 1985-86 to 1997-98 are relevant to this issue, although covering a period which is now out-dated. The Committee observed that “there were many cases of breach of clear-cut provisions of the rules governing delegation of financial powers, award of and administration of contracts for works and purchases....”, “... a percentage check by external audit reveals a large number of deviations....year after year in all major departments....a much larger number of irregularities would be unearthed if the quantum of audit effort were to be raised...”. The ad hoc PAC (Punjab) further observed that “the departments’ own internal controls and procedures for supervision by senior and experienced officers are not working”. The Committee recommended in-service training and refresher courses so that the staff and their supervisors understand the essentials of financial rules and regulations. The most recent Auditor General’s reports on district audits found non-availability or non-production of records as a serious deficiency.
96. The Pakistan internal control system is rooted in a series of laws including the General Financial Rules, Fundamental Rules, Supplementary Rules, Treasury Rules, Delegation of Financial Powers, Rules of Business. Many of these legislative instruments are derived from the colonial system and need revisions to incorporate modern practices in PFM and to make these consistent with the existing organizational structure. There has been an intention under PIFRA to revise this system but not yet actioned. Based on the error rate identified in audits and the lack of modernization of the system of internal control, a rating of ‘c’ is appropriate.
97. The majority of the large number of audit observations pending resolution relate to irregularities, non-compliance with rules and regulations and non-provision of information by the executive. This clearly indicates problems in the existence, effectiveness and operation of internal controls. These internal control procedures contained in many rules and regulations are not generally understood and have multiple interpretations, which ultimately provide undue discretion to the government functionaries.
98. In order to improve public financial accountability and reduce abuse of systems, successive governments over the years had introduced several layers of checks and balances; these made the financial release procedures very time-consuming and

cumbersome¹⁸. There is need to reengineer the process to remove duplicate and redundant controls and steps.

99. The record of assets (dead stock register) is not integrated or reconciled with the accounting records and thus no asset accounting is being done. PIFRA implementation provides for asset accounting, and the challenge will be to collect and feed the data relating to the public assets in existence when the system rolls-out.
100. Different public enterprises are subject to varying levels and nature of controls internal to the organization and exercised by the government departments responsible for oversight. A major exercise is underway to assess the current status of these enterprises and to decide a direction for each of them.
101. Government functionaries need to be motivated through well-thought out, across the board, civil services reforms. Four elements are critical for any such reforms including training/retraining of staff, reasonable remuneration, necessary tools and equipment and sound risk management and accountability controls.

Effectiveness of internal audit

– rating ‘d’

102. The PFM Framework expects an effective internal audit function in operation. Regular and adequate feedback to management is required on the performance of the internal control systems, through an internal audit function that is appropriately structured, has adequate independence, breadth of the mandate, and power to report, utilizes appropriate professional standards, and reports on significant systemic issues. The internal audit function in most of the departments has become dormant over the years and overlaps with the pre-audit of DAO. Internal audit staffs that remain lack expertise necessary for performing their responsibilities. This is affecting the whole framework of internal controls and financial accountability systems¹⁹. A rating of ‘d’ is assessed in the absence of comprehensive internal audit units.
103. The internal audit is an integral component to any governance regime, the absence of which is resulting in numerous objections from the pre-auditors and in audit paragraphs from the Auditor General. The strengthening of this function will relieve the executive from the efforts needed to resolve these objections.
104. Regular and adequate feedback to management is required on the performance of the internal control systems, through an internal audit function (or other systems monitoring

¹⁸ For example, in case of development projects, after approval of PC1 by the competent authority (PDWP, CDWP or ECNEC etc.), ADP for the project for the first year will be sent to the P&D Board for review after the concurrence of Departmental Scrutiny Committee. The detailed ADP proposal based on pre-approved estimates will be submitted to the ADP Review Committee for Final Approval. After the approval of ADP, the Schedule of New Expenditure will be furnished through the Secretary Concerned to the Finance Department. The Budget Section will be recipient of SNE so submitted. This will be made part of the draft Budget documents laid before the Provincial Assembly as part of the budgetary process. The six line breakdown of SNEs in the project will be published in the Volume IV, ADP of the Punjab Budget after authorization of the Assembly. This is formal approval of the budget, which is conveyed to the Finance Department, Accounts Offices, Administrative Secretaries and all other concerned. Now, a request for the administrative sanction and release of annual amount will be made to the Expenditure Section of the Finance Department. In case of loan projects, there are additional steps to be followed. Similarly the payments will undergo a detailed checking and re-checking by the executive and accounts offices. The pre-audit has over the time become ineffective and obsolete. Lastly, the approval process at each stage may involve cumbersome sub-processes.

¹⁹ Internal audit function is found to be weak in the public sector as generally reported in many CFAA studies and there is no single set of recommendations or model that can be accepted as best practice. The recommendations in this section are based on key features of effective internal audit based on the standards issued by the Institute of Internal Auditors.

function) that is appropriately structured, has adequate independence, breadth of the mandate, and power to report, utilizes appropriate professional standards, and reports on significant systemic issues. Specific evidence of an effective internal audit function would also include assessment and monitoring of error rates in procurement and expenditure transactions, a focus on high risk areas, reporting on correction rates, use by the AGP of the internal audit reports, and action by management on internal audit findings.

105. At the provincial level the specific recommendations are to enhance the quality and number of staff by recruiting qualified staff to meet requirements, develop internal audit manuals and guidelines that will be used as a guide by the staff when carrying out internal audit tasks, develop a comprehensive training and capacity building program, establish internal audit as an independent function and to establish a provincial audit committee for all line departments that would support and monitor implementation of internal audit findings and recommendations.
106. The Local Government Ordinance, 2001 provides a sound basis for establishing an internal audit office in District Governments or TMAs. The reporting lines are clear where the overall responsibility for instituting and guiding the internal audit function is that of the Nazims, whereas the internal audit reports will also go to the Accounts Committee of the Council for discussion in the public hearings. The Internal Audit Rules have also been notified under the LGO, 2001 which is a major step towards the initiation of an internal audit function at the local level. GoPj plans to post a few of the officers being recruited among 250 for PFM and train them as internal auditors. .

Effectiveness of payroll and General Provident Fund controls

– rating ‘c’

107. The PFM Framework looks for payroll records and nominal roll that are directly linked through a computerized information system to which the department of finance has easy access, where authority to change the payroll is restricted, and changes result in a computerized audit trail being created. Changes required to the nominal roll and pay requirements should be updated in a timely way and there should be a strong system of payroll audit to identify control weaknesses and/or ghost workers. The approved establishment lists of staff in the line departments in Punjab have lost the trail and therefore inconsistencies exist between data available from different sources. This needs an immediate reconciliation for effective expenditure estimation to avoid potential delays in maintaining GP Fund accounts and authorizing payment of pensions/gratuities to retired provincial government employees. Arising from the factors as aforementioned, a rating of ‘c’ is assessed.
108. GoPj is cognizant of the shortcomings in the current arrangement and has therefore mandated S&GAD to engage technical support to determine the institutional location of a human resource database, determine how to reconcile the human resource database with the payroll database, and establish systems for updating the human resource database. The provincial government is working to develop a comprehensive MIS for human resource management which would also effectively address payroll issues and calculations/projections of G.P. Fund and Pension liability.

Transparent procurement system

– rating ‘d’

109. The preferred system is defined by a clear regulatory framework which is consistently implemented under the oversight of both internal and external control systems. Contracts are awarded on the basis of competition, in accordance with rules, or justified when other methods are employed. There is regular advertisement of opportunities and publication of data on public contracts. There are few unexplained delays in awarding contracts and in making payments. The system provides for timely feedback of cost data and execution against plans to support the PFM process. In Punjab, procurement procedures and their implementation need review in order to be made more transparent and less bureaucratic. The Auditor General’s district audits for 2001-02 (the most recently published) reported that collusive tendering was prevalent. There should be a complaint mechanism which aggrieved bidders can pursue. Work is being done on this by devising suitable legislative instruments to remove the following known weaknesses:
- (a) In-adequate bidding documents
 - (b) Inadequate response time to bidders (Gallop tenders)
 - (c) Tenders issued against earnest money
 - (d) Multiple registration (restricts competition)
 - (e) Calling tenders without technically sanctioned estimates
 - (f) Inclusion of non-scheduled items
 - (g) Use of discretion in imposing penalties and
 - (h) Lack of independent complaints handling process
 - (i) Irregularities in inspections or measurements.
110. On the basis of the above, a rating of ‘d’ is assessed.
111. There is a need for staff training. The government is considering the need for a public procurement law and the formation of an independent procurement regulatory agency. The Government has issued consultant’s Procurement Guidelines and Procurement of IT Equipment Guidelines.
112. Communication & Works Department (i) adopted market rates criteria for projects costing Rs. 50 million and above (other departments to follow), (ii) revised composite schedule of rates on quarterly basis to serve as a benchmark for market cost calculations, and (iii) committed to further align procurement procedures with international best practices.
113. The reform of procurement through the Procurement Authority is underway. There is a need to ensure that the new institutional arrangements include proper concern for segregation of functions which conflict such as allowing a separate complaint redress mechanism.

Chapter 9: Assessment of Accounting and Reporting

Timeliness and regularity of data reconciliation

– rating ‘c’

114. The PFM Framework looks for high quality bank reconciliation at aggregated and detailed levels at least monthly, with very little backlog, suspense accounts routinely reconciled and cleared quarterly, and advances accounts reconciled quarterly. Few suspense and advance accounts should have old, brought-forward balances. The accounting system in Pakistan is undergoing major reforms supported by PIFRA in the shape of implementation of NAM in an automated (SAP R/3) environment. Until these reforms have been fully rolled-out, the manual record-keeping of a multiplicity of financial transactions will make timely reconciliations most difficult to achieve. While concerted efforts are made to reconcile the Consolidated Fund financial transactions, the Public Accounts have remained largely un-reconciled. On the basis that important accounts are not fully reconciled, the rating is assessed as ‘c’.
115. Since many institutions are involved in PFM, reconciliations are required to ensure the integrity of data held by these institutions. These reconciliations include:
- (a) Reconciliation of receipts and expenditures in accounts offices with the SBP
 - (b) Reconciliation of transactions record held with the DDOs and PAO with the accounts kept by the accounts offices
 - (c) Reconciliation of inter-governmental accounts (exchange accounts)
 - (d) Reconciliation of transactions posted in suspense accounts
 - (e) Reconciliation of debt balances with the Federal Government and donors
116. In summary, at provincial and district levels, regular reconciliation processes are in place but substantial differences between compiled provincial accounts and departmental accounts are un-explained. Monthly Civil Accounts are produced by the Accountant General using reports from District Accounting Offices (DAOs) compiled from cash transactions processed through the Offices. Reconciliation of expenditures recorded at the DAOs and the bank scrolls are conducted daily and differences resolved. Reconciliation of receipts is at 96% and expenditures at 86%.
117. Accounts are separately maintained in departments by aggregating district level data. Variations between the accounts maintained by the departments and those of the Accountant General are substantial and a reconciliation process is conducted between each DAO and spending DDO on a monthly basis, and at an aggregate level between the Accountant General’s Office and the departments at the end of the year. The certified provincial and district accounts at end-of-year show substantial un-reconciled differences. For the latest audited district and provincial accounts published (year 2001-2002) the Auditor General issued a qualified audit certificate by reporting that the accounts properly present the accounting transactions in *most* material aspects (as contrasted with the requirement in the relevant international auditing standard and the Punjab Accountant General’s Certification Manual that an unqualified certificate requires compliance in *all* material respects).
118. The problems are likely to be resolved with the introduction a double-entry computerized system based on NAM, and covering all of the DAOs. Technological

interface between CBR, SBP, NBP, and PIFRA accounting sites during PIFRA II implementation will support the resolution of the existing problems in reconciliations. Meanwhile, Fiscal Monitoring Committee (FMC) is continuously working to improve the process of reconciliation on a monthly basis.

Timeliness, quality and dissemination of in-year budget execution reports

– rating ‘c’

119. The PFM Framework looks for reliable Budget reports, with classifications that allow direct comparison to the budget, and incorporate expenditure, revenue and debt information, that are disseminated within government within four weeks of month and quarter end. The Accountant General at the provincial level and DAO at the district level provide mid-year accounting reports to the Finance Department/EDO(F&P). These monthly civil accounts are difficult to compare with the budgets and there might be some concerns of accuracy due to delay in recording and reconciliation of data. Since the line departments/offices are also keeping a separate account of expenditures and revenues, these monthly civil accounts provide little value to them. A rating of ‘c’ is assessed based on the PFM Framework scales.
120. Various separate systems of accounting and financial reporting exist for the development projects, particularly those being managed in a ring-fenced arrangement²⁰. These provide an uneven quality of execution reports to the project management and the government.
121. District Accounts Officer, Faisalabad in conjunction with the District Government has devised a monthly Project Expenditure Tracking System for monitoring progress against the Annual Development Program. The FD desires to replicate the same good-practice system to all districts of Punjab.
122. Annual Appropriation Accounts are prepared where the budget outturn is compared to the original Estimates/Appropriation and, reasons for the differences identified.
123. There is no requirement for mid-year budget execution reports to be submitted to legislature and released to the public. A one-page abstract of the ‘budget execution report’ is however published on the web site of the Department of Finance, GoP. The Finance Department is trying to publish the monthly civil accounts on the web. There are no requirements for periodic financial reporting to the Cabinet. The Planning and Development Department holds the ADP quarterly review meetings for tracking the execution of ADP. Monthly ADP utilization reports are also sent by the administrative departments to the Planning and Development Department.

