

FIDUCIARY SYSTEMS ASSESSMENT

A. Introduction

1. The Energy Sector Reforms and Financial Sustainability Program (ESRFSP) will help Pakistan reduce the fiscal, governance, technical, and policy deficits in energy sector, which adversely impact sectoral sustainability and affordability and challenge the fiscal balance and macroeconomic stability of Pakistan. The program will (i) secure financial sustainability by reducing circular debt flow and stock; (ii) strengthening governance by rationalizing competitive market roadmap, separation of policy and regulatory functions in hydrocarbons sector, appointment of appellate tribunals, implementation of multiyear tariffs and unbundling of gas sector; and (iii) reinforcing infrastructure and supply system improvement by focusing on integrated planning and complementary public and private sector investment across the energy supply chain.

2. The ESRFSP is a budgetary support program for the Government of Pakistan and will assist the government in implementing the energy sector reforms with Asian Development Bank's (ADB) financing. Fiduciary risk assessment has been carried out as part of the preparation of ESRFSP. Program has been developed in line with the International Monetary Fund (IMF) facility to align with the overall economic reforms of the government.

B. Information Source

3. This fiduciary systems assessment was drawn from latest public financial management assessment conducted by development partners and applicable public financial and fiscal legislations in vogue and is intended to determine the degree to which the systems—for public financial management (PFM), procurement management, and anticorruption measures—will be able to manage fiduciary risks and provide assurance that program funds will be used for the intended purposes, with due consideration for economy and efficiency.

4. The primary PFM assessments include (i) the Public Expenditure and Financial Accountability (PEFA) PFM assessment, and (ii) a review of financial controls and accountability mechanism prevalent within the country, reforms initiative taken by the government and detailed mechanism provided by Public Finance Management Act, 2019 for management of public finances. The anticorruption assessment reflects the government's good governance and its strong will to eliminate the corruption within the country. National Accountability Bureau is actively contributing in government's efforts and is implementing across the board accountability without any compromise.

C. Financial Management System

5. The fiduciary-related financial management system assessment focused on accountability and transparency of the financial management system. A latest PFM assessment is in process and the result has not yet been made public on PEFA website.

6. Last PEFA assessment was completed in 2012. According to that assessment, country-level PFM arrangements have many strengths. This PEFA assessment has been undertaken as a follow up to the 2009 PEFA Assessment for Pakistan. Measured against the six core PFM objectives examined by the assessment, the assessment indicates that there have been improvements in some areas in recent years, which have served to improve general public financial management.

7. **Overall assessment.** The last PEFA Assessment for the Federal Government was published in June 2009. The table below compares the overall trajectory of the indicators from 2009 PEFA Assessment to current 2012 PEFA Assessment. Overall, the maximum number of indicators remained unchanged. There was a decline in 5 indicators and 11 indicators showed positive progress over the period between assessments. Out of total 31 indicators, 2 were not scored because of non-applicability or lack of information while 3 indicators are incomparable due to changed methodology.

Table 1: Trajectory of Change Since 2009^a

Indicator Group	Impact on Fiduciary Risk		
	Lower	Equivalent	High
Credibility of the budget	1	-	-
Comprehensiveness and transparency	3	3	-
Policy based budgeting	2	-	-
Predictability and control in budget execution	3	4	1
Accounting, recording and reporting	-	1	2
External scrutiny and audit	2	1	-
Donor practices	-	1	2
Total	11	10	5

^a Change since 2009 was measured against the 2012 assessment.

8. **Budget credibility.** On the higher level, credibility of the budget has shown some progress but there are three indicators out of four, which were either not rated or rendered non-comparable. The only comparable indicator, the comparison of aggregate expenditure with original budget estimates, showed improvement over the period. The expenditure, at aggregate level, depicted minor deviations from the original budget. The budgetary comprehensiveness and transparency has recorded some progress over the period for comprehensiveness of the information provided in the budget document, which can directly be attributed to utilization of New Accounting Model (NAM), and improvement in public accessibility to fiscal information. Oversight of fiscal risk arising from autonomous bodies and public enterprises continues to remain weak. Policy-based budgeting remains strong and further improvement was observed through the successful implementation of MTBF in all line ministries at federal level. Budget execution remained the most troubled area, especially the tax system currently employed in the country

