

I. Introduction

1. Study Background

The 1997 financial crisis in Asia exposed structural weaknesses in the banking and corporate sectors of affected countries, owing largely to poor governance, lack of transparency, and weak supervision and regulation.³

The Asian Development Bank (ADB) has been taking a number of initiatives to assist Developing Member Countries (DMCs) in overcoming these structural problems. The focus on improved governance includes enhancing the effectiveness of public administration and development management at the sector level and in national institutions in the DMCs. Where appropriate, institutional development of the local and provincial agencies and the private sector is also covered. A sound regulatory financial framework and its enforcement, capable institutions, skilled human resources, and effective monitoring and supervision are important prerequisites to an efficient financial structure.

Regional Technical Assistance (RETA) No. 5877 – *Strengthening Financial Management and Governance in Selected DMCs* – was approved by ADB for the purpose of carrying out initial studies to identify gaps and weaknesses in financial management and governance and to recommend courses of action to overcome these problems.

2. Objectives

ADB has demonstrated its stand on the importance of good governance, through effective financial management, for sustained economic development. This RETA involved a diagnostic review of the existing accounting and auditing support, and standards in the selected DMCs. After carrying out this diagnostic review, the study assessed the need for assistance to improve the current situation. Objectives were to:

- (i) assess the capability and capacity within each country to provide efficient and effective accounting and auditing support, to meet international standards and best practices, and address the issue of training and capacity enhancement

³ Zhuang, Juzhong, David Edwards, David Webb and Ma. Virginita Capulong. 2000. *Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand*. Asian Development Bank: Manila.

- (ii) determine the existing accounting and auditing standards of each country
- (iii) assess the degree of deviation from International Accounting and Auditing Standards (IAAS) while identifying weaknesses and possible corrective options
- (iv) discuss the fieldwork findings and introduce the concepts of the international standards through workshops
- (v) develop reference materials for potential users of the IAAS, and
- (vi) determine the level and type of assistance needed by each country in order to provide acceptable accounting and auditing support to the private and public sectors.

3. Scope

The RETA involved an in-depth study of the key issues relating to accounting and auditing support in the selected DMCs, identified gaps and weaknesses that need to be addressed to improve accounting and auditing support, and developed assistance programs in collaboration with other donors to rectify the identified weaknesses. Pakistan was one of seven countries participating in the RETA.

4. Country Case Studies and Workshops

The first part of this study examined the current accounting and auditing structure and systems adopted in Pakistan. It also (i) analyzed the political, institutional, regulatory and legal framework on accounting and auditing practice in Pakistan, and the level of enforcement of existing laws, rules, and regulations, (ii) identified gaps and weaknesses in accounting and auditing support available and deviations from international standards, and (iii) identified alternative options to remedy the identified weaknesses, with the objective of eventually doing away with these.

The second part of this study disseminated the findings of the country research through in-country workshops. The workshops provided a cross-section of views on the findings of the research and established ways to move forward to improve financial management and governance in the country. After carrying out the assessment of accounting and auditing support in Pakistan, the study findings and recommendations were discussed at a workshop in Islamabad on 5-6 June 2000, and at an international conference at ADB Headquarters in

Manila from 16 - 18 October 2000. This report incorporates feedback from the Workshop and the Conference.

5. ADB Focus on Financial Governance in Pakistan

The main focus of ADB's operational strategy in Pakistan is poverty reduction and good governance is a core part of this strategy. This RETA complements other ADB initiatives that will lead to improved financial management and governance.

6. Pakistan

Pakistan is an Islamic Republic and its capital is Islamabad. Pakistan has four provinces: Baluchistan, North West Frontier Province (NWFP), Punjab and Sindh. Their respective capitals are: Quetta, Peshawar, Lahore and Karachi. In addition to these provinces is the Federal Administered Northern Area (FANA), which is divided into the districts Dramer, Ghanche, Ghizer, Gilgit, and Skardu. There are also Federally Administered Tribal Areas (FATA).

Pakistan has a population of over 140 million. At present, the growth rate is 2.8 percent per annum. The major cities are Karachi (10 million), Lahore (5.5 million), Faisalabad (2 million), Rawalpindi (928,000), Hyderabad (800,000), and Islamabad (340,286).

The density of religions is Muslim (97 percent), Hindu (1.5 percent), Christian (1 percent) and several other minor religious groups. The national language is Urdu while the official language is English.

Pakistan's major exports include raw cotton and cotton products, rice, fish, carpets and leather goods. Major imports include tea, petroleum, milk agricultural machinery, transport equipment and medicines. Major trading partners are the United States, Japan, Germany, United Kingdom and Hong Kong.

The metric system is used as the official system of weights and measures. The basic unit of currency is the Rupee and exchange rate is PRe56.88 = US\$1.00 as at 5 November 2000.

Pakistan's assets include a rich cultural heritage, abundant natural and human resources, a large and potentially more productive agricultural sector, and a strategic location for trade. Although Pakistan has been burdened by internal political instability and costly regional conflicts in its first 50 years of independence, it has still managed to achieve substantial economic growth.

While Pakistan's social welfare indicators have improved over the past two decades, progress remains slow and the challenges daunting. Only 40 percent of the population is literate, compared to the average literacy rate of 49 percent in the South Asia and 53 percent in low-income countries worldwide.

7. Project for Improving Financial Reporting and Auditing

In the case of Pakistan, many improvements to financial reporting and auditing have been identified by the Pakistan Audit Department (PAD), the World Bank (WB) and selected consultants and included in the "Project for Improvement to Financial Reporting and Auditing" (PIFRA).

Internal and external studies for PIFRA commenced in the early 1990s and the Project eventually was approved and commenced in 1997. The Project has two main components:

- To improve the public sector accounting and financial systems; and
- To provide the basis for enhancing public sector accountability.

Where appropriate, reference has been made throughout this study to both the current system and the recommended systems and procedures with most emphasis being placed on the latter. Reference should be made to the chapter on Donor Assistance for a comprehensive analysis of the PIFRA Project.