Timeliness and quality of the audited financial statements submitted to the legislature

– rating ‘d’

124. The PFM Framework looks for financial statements, certified by the external auditor, to be presented to the legislature within 12 months of the year end, in accordance with IPSAS, GFS or an acceptable national standard. The legislation does not set times for the preparation and audit of government financial statements. Because of this anomaly,

²⁰ An ADB technical assistance is in progress that aims at development of a standard accounting manual for funded projects that would provide financial reports compatible to NAM.

not all of the provincial and district accounts of even 2000-01 have been laid before their respective legislative organs. Until these financial statements are laid before the legislature, they do not become public and the required authenticity cannot be derived. As a result of the delays, a rating of 'd' is assessed under the PFM Framework rating system.

125. The national standards for preparation of government financial statements are contained in the Constitution, the Accounts Codes/NAM, the Audit Code and the Local Government Accounts Rules in addition to other statutes and sub-ordinate legislation. The operational standards are in the process of substantial improvement through PIFRA as far as financial reporting and disclosure requirements are concerned and for their alignment with International Public Sector Accounting Standards..

Chapter 10: Assessment of External Audit

The scope and nature of external audit

– rating ‘b’

126. The PFM Framework looks for external audit that is adequately empowered, covers all major entities in the public sector and the full range of financial audit, focuses on significant and systemic issues in its reports, and generally adheres to auditing standards. The Auditor General (Function, Duties...) Ordinance, 2000 explains the constitutional mandate of the Auditor General of Pakistan whereby he is responsible for auditing all government formations and semi-government enterprises, which are 50% plus funded by the government. PIFRA has updated auditing methods and a district audit function has been established. Newly corporatized education and health bodies and Aukaf funds etc. are gray areas. Section 115(1) of the Local Government Ordinance, 2001 provided that the audit of Tehsil Municipal Administration or Town Municipal Administration and Union Administration shall be conducted by the local Fund Audit Department, in the prescribed manner, till such time that adequate capacity is developed to conform to the national audit system notified by the Auditor General of Pakistan. The quality of other auditors including the Local Fund Audit Department²¹ is debatable. The scope of the Auditor General should be clear and it should be within the internal functional prudence of the Office of the Auditor General whether he outsources some of the audit work to private firms²² or to government agencies. Although there are some unresolved issues for the audit of the lower levels of local government the new PIFRA methodologies are being rolled out and a rating of ‘b’ is assessed for the provincial and district governments.

127. An audit methodology should clearly outline²³:

- (f) the audit confidence level (usually 95% confidence)
- (g) the minimum requirements for an audit, including how audit planning, audit work papers and the audit summary is documented
- (h) how audit materiality is determined and what is an acceptable level of audit risk and confidence, along with how these factors are documented
- (i) how to develop an appropriate mix of audit work, in order to adequately address the audit risks identified.
- (j) how audit errors are recorded, summarized and evaluated against audit materiality.

128. The mix of audit work would include:

- (k) the documentation of key accounting and management information systems
- (l) the identification of key controls in and around those systems, with audit walkthrough tests to verify the systems and controls in operation

²¹ Discussions are continuing between the Auditor General and the Provincial Government on the potential for using the Local Fund Audit staff in conjunction with staff of the Auditor General for these local government audits but no agreement has yet been reached. The local auditors operate more as internal auditors and also provide pre-audit services. There is no independent audit of these accounts until the Auditor General is adequately staffed for the function.

²² The Auditor-General of Pakistan has already signed an MoU with Institute of Chartered Accountants of Pakistan for joint audits.

²³ Sourced from material supplied to the World Bank by the New Zealand Audit Office 2004

- (m) an evaluation of the information systems control environment
 - (n) an overall assessment of the control environment
 - (o) the combination of audit compliance and substantive testing (key item testing, analytical review and sampling) procedures that are necessary in order to form a view on key account balances and transactions.
129. Certification audits have recently been started for district governments and the format of the Audit Certificate is not yet very comprehensive and currently does not give full assurance to the stakeholders. The scope of the audit certification can be differently interpreted as to whether it covers the fairness of the financial statements or is limited to the mathematical accuracy of the compilation process. The audit opinion for the 2001-2002 accounts states that the accounts properly present the accounting transactions in most material aspects rather than all material aspects. The audit certificate also points to detailed audit observations in other audit reports. This leaves some uncertainties as to what parts of the accounts are incorrect. As accounting and operational systems are becoming increasingly computerized the auditor needs to use powers to access computer records for audit purposes. This needs authority and competence.
130. The DG Provincial Audit has received the Financial Audit Manual and the staff need extensive training to implement the risk-based audit approaches with robust sampling techniques.
131. Most of the focus of external audit in the public sector was on the regularity of expenditures. There are approximately 76,000 paragraphs outstanding at different stages of scrutiny and oversight. This is a very large number and requires considerable time and resources to clear. Priorities are needed together with arrangements to ensure that clearance is undertaken in a proper manner.
132. Despite the actions to create a Controller General of Accounts separate from the audit body, there remain issues relating to sourcing of auditors and accountants from a common Accounts and Audit Service with the conflict of interest problems arising from the associated transfers policies and hierarchy issues which need to be resolved.
133. Accounts for the 34 District Governments, 123 municipal and town councils, and 3,453 Union Councils are required for the years 2001-02 onwards. Regional directorates of the Auditor General have been established during 2004 in the Province to audit the annual district and local government accounts. The Auditor General has approval to appoint 135 new audit staff for these tasks and as an interim measure has transferred staff to the function and initiated the appointment of staff on a temporary contract basis while normal recruitment processes continues. A new Local Government Accounting Manual under the Local Government Ordinance of 2001 has been issued. District Accounts for 2001-02 have been audited. Detailed Audit Reports on the transactions in these accounts are in final preparation and are yet to be provided to the district legislatures²⁴.
134. The certification audits for 2001-02 were the first for the districts and all were qualified for expenditure and accounting discrepancies. The duality of Administrative Control over District Account Offices was cited as resulting in the non-reconciliation of Appropriation Accounts with the Accounts of the District Governments/Budget books

²⁴ These should better be sent directly to the local legislature and not through the Governor.

of the districts, hence difficulty in the certification of Accounts. This duality needs to be resolved as a matter of priority.

Follow up of audit reports by the executive or audited entity

– rating ‘c’

135. The purpose of accountability is not fully served just by identifying those who have not performed well or caused losses, and taking action in respect of them. The process must lead to continuing reforms in organization and to better procedures for proper direction and effective controls in the future. Accountability must serve the progress towards good governance. The PFM Framework looks in this broad sense for evidence of effective and timely follow up by departments to audit findings.
136. The audit process requires that audit queries are conveyed to the auditee at the end of each day, there is an exit meeting with the auditee at the end of the audit, communication to the controlling officer and DAC of audit issues in draft paragraphs, where attempts are made to settle paragraphs and then submission of a final audit report setting out all the remaining negative findings to the PAC through the legislature. There is a formal response to audit findings, though very much delayed and insufficient follow-up occurs. The Auditor General’s most recently reported audits of districts found there was a poor response by auditees to audit observations. In the light of these concerns a rating of ‘c’ is therefore assessed.
137. It is obvious from the fact that so many audit queries are pending resolution that the auditees do not sufficiently utilize the opportunities for early settlement of issues by corrective action by the DDO or DAC rather than adopting argument or negotiation about their validity. The Finance Department advised that the Provincial Government has decided that a pending audit report against a civil servant shall be duly considered while deciding upon his promotion to a higher post.
138. Although meetings of DACs are being held, the focus is not sufficiently directed to efficient and quick resolution of issues and correction of deficiencies, and the Auditor General has reported non-convening of DAC and SDAC meetings. The Finance Department is rightly emphasizing the holding of meetings and resolution of outstanding issues to move the process forward but more rigorous requirements need to be placed on these committees to implement the agreed recommendations of the audits. They should not be tasked only to attempt to resolve audit issues before they are reported but must be more importantly tasked to ensure that demonstrable rectification action is taken at the earliest possibility on the audit findings, recoveries made where appropriate and actions taken to prevent repetition.
139. An analysis should be conducted of the most common pre-audit and post audit observations and based on that a DDO handbook should be developed for training of the DDOs in PFM so as to reduce the number of common problems. The handbook should also be translated in Urdu for easy understanding by the DDOs.

Chapter 11: Legislative Scrutiny of External Audit Reports.

Assessment of Legislative scrutiny

– rating ‘c’

140. The PFM Framework proposes that a parliamentary committee’s examination of the external audit reports concentrate on key findings and report within one year of the report’s issue. For a ‘b’ rating, reports must be issued within 3 years of the year of the accounts. Follow up actions need to be recommended to the executive, and to be generally acted upon. It has been noted in Pakistan that seldom have the reports to the PAC been checked in time for any action to be taken.²⁵ Provincial Accounts have been routinely audited by the Auditor General of Pakistan and annual accounts submitted to the Legislature together with an audit certificate on the accounts. The Budget Manual of Punjab (section 16.6 page 117) requires that the accounts and audit report be prepared by a prescribed date but no date has yet been prescribed. A separate detailed Audit Report on the expenditure and receipts transactions is provided subsequently and both are referred to be examined by Public Accounts Committees. The Provincial Assembly of Punjab established two Public Accounts Committees in 2004. The Committees have almost completed examination of the Auditor General’s Reports together with the audited accounts for the years 1999-2000 and 2000-01. The Audit Report for 2001-02 has also been referred and examination is expected to start in May 2005. Thus no reports have yet been issued by the PAC within 3 years of the relevant year of audit. The Budget Manual requires that the PAC report be submitted to the Provincial Assembly within one year of the date of referral and that the Assembly may discuss the report and make additional recommendations to the Government. The Finance Department is responsible for dealing with the PAC recommendations. Audit reports of earlier years were examined much after the event by an ad hoc PAC comprised of persons not from the Legislature. It operated during a period that the Legislature was suspended. Previous long delays in legislative scrutiny of Appropriation Accounts were mainly due to absence of reconciled figures with the result that Excess Budget Statements have not been prepared and presented to the provincial legislature for many years. The District Governments and other local government authorities have yet to develop and implement a mechanism to review and report on the accounts and reports. Based on the more recent performance at the provincial level, a rating of ‘c’ is assessed as no PAC reports have been made within 3 years of the relevant year of the accounts.
141. There is concern that audit observations go into abeyance during the period between of their becoming part of the Audit Report and the PAC examining the observation. The Departmental Accounts Committees cease to consider audit observations once they are made part of the Audit Report. This has led to so many observations being pending for periods so long that investigation becomes impractical and is seen as a mechanism for avoiding proper scrutiny. The Budget Manual provides for the Finance Department to take action on any matters in the audit report that is laid before the Assembly. However this process should not prevent the DACs continuing their scrutiny and providing the PAC with information on the actions they have taken to deal with the audit observations. Similarly the Finance Department should ensure that action is taken on serious matters before the PAC hearings.

²⁵ Transparency International National Integrity Systems Country Report 2003

142. Zila and Tehsil Accounts Committees have been established but have yet to begin work. For the district level, this delay on action is due largely to reports having yet to be issued by the Auditor General because he has decided to provide the reports of all districts to the Provincial Governor before submitting them to the District Legislatures. The delays in waiting for all the reports to be available and adding a Provincial step rather than passing reports to individual district legislatures as and when completed are self-evident. At the local level Accounts Committees have only recently been nominated and these can examine the reports of the Local Fund Audit.
143. The mandate of ZACs as per Section 114 of the Local Government Ordinance, 2001 is significantly more than the PAC at provincial level. The ZACs have to hold monthly public hearings on the monthly accounts²⁶ of the local government. In this way ZAC will function as a bridge between the government functionaries and the general public in the process of review of monthly accounts, variance from approved budget, and any reports from internal or/and external auditor.
144. In general it can be concluded that there is little response to audit criticisms at any level of government unless a legislative committee is involved; and even for this there is a very patchy record of success. Recent activity at least at the provincial level has developed stronger confidence about follow-up.
145. The summary of the ad hoc PAC's report for the 13 year backlog to 1997-98 advised that its examination covered 16,415 audit paragraphs of which 1,095 were judged 'inconsequential', 5,424 had satisfactory action taken, 5,539 carried specific directions of the Committee the implementation of which was to be monitored by the Finance Department, and the remaining 4,357 audit paragraphs (27%) were kept pending for various reasons.
146. Under the rules of procedure of the Punjab Assembly, a PAC is to examine any amounts spent on any service in excess of the amount granted by the Assembly for the purpose and make any recommendations it deems fit. It therefore has no power to direct. The two current PACs are examining the validity of the audit observations and also the actions taken by departments on valid issues. The Committees have not yet issued any report but progressively issue minutes on their deliberations to the relevant officials. To date there is no summary tracking record of compliance with the earlier ad-hoc PAC recommendations but the process now applied by the Committees of assessing immediate actions taken and keeping matters pending provides greater confidence that issues will be followed up by subsequent PAC hearings. Where a department was advised of recoveries, the Committee requested audit verification before reporting on the issue.
147. For the continuous and effective working of PACs, trained secretariat staff are required for proper organization of meetings. In order to enable PAC to review its performance and discover new endeavors in its role proper research assistance should be provided to PAC.
148. The ad hoc PAC held its hearings in public thereby improving the access of the media and the public to audit information. The media has a role in informing the public about

²⁶ Monthly accounts need to be displayed at conspicuous places every month for the public (LGO, 2001).

matters under committee's investigation, and in practice, the committee makes occasional press releases of its findings.

149. The committee has to be able to provide assurance to the public that government is receiving value-for-money and public money and assets are being managed in a proper way. This helps raising the confidence of the public in political institutions.
150. Progress in the PAC has been substantial and effective mechanisms are needed for ensuring progress on the implementation of the Committee's recommendations. The progress in dealing with the observations and recommendations of the ad hoc PAC included in the Annex must be reported by the Finance Department.