9. **Audits and scrutiny.** While external audit practices showed positive impacts, legislative scrutiny is still lagging. Reforms introduced in the AGP have improved the timeliness of submission of the reports. The improvements in legislative scrutiny have lately been observed, with clearance of majority of inherited backlog of audit reports. At the same time, due to the large backlog, timeliness of review of the latest audit reports has been delayed and scores have not improved. The ratings for donor practices declined over the period, largely due to non-compliance by a major donor, USAID with good practices for aid effectiveness

10. **Aggregate fiscal discipline.** The fact that budget preparation takes place within an increasingly transparent medium-term budget framework helps in maintaining aggregate fiscal discipline. This is also assisted by Cabinet-approved budget ceilings which are generally respected in Ministries, Departments and Agencies (MDAs) budget submissions. However, deficiencies in overall expenditure controls, such as non-recording of commitments at the MDA level and a partly deficient internal control system as well as lack of internal audit continue to affect and weaken the ability of Federal Government to match revenue with expenditure. The ability to introduce several amendments including expansion of the budget with formal ex-post regularization the year after significantly hinders fiscal discipline.

11. **Strategic allocation of resources.** The preparation of the budget on 3-year rolling basis under medium term budgetary framework (MTBF) helps to set the framework for relative budget priorities, which are intended to be reflected in the MDA's budgetary ceilings. The strategic policy and sectoral objectives set out in the government's medium-term budget estimates for service delivery could possibly provide the basis for guiding inter- (and intra-) sectoral allocations, including external finance. The successful implementation of NAM with improved procedures and documentation assists in increased allocative efficiency and transparency of the budget. However, the high level of budget reallocations, gaps in in-year reporting on budget execution, lack of systemic internal audit function and weak procurement practices increase the risk of misallocation without public scrutiny and proper prioritization. Also, Federal Government needs to strengthen the linkage between MTBF and subsequent year's ceilings to adopt the consistent allocation policy.

12. **Efficient service delivery.** The accountability process is found to be deficient in holding responsible the persons liable for poor delivery of services. The lack of internal audit and timely legislative scrutiny are among the weaknesses identified. Procurement practices are considered deficient and are likely to limit the efficiency of ongoing activities. The ability for planning and management of quality service delivery is also affected by the deficiencies in the in-year budget reports and the adjustments to budget allocations during the year.

D. PFM Reform Initiatives

13. In line with above assessments, the government has developed and is implementing a comprehensive and coherent suite of PFM reforms to address identified issues and strengthen PFM arrangements, with development partner support.

14. Economic Reform Unit has been established within the Ministry of Finance (MoF) with main objectives to: (i) formulate a private sector development strategy; (ii) review existing laws, rules and regulations pertaining to the business environment that are obsolete, overlapping and inconsistent or unduly add to the cost of doing business; (iii) act as a quality filter for new regulations and propose changes that stimulate private sector development, improve transparency, reduce costs and are consistent with international best practices; (iv) establish a Better Business Advisory Council (BBAC), comprising of representatives from both the private and public sectors to advise the government on priorities of private sector friendly reforms at the national, provincial and local levels; and (v) develop a prioritized sector wise reform plan and a roadmap with benchmarks for its effective monitoring and implementation, supported by funding interventions, wherever necessary.

15. **Public Sector Companies Corporate Governance Rules, 2013 (amended in 2017).** The Securities and Exchange Commission of Pakistan (SECP) issued corporate governance rules that are applicable for all public sector companies. The rules allow the public sector companies' board of directors to manage and operate the affairs of company independently. Corporate governance rules encouraged the board to have a rationalized mix of independent and government nominees including women directors. Board can make its own policies and procedure and the performance of board is evaluated by government through performance contract having well defined KPI's. Rules also bind the company to have professional Chief Executive Officer, Chief Financial Officer, Company Secretary and Chief Internal Auditor to be hired through a competitive process. Rules also strengthen the financial management processes of the companies as company should have an external auditor in addition to a well-established internal audit department. Audit affairs will be looked after by audit committee of board of directors to be headed by independent director. Chief Internal Auditor will report directly to the audit committee

of board. Companies are required to have a separate books of account to be audited annually by external auditor firm of Chartered Accountants.