Chapter 12: Action Matrix

Based on the recommendations presented in each of the preceding sections, a comprehensive action plan has been prepared to consolidate them into a format that is easy for the GoPj to track:

<i>Theme</i>	<i>Actions</i>	<i>Agency</i>	<i>Actions Status</i>
PFM Out-turns	Improve the definitions for revenue taxes and conduct surveys of revenue potential for local governments and for the provincial government.	FD through PRMP & DSP	
	Remove systemic and procedural hurdles in spending and disbursing through process analysis and improvement.	FD, AG	FD has streamlined the spending capacity of Local Governments by notifying the Budget Rules, Accounts Rules, Fiscal Transfer Rules, Internal Audit Rules and extending financial powers rules. More specific rules are to be framed while others need to be reviewed.
	Expedite and accomplish the planned recruitment in PFM.	FD	FD selection of 250 professionals into Local/Provincial Government is being negotiated with firms and the contracts are to be finalized by 30 April.
	Expedite the implementation of NAM to identify and manage commitments and arrears.	FD, AG	Budget Estimates for 2005-06 will use NAM.
Comprehensiveness and Transparency	Develop and implement a system for TMA financial reports to be consolidated monthly at the provincial level.	FD, AG	CGA has notified function/object codes for incorporating financial reports of TMAs in the national accounts. CGA needs to implement the decision and organize collection and consolidation

<i>Theme</i>	<i>Actions</i>	<i>Agency</i>	<i>Actions Status</i>
	Develop and implement a quarterly reporting mechanism on the summary operations of public enterprises and related monitoring framework.	FD	of data. PRMP includes a study to reflect the financial reports of PEs into the budget estimates.
Budget Presentation	Improve and devise new budget presentation formats by including details of financial assets, debts, contingent liabilities, guarantees and off-budget items.	FD	On presentation of budget estimates under NAM in 2005-06 the system is likely to include details of financial assets, debt, contingent liabilities, guarantees and off-budget items.
	Introduce program and performance budgeting (through related program classification) for recurrent expenditures as part of overall MTBF reforms.	FD	The MTBF will continue its implementation through 2005-06 to 2007-08. Performance orientation of budget is yet to be achieved.
Mid-term Planning and Budget Formulation	Institute the formulation of policy priorities with greater consultations at the cabinet level and clear indication of the revenue and expenditure targets/ceilings through the Budget call letter.	FD, Line Departments	The 2005-06 Budget Call Circular includes a greater policy guidance but lacks in respect of indication of ceilings.
	Develop a budget allotments and commitments register to document yearly commitments in respect of development projects.	FD, P&D	An allotments register and a system for managing commitments is likely to be included in NAM implementation from 2005-06.

<i>Theme</i>	<i>Actions</i>	<i>Agency</i>	<i>Actions Status</i>
Budget Execution	Devise a cash flow forecasting system for effective utilization of cash resources.	FD	
	Undertake further routine debt sustainability analysis.	FD	
	Devise and implement a system of issuing, recording and reporting guarantees.	FD	
	Enforce the timely distribution of budget at the disposal of administrative secretaries to the spending units.	FD, Line Departments	After approval of Budget Estimates and the Schedule of Authorized Expenditure, the budget allocations are available to Administrative Departments for further allocation. Similarly allocations against approved development schemes are released on 1 July. Allocations for un-approved schemes are released on approval. These need to be further distributed to DDOs in a timely manner.
Internal Controls and Procurement	Devise a user-friendly hand book for DDOs containing an introduction to all financial management rules, regulations and systems.	FD	FD has updated the ESTA Code and posted all financial rules on the web-site as a reference material yet there is a need of a concise and user-friendly hand book for non-financial managers.
	Identify and implement a mechanism for the creation and subsequent implementation and monitoring of Public Procurement Rules.	FD	

<i>Theme</i>	<i>Actions</i>	<i>Agency</i>	<i>Actions Status</i>
	Create Public Procurement Rules with implementing Regulations and Procedures that meet international best practice.	FD	
Accounting and Reporting	Identify mechanism for ensuring early preparation and reporting of financial statements – this may involve making provisional financial statements public before the audit certification.	FD, AG, AGP	The Fiscal Monitoring Committee chaired by the Finance Minister exercises oversight on fiscal reconciliations. The unaudited quarterly Civil Accounts are placed on the web-site.
	Establish and strengthen the internal audit functions in the line departments, local governments and public enterprises.	FD	FD re-structuring of the existing treasuries and accounts service, and Local Fund Audit into the Provincial Finance and Accounts Service will include the internal auditors.
	Make available to the public, information on the awards of contracts for all tenders above a specified threshold.	FD	
	Establish a process that reports on procurement related complaints and their resolution, in conjunction with the AGP.	FD	
External Audit	Clarify any ambiguities that infringe the Constitutional mandate of the Auditor General of Pakistan and establish institutional linkages with Local Fund Audit etc. to resolve any functional and	AGP, MoF, FD	

<i>Theme</i>	<i>Actions</i>	<i>Agency</i>	<i>Actions Status</i>
	institutional deficiencies.		
	Provide extensive training to audit staff for implementation of risk-based audit approach contained in the new financial audit manual.	AGP	
	Establish the prescribed date required by paragraph 16.6 of the Punjab Budget Manual for the audit report to be provided on the accounts.	AGP	
	Organize orientation programs for the executives in respect of objective, nature, scope and methodology of audit so that they can effectively cooperate with the audit staff leading to a reduction in audit paragraphs raised.	FD, AGP	
	An analysis of audit observations of pre-audit and post audit be conducted with a view to identify and resolve causes of most common observations.	FD, DG Audit	
Legislative Scrutiny	Provide trained secretariat staff to the PACs with adequate facilities to support the PAC.	Provincial Assembly	
	PAC hearings should be informed by	Departments, FD,	

<i>Theme</i>	<i>Actions</i>	<i>Agency</i>	<i>Actions Status</i>
	reports from DAC and SDAC on observations made by the Auditor General in his Audit Reports.	PACs	
	Implement a strategy to assist the PAC more effectively to concentrate on important issues and systemic problems set out in audit reports and maintain a tracking system to report regularly to the PAC on PAC recommendations and actions taken.	AG, FD, PAC	

List of Annexes

Annex A – Introduction to Punjab

Annex B – Governance Systems and Structures under the LGO

Annex C – Punjab Medium Term Budget Framework – An Extract from Punjab Education
Sector Adjustment Credit Project Appraisal Document

Annex D – Ad hoc PAC (Punjab) Recommendations

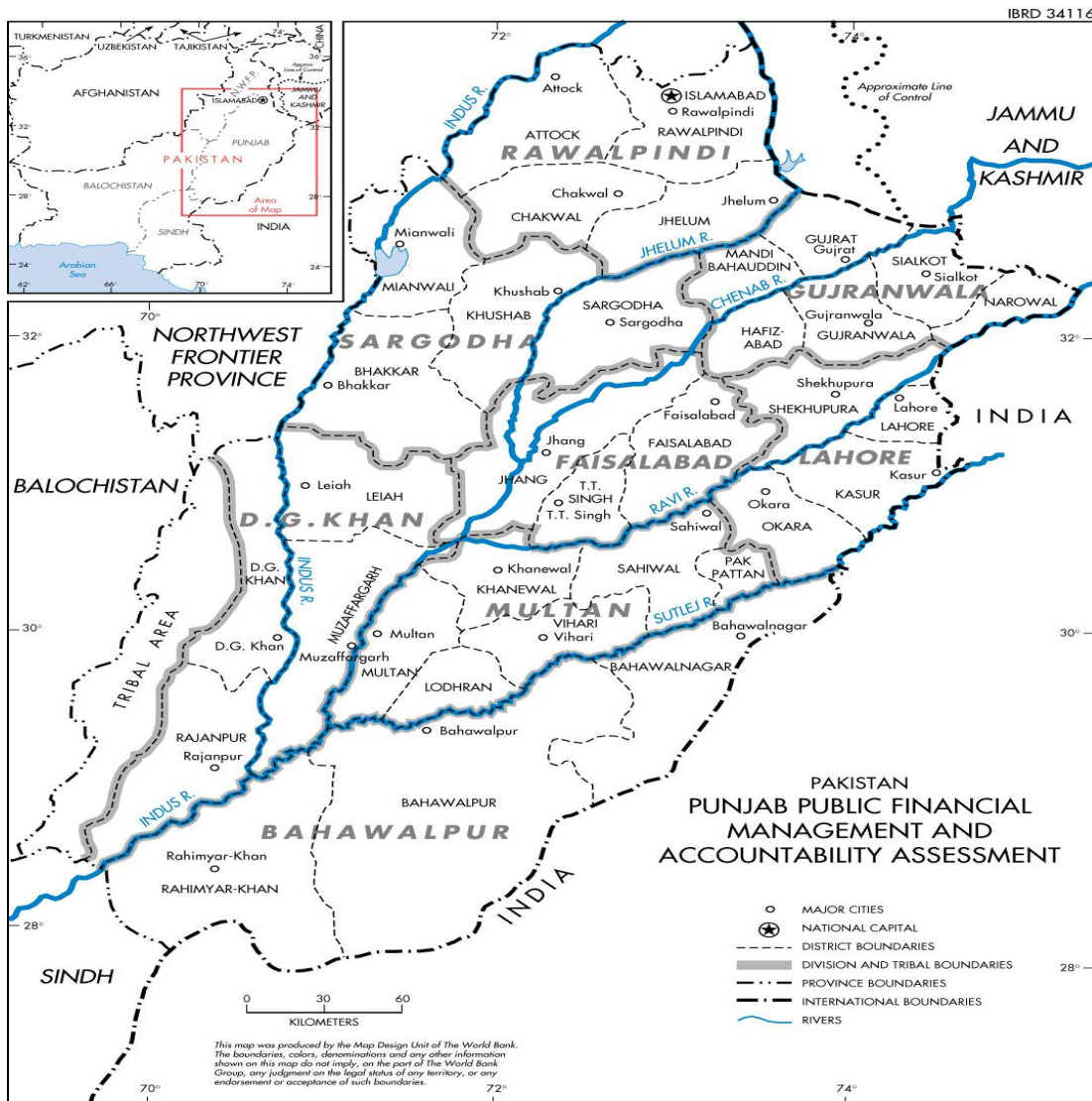
Annex E – List of People Met

Annex F – Primary Documents Reviewed

Annex A: Introduction to Punjab

Pakistan is a vast country having four provinces and tribal areas. Areas of the country are remote. This makes lines of administration, communication and supply somewhat complex and difficult to maintain efficiently. Having population of 144 million, it is a diverse country with a number of distinct ethno-linguistic and cultural traditions. The literacy rate is quite low at 43.2% and significant differences between gender welfare and opportunities exist. The more remote the area the more that some of these issues impact on the ability to sustain administrative systems and supply lines.

The **Punjab** province of **Pakistan** is part of the larger **Punjab** region. Neighbouring areas are Sindh to the south, Balochistan and FATA to the west, NWFP to the north and Punjab, India and other **Indian** states to the east. Punjab is the second largest province at 205,344 km² (79,284 square miles) and has the largest population more than 70 million. The major language spoken in the Punjab is Punjabi, and likewise the largest ethnic group. The capital and main city of Punjab is Lahore, which has been the historical capital of the region. The region contains the Thal and Cholistan deserts. The Indus river and its many tributaries traverse the Punjab from north to south.



The name Punjab means "five rivers", referring to the Indus, Ravi, Chenab, Sutlej and Jhelum rivers. Despite its dry climate, extensive irrigation makes it a rich agricultural region. Wheat and cotton are the largest crops. Other crops include rice, sugarcane, millet, corn, oilseeds, pulses, fruits, and vegetables. Livestock and poultry production are also important. Punjab is one of the most industrialized states of Pakistan; its manufacturing industries produce textiles, machinery, electrical appliances, surgical instruments, metals, bicycles and rickshas, floor coverings, and processed foods.

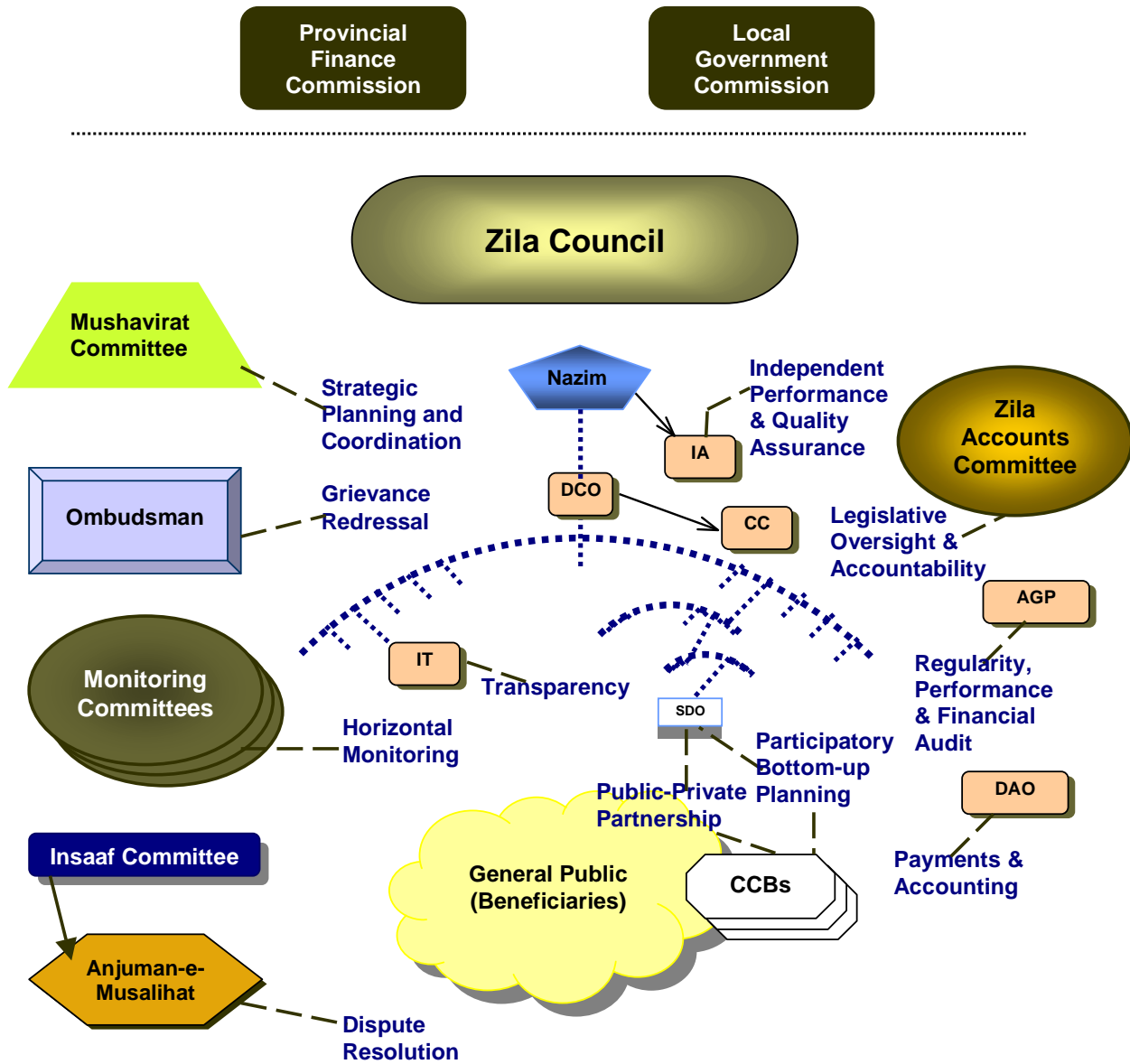
Punjab has over 80 million people, more than half Pakistan's population. It is heavily dependent on fiscal transfers from the federal government (Rs billion 107 of total revenues Rs billion 132 for FY 2002/03). The provincial government is responsible for the delivery through the district government of basic social sector services and its performance has major impacts on social and economic development indicators. The largest expenditures are on education (Rs billion 32.6 for FY 2002/03), access to justice (Rs billion 12.5), irrigation (Rs billion 9.8), roads, highways, and bridges (Rs billion 4.8) and health (Rs billion 2.7).

There are substantial structural changes underway. The devolution program has been transferring responsibilities for delivering services, such as education and health, to elected local governments. New accountability arrangements are being established, for example the use of more block grants from the provincial government to the district governments. The Government of Punjab is undertaking a program of governance reform supported by a program of comprehensive education sector reform – supported by the Bank. Various program targets have been adopted, for example to reduce the overall annual population growth rate from 2.6% in 1998 to 1.8% in 2004 and 1.6% by 2012; and welfare program coverage from 65% of the population in 2001 to 76% in 2004 and 100% in 2012.

Annex B: Governance Systems and Structures under the LGO

The reforms established a new devolved political system, which involved elections at Union, Tehsil and District levels, with women guaranteed one third of the seats in Union Councils. Other minorities are guaranteed representation in Union Councils. District officials are now accountable to elected representatives, with an elected Nazim working as Chief Executive. A District Co-ordination Officer supervises a team of EDOs, with monitoring committees made up of elected councillors established to maintain oversight over the workings of LG Offices. These arrangements are mirrored at Tehsil and Union levels. Tehsil and Union Nazims are responsible at their respective levels for administrative and development functions.

Figure 1: Governance Systems and Structures under LGO, 2001



DCO – District Coordination Officer
 IA – Internal Auditor
 CC – Complaint Cell
 SDO – Service Delivery Outlet

AGP – Auditor General of Pakistan
 CCB – Citizen Community Board
 DAO – District Accounts Officer

These comprehensive changes have exposed key weaknesses. Not all councillors are well educated, and many lack basic knowledge, experience and skills. Few councillors have the understanding and skills needed to perform effectively as assembly members, or to act as effective members of monitoring committees. In particular, many councillors appear to have a poor understanding of the functions, responsibilities and powers conferred upon them by the LGO. Exposure to planning and budgeting systems has been very limited, and most have little experience of ensuring plans and budgets are directed towards the needs of the poor.

The local government reform process has given considerable power to communities and elected representatives to hold officials to account. To work effectively this requires a change in the behaviour and attitudes of administrators and managers, towards an ethos based on trust in and partnership with elected representatives and local communities. This type of change is never easy nor rapid, and attitudinal change clearly has a long way to go.

There are also problems related to the changes that have taken place at different levels of local government. There has been a redefinition in roles, functions and relationships, particularly between district and province, and many uncertainties remain. This uncertainty can lead to misunderstanding and conflicts of interest, and there is a need to address this lack of clarity. Similarly, accountability mechanisms at District and Tehsil levels are well defined in the LGO but need testing and review to ensure that they work effectively.

Annex C: Punjab Medium Term Budget Framework – An Extract from Punjab Education Sector Adjustment Credit Project Appraisal Document

Introduction

1. Despite some significant improvement during the last three years, Punjab's fiscal situation has remained weak. This is mainly a result of the changes in revenue sharing formula brought about in the 1997 NFC Award²⁷. The 1997 NFC Award reduced the share of provinces in more buoyant federal taxes (income tax and GST), while at the same time allowing them a share in custom duties, which, because of tariff reforms, have been fast losing their revenue potential. As a result, federal revenue transfers to Punjab in 1997/98 were 15% below those in 1996/97 in nominal terms. Moreover, the average growth in federal tax transfers during the last 5 years has only been about 7% per annum, showing a marked deceleration from the 25% per annum growth during the term of the 1991 NFC Award. This also compares unfavorably with the growth trend of 10% per annum in provincial expenditure during the five years immediately before the NFC Award.

2. Notwithstanding the deceleration in federal revenue transfers and the limited number of buoyant tax bases in the provincial domain, the province has made insufficient efforts to utilize the full potential of the relatively more buoyant taxes assigned to it (e.g. Agricultural Income Tax and Urban Immovable Property Tax, etc.). This contributed towards the absolute dependence of provincial finances on federal revenue transfers. Nevertheless, over the last few years, the province has made some efforts to improve, or at least prevent, deterioration in its financial situation.

3. The province has made some attempts to rationalize provincial taxes by eliminating irrelevant small taxes, improving tax compliance through lowering the rate of Urban Immovable Property Tax (UIPT) and standardizing and improving the structure of Stamp Duties. The province's own revenues increased by 13% during 1998/99. However, lack of additional measures and tax administration problems led to a relative stagnation in provincial revenues during the last three years. Because of the low growth in fiscal transfers from the federal government and in province's own revenue, the province has continued to run significant fiscal deficits since implementation of the 1997 NFC Award (see Table 1). This was despite provincial efforts to keep its expenditure within the resource envelope through strict expenditure controls. As a result, the growth rate of provincial expenditure at present is only one half of its level of early-1990s. While this has helped the province to keep its budget deficits from getting out of hand, over the years it has caused major gaps in provincial infrastructure and delivery of social services. Viewed only in terms of province's cash balance position, however, Punjab's financial condition is somewhat better than those of other provinces, primarily because the population-based revenue sharing formula favors Punjab.

Structural weaknesses in provincial finances

4. Notwithstanding its relatively better fiscal situation, the aggregate finances of the province present some disturbing features. Firstly, despite being the largest province with significant opportunities for resource mobilization, Punjab remains heavily dependent on fiscal transfers from the federal government. Moreover, fiscal dependence on the federal government has been increasing over time (see Figure 1). The province, which used to generate 26% of its total revenue from its own resources in 1989/90, is currently mobilizing less than 15% of its revenue receipts from provincial sources. This fiscal dependence, is partly an outcome of skewed assignment of taxes, which allocates all the major buoyant taxes to the federal government. It is also partly a result of lack of political will and weak tax administration at the provincial level which prohibits the government from mobilizing additional fiscal resources from provincial tax and non-tax bases.

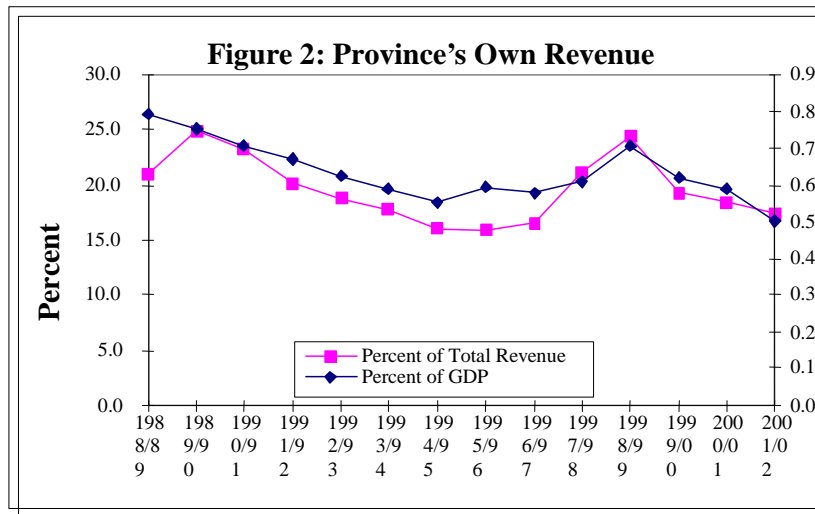
²⁷ The National Finance Commission Award is the mechanism through which the federal government awards the provinces their share of revenue based on a population-based formula.

Table 1: Punjab -- Fiscal Accounts, 2000/01-2003/04

	(Rs Millions)										
	2000/01		2001/02		2002/03		2003/04		Percentage Change		
	Budget	Revised	Revised	Budget	Revised	Budget	FY03 RE/	FY04 BE/	FY04 BE/	FY03 BE	FY03 RE
Total Resources	124,199.015	111,910.248	114,839.973	133,279.361	131,221.222	149,435.516	-1.54	12.12	13.88		
Total Revenues	118,137.015	109,356.748	112,286.473	130,725.861	129,336.340	149,346.900	-1.06	14.24	15.47		
Tax and Non-Tax Transfers	98,068.290	89,729.766	91,527.722	109,751.981	107,549.676	120,687.749	-2.01	9.96	12.22		
Provincial Revenues	20,068.725	19,626.982	20,758.751	20,973.880	21,786.664	28,659.151	3.88	36.64	31.54		
Tax Revenues	12,801.395	11,322.287	11,640.646	12,033.480	12,567.760	14,086.781	4.44	17.06	12.09		
Non-Tax Revenues	7,267.330	8,304.695	9,118.105	8,940.400	9,218.904	14,572.370	3.12	62.99	58.07		
Development Grants	6,062.000	2,553.500	2,553.500	2,553.500	1,884.882	88.616	-26.18	-96.53	-95.30		
From the Federal Government	5,943.000	2,201.000	2,201.000	2,201.000	1,625.182	0.000	-26.16	-100.00	-100.00		
From Donors	119.000	352.500	352.500	352.500	259.700	88.616	-26.33	-74.86	-65.88		
Total Expenditure	130,164.714	115,603.388	118,454.626	137,850.185	139,169.514	159,695.489	0.96	15.85	14.75		
Current Expenditures	107,153.714	98,601.445	101,526.249	117,100.185	115,022.032	129,195.489	-1.77	10.33	12.32		
General Administration	12,433.699	12,010.372	13,626.642	16,102.581	13,377.339	15,320.541	-16.92	-4.86	14.53		
Law & Order	9,500.434	9,795.720	10,808.444	12,188.727	13,379.424	15,776.795	9.77	29.44	17.92		
Community Services	3,538.707	3,365.902	3,616.313	5,528.360	1,717.766	1,949.699	-68.93	-64.73	13.50		
Social Services	39,219.775	35,641.118	37,588.877	41,643.892	6,206.335	10,889.411	-85.10	-73.85	75.46		
Economic Services	11,731.771	9,914.785	10,148.563	13,544.866	8,234.931	10,612.858	-39.20	-21.65	28.88		
Subsidies	5,000.000	4,000.000	2,500.000	3,000.000	3,000.000	1,920.000	0.00	-36.00	-36.00		
Debt Servicing	15,655.840	15,759.919	16,270.766	16,131.142	16,348.160	14,781.995	1.35	-8.36	-9.58		
Grants	10,073.488	8,113.629	6,966.644	8,960.617	52,758.077	57,944.190	488.78	546.65	9.83		
Development Expenditure	23,011.000	17,001.943	16,928.377	20,750.000	24,147.482	30,500.000	16.37	46.99	26.31		
Locally Financed (ADP)	16,472.000	10,944.921	10,019.152	12,381.500	17,652.425	22,111.384	42.57	78.58	25.26		
Foreign Project Assistance (FPA)	6,539.000	6,057.022	6,909.225	8,368.500	6,495.057	8,388.616	-22.39	0.24	29.15		
Revenue Surplus (+)/Deficit(-) ¹	10,983.301	10,755.303	10,760.224	13,625.676	14,314.308	20,151.411	5.05	47.89	40.78		
Fiscal Deficit ²	-5,965.699	-3,693.140	-3,614.653	-4,570.824	-7,948.292	-10,259.973	73.89	124.47	29.08		
Financing	5,965.699	3,693.140	3,614.653	4,570.824	7,948.292	10,259.973	73.89	124.47	29.08		
Foreign Loans	6,420.000	5,704.522	6,556.725	8,016.000	6,235.357	8,300.000					
Loans from the federal Government	0.000	0.000	0.000	0.000	0.000	0.000					
Others (Domestic Loans & Cash) ³	-454.301	-2,011.382	-2,942.072	-3,445.176	1,712.935	1,959.973	-149.72	-156.89	14.42		
¹ Total revenue less current expenditure.											
² Total resources less total expenditure											
³ Derived as a residual.											

5. This excessive dependence on federal revenue transfers has several negative implications: (i) it makes the provincial finances dependent on federal revenue collection, as large shortfalls in federal revenue have a devastating impact on the provincial fiscal situation and makes it impossible for the provincial government to execute its budget and pursue its development objectives according to its own wishes; (ii) fiscal adjustment becomes more difficult as the province has little control over its aggregate revenue; provincial fiscal and development policies become more susceptible to pressures from the federal government; and (iv) accountability of provincial expenditure decisions gets compromised, especially to the tax payers. The provincial government, which does not have to raise taxes (or user charges) to provide public services and/or infrastructure to its citizens, is likely to be less prudent about the quality of its expenditure decisions.

6. In addition, provincial expenditure is marred with acute structural rigidities. An excessively large provincial establishment and provincial debt (mainly to the federal government) makes personnel expenditures (salaries, allowances and pensions) and debt servicing dominate the provincial budget, allowing it to allocate only meager amounts for essential non-salary non-interest expenditure heads. This imbalance between wage and non-wage operation and maintenance (O&M) expenditures has compromised the effectiveness of public expenditures. The problem is exacerbated by deteriorating fiscal conditions, a strong government bias for creation, rather than maintenance, of public infrastructure, and at source deduction of the unpaid utility bills by the federal government from the revenue share of the province.



7. As is obvious from the above discussion, low levels of fiscal deficits²⁸ do not in any sense reflect the soundness of provincial finances. According to the provision of the Constitution, the provinces cannot borrow except from, or with the consent of, the federal government. This limited access to the capital market forces the provinces to curtail their expenditures in times of adverse fiscal situations. In other words, fiscal adversity is not reflected as much in fiscal deficits as it is in the decline in production and quality of provincially provided public services and infrastructure.

8. The low and stagnant social and economic indicators point to a long term fiscal crisis in the province, not in the sense of running high fiscal deficits, but in a deeper sense of running high “infrastructure deficits”²⁹ due to inadequate maintenance of roads, water supply, and other infrastructure, high “social deficits”³⁰ because of inadequate public services in health and education, and high “irrigation deficits”³¹ because of inadequate drainage, operations and maintenance on irrigation canals. These deficits lead to erosion in the stocks of infrastructure, human capital, and irrigation infrastructure, impacting the productive capacity of the provincial economy. This, in turn, leads to erosion in the potential tax base, and therefore, perpetuation and worsening of a vicious cycle of low fiscal resources - low levels of public expenditures - low augmentation of physical and human capital - low productivity - low fiscal capacity – low fiscal resources. In addition, people are less willing to pay taxes as they see less payoff to their tax rupees. This aggravates the problem of low revenue, which, in turn, makes even less money available for public services.

9. A sustained increase in expenditure on public services can help the province break out of this vicious circle. However, under the given adverse fiscal situation this appears unlikely because, (i) while Punjab’s finances are sustainable at current levels of spending, there is not much fiscal space for a major expansion of spending; and (ii) the existing level of public spending does not translate effectively into the quantity and quality of services which are demanded by the public.

10. Inflow of additional fiscal resources (from the federal government or donors) to the province, can therefore help the province to overcome some of its fiscal constraints, and by relaxing some of the structural rigidities in the budget, can improve the levels and productivity of public expenditure.

²⁸ The fiscal deficit of the province has generally remained in the range of 5%-7.5% of aggregate provincial expenditure (signifying the proportion of provincial expenditure met through borrowing).

²⁹ Can be defined as the decrease in the economic valuation of infrastructure.

³⁰ Defined as the decline in human capital.

³¹ Defined as the decline in the value of the irrigation system.

11. In addition, increased effectiveness of public expenditure can contribute significantly towards breaking the vicious cycle, which has been limited by the poor incentives for service delivery, poor governance and, at least in the past, an extremely centralized system of public spending. Improving the effectiveness of public expenditure requires a significant improvement in allocative efficiency of expenditures, through careful evaluation of expenditure priorities, and correcting the balance between development and recurrent and wage and non-wage O&M expenditures. Moreover, there is ample scope for improving overall governance and management of key sectors and departments to reduce waste and enhance efficiency. This however requires fundamental changes in government process and procedures, especially those governing provincial budgets and finances.

12. Similarly, there is a need to revise the incentives regimes for civil servants and to change the delivery of public services from a centralized, top-down, supply-driven, unaccountable system to a decentralized, bottom-up, demand-driven, accountable system.

13. More specifically, there are substantial reasons for the government and the donor community to support the devolved system of service delivery. While decentralization is no panacea for the problems plaguing the effectiveness of public expenditures, and is subject to many pitfalls, it provides the best opportunity for improving the structure of governance and the effectiveness of public services. The system needs considerable fine-tuning to achieve these objectives.

14. This requires providing the local (especially the district) governments with adequate fiscal and human resources to fulfill their duties appropriately and efficiently. Considerable efforts need to go into developing the managerial and technical capacity of the local governments and providing them with adequate office technology. Nevertheless, without a significant increase in fiscal resources of local and provincial governments, there is little hope for any major improvement in public services through the devolved delivery system. At present, the sub-national governments are facing a severe fiscal squeeze. Whereas the National Finance Commission (NFC) has been seriously considering an increase in the share of provinces in the federal divisible pool from 37.5 percent to 40 percent, a much greater flow of funds would be required to achieve the I-PRSP targets. Mechanisms need to be developed to allow a large portion of fiscal space that may be created at the federal or provincial level (due to better debt and/or expenditure management) to be passed down to the local level. This shift will require the NFC and Provincial Finance Commissions (PFCs) to not only assign much greater formula-based transfers to the lower-level governments, but in addition put in place a system of financial incentives for the local governments to internalize national priorities within their own policies and plans.

Budgetary and fiscal reforms

15. ***The Medium-Term Budget Framework:*** While the Punjab government has taken some important steps for improving its budgetary and financial procedures and towards fiscal decentralization, considerable progress would be required in coming years to provide a sound fiscal and financial footing to the local governments. The provincial government over the last four years has been preparing a basic performance budget for the key sectors. Although the exercise is not yet fully established within the government's budget-making process, it has provided a base for further improvements in budget processes. From 2003/04, as part of preparation of the provincial Poverty Reduction Strategy Paper (PRSP), the Punjab government is embarking on Mid-Term Budget Framework (MTBF), mainly focusing on pro-poor expenditures.

16. The projected expenditure pattern of the province reveals a strong shift from an asset creation bias to maintaining provincial assets and infrastructure. With development expenditure projected to increase by only 5% per annum the province seems to be opting for consolidation, rather than expansion, of provincial expenditure.

17. Over the next three years (2003/04-2005/06) provincial expenditures, recurrent and development, are projected to grow at about 11% (Table 2). The MTBF makes a strong attempt to refocus provincial priorities and divert provincial resources towards pro-poor and social expenditures. During the next three years, the overall pro-poor expenditure, which was estimated at Rs. 66 billion in the 2002/03, is projected to grow by

23% per annum (see Table 3), with current expenditure (including additional resources to be provided from the budget) to increase by 20% per annum and development expenditure growing by a sizeable 45% per annum.³²

18. The education sector expenditure, which comprised a little less than 24% of overall expenditure in 2002/03, is expected to grow at 18% per annum. As a result, the share of the education sector in total will increase to over 28% in 2005/06. While significant increase is projected in all sub-sectors of education (see Table 4), owing to the past neglect of the sector, the largest increase (of about 15% per annum) is allocated for General Universities and Colleges. This, however, by no means reflect a wholesale shift in sub-sectoral priorities, as significant increases of about 12% and 10% per annum have also been projected for expenditures on primary and secondary education, respectively.

Table 2: Punjab -- Medium-Term Fiscal Framework, 2002/03-2005/06

(Rs Billion)

	2002/03	Projections			(Annual Percent change)			Average
	Estimate	2003/04	2004/05	2005/06	2003/04	2004/05	2005/06	Growth
Revenue Receipts	129.061	152.821	168.116	188.412	18.4	10.0	12.1	13.4
Federal Tax Transfers	96.153	106.734	128.749	144.402	11.0	20.6	12.2	14.5
Provincial Revenue	21.809	32.387	24.867	28.610	48.5	-23.2	15.1	9.5
Provincial Tax & Non-Tax	19.883	20.825	24.867	28.610	4.7	19.4	15.1	12.9
Tax Revenue	12.568	14.087	16.291	18.356	12.1	15.6	12.7	13.4
Non-Tax revenue	7.315	6.739	8.575	10.254	-7.9	27.3	19.6	11.9
Privatization Proceeds	1.926	7.479	0.000	0.000	288.4	--	--	--
Maturity of Investments	0.000	4.083	0.000	0.000	--	--	--	--
Grants and Others	11.100	13.700	14.500	15.400	23.4	5.8	6.2	11.5
Total Expenditure	139.170	164.345	177.043	191.663	18.1	7.7	8.3	11.2
Current Expenditure	115.022	133.845	143.802	155.432	16.4	7.4	8.1	10.5
Development Expenditure	24.147	30.500	33.241	36.230	26.3	9.0	9.0	14.5
Fiscal Balance	-10.108	-11.524	-8.928	-3.250	14.0	-22.5	-63.6	--
Financing	10.108	5.592	2.765	-2.857	--	--	--	--
Net Domestic Borrowing	-2.984	-13.106	-13.600	-14.100	--	--	--	--
Net Foreign Borrowing	4.624	15.600	13.365	11.243	--	--	--	--
Cash Balance Utilization	8.469	3.099	3.000	0.000	--	--	--	--
Financing GAP before IDA	0.00	-5.93	-6.16	-6.11	--	--	--	--
<i>Memo items: (as a % of Total Expenditure)</i>								
Fiscal Balance as a % of Exp.	-7.3%	-7.0%	-5.0%	-1.7%				
Education Expenditure	23.7%	25.6%	27.2%	28.1%				
Pro-Poor Expenditure	53.2%	60.3%	68.1%	71.8%				

Source: Figures for 2002/03 and 2003/04 are taken from the provincial 2003/04 budget. Figures for 2003/04- 2005/06 have been adjusted to incorporate the effects of salary and pension increase, reduction in subsidies and fall in interest payment due to proposed retirement of federal government debt.

Note: The financing gap (before disbursements from IDA credit) is based on government statements on retiring of federal government debt. The gap could be narrowed to IDA disbursement by reducing/increasing these repayments.

19. As a large portion of the pro-poor expenditure is to be incurred at the district level, the district governments need to be provided with enough resources in order to facilitate these expenditures. Table 5 shows a significant increase (12% per annum) in the projected revenue transfers to the district governments over the next three-year period.

20. To meet the vast unmet needs of the province, however, further injection of large-scale public resources in social sectors will be required. The success of provincial government efforts to reduce poverty in

³² These expenditures exclude the impact on recent salary increase. For this reason only, these numbers are somewhat different from the expenditure figures of Table 2, which include the estimated impact of increase in salaries and pensions.

the province would depend critically on the success of the federal and provincial governments to mobilize additional resources and create significant fiscal space through better debt and expenditure management, and to devise mechanisms to channel these additional resources to the district governments, which have to incur bulk of the pro-poor expenditures. Moreover, strong efforts will also be needed to enhance the effectiveness of public expenditure through improved governance, and by adopting better budgetary procedures and financial management practices.

Table 3: Punjab Government Expenditures, 2002/03-2005/06 \1

	<i>(Rs Million)</i>				<i>(Annual Percent change)</i>			Average Growth
	2002/03	2003/04	2004/05	2005/06	2003/04	2004/05	2005/06	
Roads Highways and Bridges								
Current	2,544.202	2,594.104	2,827.573	3,082.055	2.0	9.0	9.0	6.6
Additional Resources		0.000	607.500	930.000	--	--	53.1	--
Total Current	2,544.202	2,594.104	3,435.074	4,012.055	2.0	32.4	16.8	16.4
Development	2,247.930	3,507.660	3,823.349	4,167.451	56.0	9.0	9.0	22.8
Total Expenditure	4,792.132	6,101.764	7,258.423	8,179.506	27.3	19.0	12.7	19.5
Water Supply & Sanitation								
Current	513.244	489.646	533.714	581.748	-4.6	9.0	9.0	4.3
Additional Resources		0.000	3,037.500	4,650.000	--	--	53.1	--
Total Current	513.244	489.646	3,571.214	5,231.748	-4.6	629.3	46.5	116.7
Development	88.000	856.500	933.585	1,017.608	873.3	9.0	9.0	125.9
Total Expenditure	601.244	1,346.146	4,504.799	6,249.356	123.9	234.6	38.7	118.1
Education								
Current	31,690.454	36,047.315	39,291.573	42,827.814	13.7	9.0	9.0	10.5
Additional Resources	0.000	0.000	1,822.500	2,790.000	--	--	53.1	--
Total Current	31,690.454	36,047.315	41,114.073	45,617.815	13.7	14.1	11.0	12.9
Development	1,355.945	5,976.000	7,063.841	8,159.586	340.7	18.2	15.5	81.8
Total Expenditure	33,046.399	42,023.315	48,177.914	53,777.401	27.2	14.6	11.6	17.6
Health								
Current	9,016.203	12,929.554	14,093.214	15,361.603	43.4	9.0	9.0	19.4
Additional Resources		0.000	2,308.500	3,534.000	--	--	53.1	--
Total Current	9,016.203	12,929.554	16,401.714	18,895.603	43.4	26.9	15.2	27.9
Development	780.000	860.000	937.400	1,021.766	10.3	9.0	9.0	9.4
Total Expenditure	9,796.203	13,789.554	17,339.114	19,917.369	40.8	25.7	14.9	26.7
Population Planning								
Current	0.000	0.000	0.000	0.000	--	--	--	--
Additional Resources		0.000	364.500	558.000	--	--	53.1	--
Total Current	0.000	0.000	364.500	558.000	--	--	53.1	--
Development	746.000	746.000	813.140	886.323	0.0	9.0	9.0	5.9
Total Expenditure	746.000	746.000	1,177.640	1,444.323	0.0	57.9	22.6	24.6
Social Security and Social Welfare								
Current	507.026	535.543	583.742	636.279	5.6	9.0	9.0	7.9
Additional Resources		0.000	0.000	0.000	--	--	--	--
Total Current	507.026	535.543	583.742	636.279	5.6	9.0	9.0	7.9
Development	10.000	15.646	17.054	18.589	56.5	9.0	9.0	22.9
Total Expenditure	517.026	551.189	600.796	654.868	6.6	9.0	9.0	8.2
Natural Calamities & Disasters								
Current	23.715	23.147	25.230	27.683	-2.4	9.0	9.7	5.3
Additional Resources		0.000	0.000	0.000	--	--	--	--
Total Current	23.715	23.147	25.230	27.683	-2.4	9.0	9.7	5.3
Development	0.000	0.000	0.000	0.000	--	--	--	--
Total Expenditure	23.715	23.147	25.230	27.683	-2.4	9.0	9.7	5.3
Irrigation & Land Reclamation								
Current	6,563.708	5,796.247	6,317.909	6,886.521	-11.7	9.0	9.0	1.6
Additional Resources		0.000	303.750	465.000	--	--	53.1	--
Total Current	6,563.708	5,796.247	6,621.659	7,351.521	-11.7	14.2	11.0	3.8
Development	1,685.138	3,826.287	4,170.653	4,546.012	127.1	9.0	9.0	39.2
Total Expenditure	8,248.846	9,622.534	10,792.312	11,897.533	16.7	12.2	10.2	13.0
Agriculture								
Current	2,610.386	2,683.540	2,925.059	3,188.314	2.8	9.0	9.0	6.9
Additional Resources		0.000	303.750	465.000	--	--	53.1	--
Total Current	2,610.386	2,683.540	3,228.809	3,653.314	2.8	20.3	13.1	11.8
Development	656.620	737.000	803.330	875.630	12.2	9.0	9.0	10.1
Total Expenditure	3,267.006	3,420.540	4,032.139	4,528.944	4.7	17.9	12.3	11.5

Table 3 (Contd.): Punjab Government Expenditures, 2002/03-2005/06

	(Rs Million)				(Annual Percent change)			Average Growth
	2002/03	2003/04	2004/05	2005/06	2003/04	2004/05	2005/06	
Rural Development								
Current	395.683	428.710	467.294	509.350	8.3	9.0	9.0	8.8
Additional Resources		0.000	0.000	0.000	--	--	--	--
Total Current	395.683	428.710	467.294	509.350	8.3	9.0	9.0	8.8
Development	0.000	1,855.000	2,021.950	2,203.926	--	9.0	9.0	--
Total Expenditure	395.683	2,283.710	2,489.244	2,713.276	477.2	9.0	9.0	89.9
Housing								
Current	21.733	148.493	161.857	176.425	583.3	9.0	9.0	100.8
Additional Resources		500.000	0.000	0.000	--	--	--	--
Total Current	21.733	648.493	161.857	176.425	2883.9	-75.0	9.0	100.8
Development	97.000	129.000	140.610	153.265	33.0	9.0	9.0	16.5
Total Expenditure	118.733	777.493	302.467	329.689	554.8	-61.1	9.0	40.5
Safety Nets								
Current	0.000	2,090.174	2,278.290	2,483.336	--	9.0	9.0	--
Additional Resources	0.000	0.000	972.000	1,488.000	--	--	53.1	--
Total Current	0.000	2,090.174	3,250.290	3,971.336	--	55.5	22.2	--
Development	0.000	0.000	0.000	0.000	--	--	--	--
Total Expenditure	0.000	2,090.174	3,250.290	3,971.336	--	55.5	22.2	--
Access to Justice								
Current	12,153.886	15,776.795	17,196.707	18,744.410	29.8	9.0	9.0	15.5
Additional Resources		0.000	2,430.000	3,720.000	--	--	53.1	--
Total Current	12,153.886	15,776.795	19,626.707	22,464.410	29.8	24.4	14.5	22.7
Development	317.300	628.000	1,000.000	1,500.000	97.9	59.2	50.0	67.7
Total Expenditure	12,471.186	16,404.795	20,626.707	23,964.410	31.5	25.7	16.2	24.3
Total Pro-Poor Expenditure								
Current	66,040.240	79,543.268	86,702.162	94,505.538	20.4	9.0	9.0	12.7
Additional Resources	0.000	500.000	12,150.000	18,600.000	--	--	53.1	--
Total Current	66,040.240	80,043.268	98,852.163	113,105.538	21.2	23.5	14.4	19.6
Development	7,983.933	19,137.093	21,724.912	24,550.156	139.7	13.5	13.0	45.4
Total Expenditure	74,024.173	99,180.361	120,577.075	137,655.694	34.0	21.6	14.2	22.9
Other Expenditure								
Current	48,981.79	49,152.22	41,977.84	40,394.46	0.3	-14.6	-3.8	-6.2
Additional Resources	-	-	-	-	--	--	--	--
Total Current	48,981.79	49,152.22	41,977.84	40,394.46	0.3	-14.6	-3.8	-6.2
Development	16,163.55	11,362.91	11,516.50	11,680.07	-29.7	1.4	1.4	-10.3
Total Expenditure	65,145.34	60,515.13	53,494.33	52,074.53	-7.1	-11.6	-2.7	-7.2
Total Expenditure								
Current	115,022.032	128,695.489	128,680.000	134,900.000	11.9	0.0	4.8	5.5
Additional Resources	-	500.000	12,150.000	18,600.000	--	--	53.1	--
Total Current	115,022.032	129,195.489	140,830.000	153,500.000	12.3	9.0	9.0	10.1
Development	24,147.482	30,500.000	33,241.408	36,230.224	26.3	9.0	9.0	14.5
Total Expenditure	139,169.514	159,695.489	174,071.408	189,730.224	14.7	9.0	9.0	10.9

\1 The FY04-F06 figures exclude the effect of 15% pay and pension increase announced in the FY04 budget.

Table 4: Punjab -- Education Sector Expenditures \1

	<i>(Rs Million)</i>				<i>(Annual Percent change)</i>			Average Growth
	2002/03	2003/04	2004/05	2005/06	2003/04	2004/05	2005/06	
Primary Education \2								
Current	18,509.365	20,175.207	21,990.976	23,970.163	9.0	9.0	9.0	9.0
Additional Resources		0.000	850.500	1,302.000	--	--	53.1	--
Total Current	18,509.365	20,175.207	22,841.476	25,272.164	9.0	13.2	10.6	10.9
Development	131.928	631.035	687.828	749.733	378.3	9.0	9.0	78.3
Total Expenditure	18,641.293	20,806.242	23,529.304	26,021.897	11.6	13.1	10.6	11.7
Secondary Education \2								
Current	7,367.442	8,025.127	8,747.388	9,534.653	8.9	9.0	9.0	9.0
Additional Resources		0.000	486.000	744.000	--	--	53.1	--
Total Current	7,367.442	8,025.127	9,233.388	10,278.653	8.9	15.1	11.3	11.7
Development	422.457	0.000	0.000	0.000	-100.0	--	--	-100.0
Total Expenditure	7,789.899	8,025.127	9,233.388	10,278.653	3.0	15.1	11.3	9.7
General Universities & Colleges								
Current	3,002.386	3,291.816	3,588.079	3,911.007	9.6	9.0	9.0	9.2
Additional Resources		0.000	486.000	744.000	--	--	53.1	--
Total Current	3,002.386	3,291.816	4,074.079	4,655.007	9.6	23.8	14.3	15.7
Development	215.127	241.320	263.039	286.712	12.2	9.0	9.0	10.0
Total Expenditure	3,217.513	3,533.136	4,337.118	4,941.719	9.8	22.8	13.9	15.4
Professional Universities & Colleges								
Current	858.625	545.199	594.267	647.751	-36.5	9.0	9.0	-9.0
Additional Resources		0.000	0.000	0.000	--	--	--	--
Total Current	858.625	545.199	594.267	647.751	-36.5	9.0	9.0	-9.0
Development	0.000	4.000	4.360	4.752	--	9.0	9.0	--
Total Expenditure	858.625	549.199	598.627	652.503	-36.0	9.0	9.0	-8.7
Teacher & Vocational Training								
Current	0.000	40.337	43.967	47.924	--	9.0	9.0	--
Additional Resources		0.000	0.000	0.000	--	--	--	--
Total Current	0.000	40.337	43.967	47.924	--	9.0	9.0	--
Development	105.269	46.806	51.019	55.611	-55.5	9.0	9.0	-19.1
Total Expenditure	105.269	87.143	94.986	103.535	-17.2	9.0	9.0	-0.6
Others \3								
Current	1,952.636	3,969.629	4,326.896	4,716.316	103.3	9.0	9.0	34.1
Additional Resources	0.000	0.000	0.000	0.000	--	--	--	--
Total Current	1,952.636	3,969.629	4,326.896	4,716.316	103.3	9.0	9.0	34.1
Development	481.164	5052.839	6057.595	7062.778	950.1	19.9	16.6	144.6
Total Expenditure	2,433.800	9,022.468	10,384.491	11,779.094	270.7	15.1	13.4	69.1
Total Education								
Current	31,690.454	36,047.315	39,291.573	42,827.814	13.7	9.0	9.0	10.5
Additional Resources	0.000	0.000	1,822.500	2,790.000	--	--	53.1	--
Total Current	31,690.454	36,047.315	41,114.073	45,617.815	13.7	14.1	11.0	12.9
Development	1,355.945	5,976.000	7,063.841	8,159.586	340.7	18.2	15.5	81.8
Total Expenditure	33,046.399	42,023.315	48,177.914	53,777.401	27.2	14.6	11.6	17.6

Source: Government of Punjab, Medium-Term Budget Framework as given in the 2003/04 White Paper.

\1 For 2003/04-2005/06, the expenditure projections exclude the impact of 15% salary increase made in the 2003/04 budget.

\2 Estimates exclude the allocation made to the sub-sector from the Punjab Education Sector Reform Program.

\3 Includes the allocations for PESRP. The PESRP allocations for 2003/04 are entirely for elementary education, while for 2004/05 and 2005/06 these may include elementary as well as secondary education.

21. **Resource mobilization:** Overall, the MTBF indicates a significant improvement in medium-term fiscal outlook of Punjab. A bulk of this improvement is to come from an expected increase in transfers from the federal government. As per the federal government medium-term fiscal framework,³³ the federal transferable revenue (tax and non-tax) is projected to increase by 11% per annum. On the assumption that the new NFC Award, which is expected to be announced during 2003/04 and which will be implemented from 2004/05 onwards, the share of the province in total divisible pool will improve from 37.5% to 40%.³⁴ Federal revenue transfer to Punjab is thus projected to increase by about 50% (i.e., 14.5% per annum) over the projection period.³⁵

³³ As agreed with the IMF under the Poverty Reduction Growth Facility (PRGF).

³⁴ The new NFC is expected to be announced in 2003/04 and would apply from the 2004/05 budget. To date there has been serious consideration within the NFC to increase the share of provinces from 37.5% to 40%. Furthermore, revenue from additional 2.5% of GST will be transferred (as per the present practice) to the provinces as straight transfers (for onwards transfer to the local governments), making the provincial share in overall federal taxes close to 44%.

³⁵ Almost the same rate of growth is projected for both the province's own revenue and federal revenue transfers.

22. The provincial government remains determined to reverse the trend of reduction in provincial revenue effort with every large-scale increase in federal revenue transfers. Despite the significant increase expected in federal revenue transfers, the provincial government is projecting an increase of 13% per annum (i.e. Rs. 9 billion over the three years) in provincial tax and non-tax revenue. This is based on additional revenue of Rs. 4 billion expected in 2004/05 and Rs 3.5 billion in 2005/06 on account of additional measures on Agricultural Income Tax (AIT), Urban Immovable Property Tax (UIPT), replacement of Motor Vehicle Tax with a fuel-based levy, converting specific Stamp Duties to *ad valorem* bases, levying of water charges (*abiana*) on irrigation as a flat rate,³⁶ and rationalizing of other user charges. In addition, a significant increase is also anticipated from the taxes and user charges in the domain of the local governments.

Table 5: Punjab Government Revenue

	(Rs Billion)				(Annual Percent change)			Average Growth
	2002/03	2003/04	2004/05	2005/06	2003/04	2004/05	2005/06	
Total Revenue	129.061	152.821	168.116	188.412	18.4	10.0	12.1	13.4
Federal Revenue Transfers	96.153	106.734	128.749	144.402	11.0	20.6	12.2	14.5
Tax Revenue	106.365	118.156	142.127	159.575	11.1	20.3	12.3	14.5
CBR Revenue	92.741	103.161	124.843	140.135	11.2	21.0	12.2	14.7
Direct Taxes	28.187	31.321	38.208	41.727	11.1	22.0	9.2	14.0
Excise Duties	8.946	9.217	10.647	11.627	3.0	15.5	9.2	9.1
CED on Gas	0.323	0.308	0.363	0.396	-4.7	17.8	9.2	7.1
Other	8.623	8.909	10.284	11.231	3.3	15.4	9.2	9.2
Sales Tax	41.385	46.663	56.156	64.748	12.8	20.3	15.3	16.1
GST on Goods	39.868	44.976	54.242	62.541	12.8	20.6	15.3	16.2
GST on Services	1.518	1.686	1.914	2.207	11.1	13.5	15.3	13.3
Custom Duties	14.222	15.959	19.832	22.033	12.2	24.3	11.1	15.7
Surcharges	1.056	0.908	0.993	1.084	-13.9	9.3	9.1	0.9
Petroleum	0.000	0.000	0.000	0.000	--	--	--	--
Gas	1.056	0.908	0.993	1.084	-13.9	9.3	9.1	0.9
Royalties od Oil & Gas	2.356	2.665	2.913	3.183	13.1	9.3	9.3	10.5
Royalty on Crude Oil	1.386	1.496	1.635	1.787	7.9	9.3	9.3	8.8
Royalty on Gas	0.970	1.170	1.278	1.397	20.6	9.3	9.3	12.9
Provincial Own Revenue \1	21.809	32.387	24.867	28.610	48.5	-23.2	15.1	9.5
Provincial Tax & Non-Tax	19.883	20.825	24.867	28.610	4.7	19.4	15.1	12.9
Provincial Taxes	12.568	14.087	16.291	18.356	12.1	15.6	12.7	13.4
Provincial Non-Taxes	7.315	6.739	8.575	10.254	-7.9	27.3	19.6	11.9
Privatization Proceeds	1.926	7.479	0.000	0.000	288.4	--	--	--
Maturity of Investments	0.000	4.083	0.000	0.000	--	--	--	--
Grants	11.100	13.700	14.500	15.400	23.4	5.8	6.2	11.5

\1 The FY04 figures include estimated revenue from new tax and non-tax measures taken by the government.

23. **Provincial-local fiscal relations:** Realizing that local governments have a key role in its poverty reduction strategy, the provincial government is making serious efforts to improve the finances of the local governments. Fiscal transfers to the district governments are budgeted to be 25% higher than last year's budget (but only 7% higher than the revised estimates). In addition, allocation for local governments' development program (in the Annual Development Program) is kept at Rs 9 billion -- the same as last year's budget, but 23% lower than the revised estimates. These transfers, however, exclude the transfers under the PESRP. Nevertheless, with a large portion of this increase likely to be preempted by salary increases, the non-salary allocations by the district governments, even for the key sectors like education, may not be adequate.

³⁶Despite some equity issues in levying of water charges, this measure is expected to yield significant additional revenue by making evasion and avoidance more difficult and by reducing the collection costs.

Table 6: Provincial Transfers to the Local

(Rs Million)

	FY03 Budget	FY03 Revised	FY04 Budget	Percentage Increase	
				FY04 Vs FY03 BE	FY04 Vs FY03 RE
District Governments	43,043.560	50,858.699	54,309.330	26.2%	6.8%
TMA ¹	3,765.200	6,792.625	6,847.120	81.9%	0.8%
Union Admins	2,410.824	2,702.160	2,702.160	12.1%	0.0%
Total	49,219.584	60,353.484	63,858.610	29.7%	5.8%
Development	9,000.000	11,858.353	9,000.000	0.0%	-24.1%
Total	58,219.584	72,211.837	72,858.610	25.1%	0.9%

¹ Tehsil Municipal Administration (TMA).

Provincial debt management strategy

24. **The debt problem:** Coupled with the weak revenue position, the Punjab government faces a large debt overhang. As per the Constitution, the provincial government can only borrow from, or with the permission of, the federal government. The federal government, until the last three years, has been providing the provincial government with Cash Development Loans (CDLs) to finance a part of its development program. Another significant part of the provincial development program is financed by donor assistance, the grant component of which has been declining over the years. As a result, the debt burden of Punjab government has been increasing quite rapidly (see Table 7).

Table 7: The Growth in Main Components of Punjab Government's Debt.

(Rs Million)

	Rs million			Average Annual Growth			Debt as a % of Revenue
	CDL	Foreign Loans	Total	CDL	Foreign Loans	Total	
1971/72	998.900	341.700	1,340.600	--	--	--	92.9%
1981/82	9,516.000	1,478.900	10,994.900	25.3%	15.8%	23.4%	120.4%
1991/92	54,464.900	5,341.500	59,806.400	19.1%	13.7%	18.5%	149.5%
2001/02	85,962.865	41,321.031	127,283.896	4.7%	22.7%	7.8%	118.2%
2002/03	83,742.474	47,476.406	131,218.880	-0.3%	1.4%	0.3%	100.0%

25. While a large portion of these loans went to finance social and community services, the CDLs carried a significant interest rate. In addition, the Punjab government has accumulated a large amount in "deferred liabilities" by utilizing employees' contributions towards their General Provident Fund (G.P. Fund) for financing current payments made from the G.P. Fund and for other budgetary expenditures. The unfunded nature of G.P. Fund, the liabilities of which carry a very high interest rate adds to the overall indebtedness of the provinces.

26. Despite the decline in market and administered interest rates, the interest on provincial debt averages about 11% (see Table 8). As a result, debt servicing, especially that of CDLs, places a major burden on provincial budget by taking significant resources away from other high-priority areas, and leaving little for spending on developmental activities and on critical social sectors. In short, the ability of the provincial government to perform its core functions effectively and provide the bare minimum services has been adversely affected by the debt burden.

Table 8: Composition of Punjab Government's Outstanding Debt*(Rs Million)*

	Loans	Average Interest Rate	Outstanding Debt (June 30,2003)	Percent of Total
a.	Rupee loans received from Federal Govt.	14.625%	83,742.47	57.18
b.	Counterpart fund rupee loans	2.300%	33.876	0.02
c.	Foreign exchange loans	1.090%	47,442.53	32.39
d.	16% Punjab Loan 2004	16.000%	106	0.07
e.	17.50% Punjab Loan 2008	17.500%	75.747	0.05
f.	General Provident Fund Accumulations	19.915%	15,056.58	10.28
	Total	10.784%	146,457.21	100

Source: Punjab Government's budget documents.

27. **The debt management strategy -- Enhancing the sustainability of high-priority programs:** The Punjab government realizes that in order to enhance budgetary allocations for key social services on a sustainable basis, provincial debt burden has to be reduced to more sustainable levels. The government has formulated a debt management strategy having three important components:

i) Swapping High Cost Loans With Low Cost Loans: Taking advantage of the recent decline in market interest rates, the Punjab government intends to borrow funds from the domestic financial sector for early retirement of more expensive CDLs. However, it is unlikely that the government would be able to borrow amounts large enough to make a significant impact on province's budgetary position. The other alternative is for the government to raise loans through floating its own securities. In this case, the provincial government will have to offer its securities for open subscription on terms and conditions more attractive to the public than instruments presently available in the market. Hence borrowing from the international donors at concessional rates remains the most viable option for the provincial government to retire its most expensive debt and create some fiscal space for enhancing high-priority expenditure. To this end, the Punjab Government has signed a Memorandum of Understanding with the Asian Development Bank for *Punjab Public Resource Management Program (PRMP)* Loan of US \$450 million for the period 2003/04 to 2007/08.

ii) Privatizing Public Sector Enterprises and other Properties: At present, fifty public properties, with an assessed value of about Rs 3 billion are with the Punjab Privatization Board, and are expected to be sold during 2003/04. In addition, another 510 properties are with the District Privatization Committees, with a total assessed value of Rs 1.2 billion. Thus the provincial government expects about Rs 4.2 billion in proceeds from privatization of these properties. Moreover, the Punjab government anticipates generation of substantial amounts through sale of government land under illegal occupation. The amount so generated, along with proceeds from policy-based International Financial Institution (IFI) loans would help the Punjab government to retire Rs 15 billion of its more expensive CDLs in FY04. This would bring a saving of Rs 1.7 billion during 2003/04. This fiscal space would be utilized for spending on pro-poor sectors.

iii) Professional Management of Provident Fund Schemes: As mentioned above Rs.15 billion debt of the provincial government is in the form of G.P. Fund accumulations, bearing an average compound interest rate of 19.915% per annum. In 2003/04, the estimated cost of interest payment on G.P. Fund liability alone is Rs 3.6 billion. The rate of interest on the G.P. Fund is exceedingly high and is financially unsustainable. The high rate of interest and the unfunded nature of the G.P. Fund are likely to create a major financial problem for the provincial government. The Punjab government has constituted a committee to examine the financial viability of the G.P. Fund and pension schemes and to suggest ways to convert them into professionally managed funds, so that the budgetary implications of the G.P Fund and pensions can gradually be phased out, thus enhancing the future sustainability of high priority provincial expenditures.

Annex D: Ad hoc PAC (Punjab) Recommendations

I – Accountability

1. In its previous Reports (1996-97 and 1997-98), the Committee pointed out its concern over the indifference of the departments concerned, including the Finance department, to report progress of action taken on PACs' directives in the years gone by. The Committee was disappointed at the lack of appreciation on the part of most of the Principal Accounting Officers (PAOs) that the implementation of PAC directives is an important link in the Accountability cycle. These directives and suggestions are formulated after detailed examination of their Accounts and working papers in response to Audit paras. Unless these are implemented promptly in letter and spirit, the process of system improvement for the purpose of reducing the incidence of irregularities, misappropriations etc in future, will remain impeded. It needs no emphasis that Accountability exercise would remain sterile if it did not lead to suitable tightening of controls and system improvements so that loopholes are plugged for better financial management. The Committee was dismayed to see that the PAOs have in most cases relied on their subordinates field staff to provide the departmental replies and explanations in response to audit observations. These replies were forwarded to the PAC Secretariat without review at a higher, more responsible level. The members of the Committee could not escape the impression that the departmental replies in the working papers had been prepared at the lower levels with the primary objective of defending and protecting even the clearly erring officials.

2. Alternatively, there were obvious attempts at passing on the blame conveniently on those who had since retired or expired – still better if they happened to be junior functionaries. It has unfortunately become an almost well established practice with the departments not to initiate any action on the contents of the Audit reports till a notice of a forthcoming PAC meeting is received. All efforts appear to be directed towards delaying as long as possible proper investigation or inquiries into the misappropriation and losses pointed out by Audit. Even such objections as can be resolved through simple verification or production/correction of record or not attended to promptly.

3. The indifference on the part of the executive has, for most of the officers, become the norm. The ad hoc PAC came across instances of this casual attitude so frequently that it has been wondering whether the mechanism for enforcing accountability on the basis of Audit Report and PAC meetings has not broken down. It appears to have degenerated into an ineffective routine of going through the motion of the exercise without achieving any constructive and lasting results. The directive for disciplinary action and recoveries do not appear to have had much effect in the area of providing sufficient warning to others to desist from mal practices. There is hardly any change in the attitude towards the positive direction of honest conformity with the prescribed Rules and Regulations. Canons of financial propriety are all but forgotten.

4. During their examination of the Appropriation Accounts and Audit Report, the members of the Committee had opportunities of discussing among themselves as well as with the Administrative Secretaries, the measures that need to be taken to ensure the enforcement of prompt and effective accountability with the twin objectives of punishing the guilty and improving matters for the future. As a first step, it appeared necessary to analyze the reason due to which the desired results were apparently not being achieved from the elaborate and costly systems of maintaining accounts, preparing audit reports, convening PAC meetings, and issuing directives and recommendations. The Committee identified the following main factors that might have contributed to the deterioration of the effectiveness of the accountability process: -

(i) There is an apparent lack of appreciation on the part of the administrative secretaries and senior officers that the Accounts and audit Reports can and should be utilized by them to assist them in their overall function of management and control of their departments. The reaction of most of them to audit observations is restricted to defending or justifying the actions of the subordinates or predecessors. They are satisfied if their departments' explanations for the financial irregularities, losses etc pass muster with PAC, and the paras are settled, dropped or kept pending for consideration in a later meeting. This approach results in two main drawbacks – both of which undermine the effectiveness of the accountability process. First, in a majority of cases, no action is initiated by the PAOs till a notice of PAC meeting is received. The result, of course, is that the persons responsible for misappropriations and irregularities have a great chance of completing their tenure of service (and drawing full retirement benefits) without being brought to book. This does not set a good example for others. Since the departmental working papers are prepared at short notice, the PAOs are not usually aware of the full implications of audit objections and the department's own stand in the matter. This is not helpful to the PAC work, and time is unnecessarily spent on long discussions to be followed by a postponement to allow the PAO concerned to review the matter at his own level. Secondly, most of the PAOs do not appear to attach any importance to the need for result-oriented follow –up action by their departments on the PAC directives given after detailed discussions. They tend to await the issue of formal minutes of the PAC proceedings and prefer to relegate to watch over compliance of the directives to relatively junior functionary. Their lack of personal interest in this aspect of the accountability process results in unsatisfactory progress in completing the requisite disciplinary action, enforcing recovering or plugging loopholes in financial procedures or supervisory control etc.

(ii) Delays in constituting PACs and the interruption in their work from time to time have also led to accumulation of heavy backlog of old audit paragraphs and Accounts that have still to be discussed and settled. In the absence of PACs, the department tends to accord very low priority to consideration of outstanding Accounts and Audits Reports. The absence of continuity in PAC work affects the accountability process. The growth of arrears of work to be tackle by the PACs when constituted, places considerable pressure for completing of examination satisfactorily within a reasonable period. At the same time, the department find it hard to trace and consult old records, get verification or reconciliation completed, and to prepare the necessary working papers for the PAC meetings. Even the audit department finds it hard to cope with the work it has to deal with in this situation. In most cases, it is not possible for the PAC as well as the departments and audit to do full justice to a proper and comprehensive disposal of the basic issues raised in the audit paras and accounts.

(iii) An important link in the accountability cycle is that concerned with the follow-up action to be taken by government on the recommendations and the directives of PACs after this discussion with the PAOs. Unfortunately, this function, which has been the responsibility of the monitoring wing of the finance department, has not received in recent years the serious and sustained attention it deserves. The result has been that the PACs' considered directives for enforcement of accountability or all but forgotten.

(iv) It is possible that the quality of account keeping and reporting may also have unwittingly contributed to the virtual devaluation of the significance and importance of the accountability process. If the account are shown (and subsequently accepted) to have been compile incorrectly because of misclassifications or carelessness, and the objection in audit paras are proved to have been raised hastily on insufficient evidence or without adequate support for audit conclusions, both the PACs as well as the PAOs cannot be blamed for erosion of confidence on the material presented by them. In such cases the natural reaction is to defer consideration till the accounts are reconciled and corrected, and the case of audit paras, agreement is reached on basic facts by reference to original records. Experience has shown that these can be quite lengthy,

contentious and time consuming processes. These cannot be avoided if truth is to be established, but when PACs have to wait for the outcome of these exercises before giving their verdict, the point of quick accountability is blunted.

5. The ad hoc PAC recommends that government may take serious note of deficiencies that have crept into process of legislative oversight and accountability. The in-service training of government servants of all levels should clarify and emphasize their roles and responsibilities in the matter of making proper use of accounts and audit reports in their work as well as in the area of accountability. The departmental accounts committees (DACs) and special departmental account committees (SDACs) should be activated so that they meet regularly. These committees should discuss the maximum number of audit objections so that necessary action is initiated and the earliest, and the draft paras are settled before the audit Reports are finalized and printed. Questions like production of record, and verification of facts and figures should be settled by these committees, so that the PACs are spared the unseemly controversies over whether the requisite record was or was not produced to Audit. Even after their printing and submission, there should be no bar on SDACs in discussing the audit paras and formulating recommendations for consideration by the PACs.

6. The Punjab ad hoc Public Accounts Committee Ordinance, 2002 provides that the Secretariat if the Provincial Assembly shall oversee implementation of the PAC's recommendations approved by the Governor. The monitoring of progress on PAC directives has got to be organized properly so that it becomes an effective activity of completion of the assignment entrusted to the PACs. Periodical reports should be compiled regularly for review by a sub-committee of the PAC. Alternatively, this review may be included among the functions of the Assembly's Standing Committees for the departments concerned. These Standing Committees have to play a significant role in examining their departments' performance in budgetary and financial areas, and there is no reason why they should not be associated with overseeing the progress in enforcement of accountability. The Committee suggest that adequate staff, facilities and equipment be provided to the Assembly Secretariat to enable it to discharge this key function of providing the necessary support to the PAC and Standing Committees satisfactorily. This oversight by the Assembly Secretariat may not be limited to watching and reporting on the implementation of the (approved) recommendations of the ad hoc PAC only, but may be continued in respect of similar recommendations of the previous and successor PACs also.

7. The Government may also consider the desirability of suggestion to the Speaker of the Provincial Assembly to constitute the PACs within a specified period (not exceeding a couple of weeks) of oath taking by the new MPAs. He may also have powers to set up ad hoc PACs during the periods the Assembly stands dissolved. These measures should help in maintaining continuity in the process of accountability, besides reducing the accumulation of unmanageable backlog of Accounts and Audit Reports.

8. The ad hoc PAC had decided to open its sessions to the media. By all accounts, this proved to be a step in the right direction. It is recommended that this should be continued; the transparency of PAC proceedings can play a significant role in enhancing the effectiveness of the accountability process. The desirability of arranging discussions or debates in the House on PAC Reports may also be considered.

9. The Committee recommends that the Accounts and Audit departments may seriously review their work procedures in order to enhance credibility in their output. The material for inclusion in the Accounts and Audit Reports should be carefully screened at experienced, senior levels to ensure accuracy and comprehensiveness. In cases where overpayment or losses have occurred due to negligence or laxity at the pre-check/pre audit stages by the divisional accountants or the

staff in the Accounts offices, appropriate action must be initiated against persons involved. These and other necessary measures should be aimed at restoring the credibility and integrity of the independent accounts and auditor functions that provide the main plank for accountability.

10. The Committee considers that it is very important that the officers and staff of all departments should undergo suitable training in selecting areas of budgeting, financial management, accounting, audit and accountability. All training courses at the H.R. Development Institute, NIPA and PASC should include carefully design modules in these subjects for the instruction and guidance of the participants of their courses. At the same time, it would be very helpful if the Audit and Accounts training institutes also develop and used in their training courses suitable modules on the organization, procedures, internal controls, governing instructions etc of the major Government departments.

11. The effectiveness of the accountability process can be enhanced if the Public Accounts Committees are vested with adequate powers to impose fines or punishments. These would be particularly useful in such cases as submission to them of misleading or incorrect explanations, flagrant disregard of or delay in initiating appropriate action on their (approved) directives and recommendations.

II – Internal Controls

12. The overall impression gained by the Ad hoc PAC after its discussions and disposal of the outstanding accounts and Audit Report was that a very significant proportion of the audit paras arose out of the carelessness in protecting public interest. There were many cases of breach of clear-cut provisions of the rules governing delegation of financial powers, procedures for the award of and administration of contracts for work and purchases, and maintenance of proper accounts and records. Detailed instructions exist for budget preparation, for control over expenditure, for prompt and full realization of Government dues, and for safeguarding government assets. There are relatively very few areas of ambiguity leading to difference in interpretation of the real intention of a rule or instruction. Yet even a percentage check by external, independent auditors reveal a large number of deviations from these elaborate instructions year after year in all the major departments. It would be natural to conclude that a much larger number of irregularities would be unearthed if the quantum of audit effort were to be raised.

13. This also shows that the departments' own internal controls and procedures for supervision and guidance by senior and experienced officers are not working. It would be obviously be a more cost-effective approach with long-term benefits to strengthen the internal working of the departments than to increase audit coverage. The control systems need to be reviewed, reinforced and implemented with a judicious injection of available (and proven) technologies. The object should be to establish the basic principles of sound financial management on a firm and honest footing at the points and time of initial transactions. This also calls for appreciating the usefulness of providing, through in-service training and refresher courses for the staff and their supervisors, a sufficient understanding of the essentials of financial rules and regulations. This is necessary particularly in the Health and Education departments in which professional personnel have problems in coping with unfamiliar rules on their appointment to administrative positions, and are sometime mislead into transgressing the canons of financial propriety.

Annex E: List of Principal Persons Met

<u>S.NO</u>	<u>NAME</u>	<u>POSITION</u>	<u>DEPARTMENT/OFFICE/ORG.</u>
1.	Mr. Salman Saddique	Secretary Finance	Finance Department
2.	Mr. Wazir Ali Qureshi	Accountant General	Accountant General
3.	Mr. Anis Marghoob Siddiqui	Director General Provincial Audit	Pakistan Audit Department
4.	Mr. Sheikh Rasheed Ahmad	Director General District Audit	Pakistan Audit Department
5.	Mr. Yawar	Deputy AG – District Accounts	Accountant General
6.	Mr. Saqlain	Deputy AG	Accountant General
7.	Mr. Arshad	PIFRA Director, Lahore	PIFRA
8.	Mr. Haroon Sharif	Sr. Economic Advisor	DFID
9.	Ms. Safia Aftab	Economic Advisor	ADB
10.	Mr. Ahmad Raza Sarwar	Deputy Secretary (Resources)	Finance Department
11.	Mr. Muhammad Arshad	Deputy Secretary (Budget)	Finance Department
12.	Mr. Rab Nawaz Khan	Deputy Secretary (Monitoring)	Finance Department
13.	Mr. Mohammad Zubair	Chief Inspector of Treasuries	Finance Department
14.	Mr. Peter Brooke	Consultant	DFID
15.	Dr. Shujat Ali	Project Director	PRMP
16.	Mr. Waseem Ajmal	Executive District Officer (Finance & Planning)	District Government Faisalabad
17.	Mr. Akhter	District Accounts Officer	Faisalabad
18.	Mr. Khateeb Alam	Country Representative	GHK Consulting
19.	Mr. Mushtaq Sawati	Accounts Officer	AGPR PIFRA Site Islamabad

Annex F: Primary Documents Reviewed

<u>S.NO</u>	<u>DESCRIPTION</u>
1.	Islamic Republic of Pakistan – Country Financial Accountability Assessment World Bank, December 30, 2003
2.	Pakistan Public Expenditure Management (Strategic Issues & Reform Agenda)-World Bank January 28,2004
3.	Accelerating Economic Growth & Reducing Poverty, The Road Ahead, Poverty Reduction Strategy Paper Government of Pakistan December, 2003
4.	World Bank-Aide-Memoir Pre-appraisal of PIFRA II (February 10-22, 2004)
5.	World Bank: Pakistan: Country Assistance Strategy FY 2003-05
6.	Pakistan Sector Assessment Review- Asian Development Bank October, 2003
7.	Pakistan Interim Poverty Reduction Strategy Paper (I-PRSP), November, 2001
8.	World Bank, Provincial Financial Accountability Assessment, NWFP February 15, 2003
9.	World Bank, Final Draft Provincial Financial Accountability Assessment, Sindh July 23, 2003
10.	Punjab Provincial Poverty Reduction Strategy Paper, October, 2003
11.	World Bank, Punjab Economic Report, October 30, 2004
12.	Program & Technical Assistance Loans-Decentralization Support Program Pakistan (Asian Development Bank) – RRP and other documents
13.	Review of Materials Relating to the Pakistan Fiduciary Risk Assessment, DFID, June 2004
14.	How To Guidelines on FRA - DFID
15.	Revised Consultative Draft, February 12, 2004 – PFM Performance Measurement Framework
16.	World Bank CFAA Reports of various countries
17.	ADB - Punjab Resource Management Program, Program Documents, Outputs of Technical Assistances (Component 1 and Component 2)
18.	Finance Department Government of Punjab - Provincial Finance Commission Award
19.	NFC Secretariat-Government of Pakistan, Report of the National Finance Commission 1996
20.	New System of Financial Control & Budgeting- Government of Pakistan, 30 June, 2000
21.	Budget Documents for 3 years
22.	Punjab - White Paper
23.	Audit and PAC Reports
24.	Budget Call Circular 2004 – 2005
25.	Economic Survey 2002-03- Pakistan

26. Pakistan Investor Guide Book (Draft Final Report) 12 January, 2004
Europe Aid
27. Auditor General (Functions, Powers and Terms & Conditions of Service),
Ordinance 2001
28. Controller General of Accounts (Appointment, Functions & Powers), Ordinance 2001
29. Constitution of Islamic Republic of Pakistan, 1973
30. The Punjab Local Government Ordinance, 2001
31. The Punjab Local Government (Budget) Rules, 2001
32. The Punjab Local Government (Accounts) Rules, 2001
33. The Punjab District Government Rules of Business, 2001
34. New Financial Audit Manual – Auditor General of Pakistan
35. Minutes of Meetings of PAC 1 and PAC 2
36. IMF – ROSC on Fiscal Transparency, 2002
37. Transparency International – Country Report on Pakistan, 2003
38. Punjab Performance Budget, 2000-2001
39. DFID – Performance Budgeting Guide (CIPFA), 2002 for training in Faisalabad and
Multan Districts
40. New Accounting Model
 - (a) Accounting Policies & Procedure Manual, Exposure Draft, Auditor General of
Pakistan June, 1999
 - (b) Financial Reporting Manual Exposure Draft, Auditor General of Pakistan
March, 2003
 - (c) Accounting Policies & Procedure Manual, Books of Forms, Exposure Draft.
Auditor General of Pakistan March, 2003
 - (d) Manual of Accounting Principles, Exposure Draft, Auditor General of Pakistan
June, 1999
 - (e) Chart of Accounts, Exposure Draft. Auditor General of Pakistan August, 2003
 - (f) Accounting Code for Self-Accounting Entities, Exposure Draft, Auditor General of
Pakistan March, 2003
 - (g) Hand Book of Accounting Guidelines, Exposure Draft, Auditor General of Pakistan
March, 2003
 - (h) NAM Training Manual Part I and II
 - (i) Mapping of DDOs AGPR Islamabad
 - (j) Input Documents in the SAP R/3 System
41. General Financial Rules
42. Treasury Rules of The Federal Government, 1947
43. Rules of Business, 1973
44. Punjab Budget Manual 1987
45. Central Public Works Department Code
46. Central Public Works Accounts Code

47. Account Code (General Principles & Methods of Accounts)
48. Audit Code
49. Civil Establishment Code
50. *District Planning Manual 2002 (Planning & Development Board, Government of the Punjab)*
51. Civil Accounts of Punjab
52. Combined Civil Accounts of Punjab
53. Monthly Civil Accounts of Punjab
54. List of Outputs from AG Punjab Site of PIFRA
55. Budget and Accounts of District Government Faisalabad
56. Budget and Accounts of TMA Faisalabad
57. Monthly Report on Development Expenditures, Faisalabad
58. World Bank – Punjab Education Sector Adjustment Credit, 2004
59. World Bank – Pakistan Structural Adjustment Credit
60. World Bank – Structural Adjustment Credit, NWFP
61. World Bank – Structural Adjustment Credit, Sindh