16. **Donor coordination.** Government has implemented various public sector management reform program through coordination from donors. Since 2013, Asian Development Bank's public sector enterprises reform program was implemented that has significantly improved public financial management system for public sector enterprises (PSEs). As a result of program (i) the compliance ratio of public sector enterprise in filing with SECP a corporate governance rules compliance statement along with annual audited financial statements has improved from 35% to 59%, (ii) an improved monitoring mechanism of PSE's has been introduced by Finance Division as for the first time an annual financial performance report for all federal government owned PSE's has been published on the website of Finance Division, (iii) fiscal transfers to PSEs has been reduced and restructuring of selected PSE's like Pakistan Railways and House Building Finance Corporation, and (iv) separate retirement cost funds for power sector distribution companies were established to be managed by independent trustees. Other Development partners are also active in the field of PFM in Pakistan include the World Bank, the UK Department for International Development and the United State Agency for International Development (USAID). World Bank program "Program for Result" on Public Financial Management and Accountability to support service delivery is intended to improve public financial management and procurement systems for better management and accountability in a service delivery for the health and education sectors.

17. **Financial reporting and audit.** To enhance financial reporting and auditing and to improve compliance with international standards, the Auditor General of Pakistan embarked upon an important reform program called 'Project to Improve Financial Reporting and Auditing' (PIFRA) funded by the World Bank. The main aims of PIFRA are to establish an effective accounting, reporting and auditing system that complies with accepted standards, strengthen financial management and tighten internal controls, improve decision support system by generating information for management decision making, and enhance organizational and staff capacity

18. **Power Sector Reform** plan has been initiated under the guidance of Cabinet Committee of Restructuring. The plan is formulated on the following key pillars: (i) improved governance structure; (ii) supportive legal framework; (iii) financial sustainability; (iv) supply side management; (v) demand side management; and (vi) promote private sector participation in the sector. Dissolution of Pakistan Electric Power Company has been initiated to ensure autonomy to power sector companies. Boards of Directors of distribution companies (DISCOs) and National Transmission and Despatch Company are being reconstituted as professional and autonomous board of directors through competitive selections. Technical, financial and managerial audit of DISCOs has been completed.

19. **Extended Fund Facility of the IMF.** On July 3, 2019, the Executive Board of the IMF approved a 39-month extended arrangement under the Extended Fund Facility (EFF) for Pakistan for an amount of SDR4,268 million (about \$6 billion or 210% of quota) to support the authorities' economic reform program. The EFF-supported program will help Pakistan to reduce economic vulnerabilities and generate sustainable and balanced growth focusing on: a decisive fiscal consolidation to reduce public debt and build resilience while expanding social spending; a flexible, market-determined exchange rate to restore competitiveness and rebuild official reserves; to eliminate quasi-fiscal losses in the energy sector; and to strengthen institutions and enhance transparency.

20. Public financial management reforms will help instill budgetary discipline, improve transparency and confidence in the spending of budgetary resources. The recent adoption of the Public Financial Management Act will increase fiscal discipline by requiring parliamentary approval of budget authorizations. Furthermore, recent legal amendments will limit the use of Statutory Regulatory Orders to genuine emergencies. Going forward, Pakistan will: (i) strengthen the implementation of the Fiscal Responsibility and Debt Limitation Act by aligning the annual report presented to the National Assembly with the content and analysis prescribed in the Act; (ii) expand the MoF's capacity for macro-fiscal work and introduce a fiscal risk unit in the MoF for proper identification and monitoring of fiscal risks, including from state-owned enterprises, public-private partnerships (PPPs), and development projects; (iii) strengthen the PPP framework by conducting a legal analysis of the current framework and addressing possible gaps; (iv) create a Treasury office in the MoF tasked with conducting sound commitment controls and cash management, closely coordinated with the debt management unit.

21. **Public Finance Management Act, 2019.** Article 79 of the Constitution of Islamic Republic of Pakistan (Constitution) requires that the custody of the Federal Consolidated Fund and all matters connected with or ancillary to the Federal Consolidated Fund shall be regulated by Act of Parliament. To comply with the constitutional requirement, the government has recently enacted a new Public Finance Management Act, 2019 (PFM Act) for regulating the custody of Federal Consolidated Fund, the payment into that Fund, the withdrawal therefrom, the custody of other funds received by or on behalf of the Federal Government, their payment into, and withdrawal from, the Public Account of the Federation, and all matters connected with or ancillary thereto.

22. PFM Act 2019 also provide elaborate mechanism of public finance management as envisaged in various Articles of Constitution¹ and to guide budgetary management processes, financial and fiscal controls, cash and banking arrangements, and financial oversight of public entities. PFM Act shall apply to all matters of Federal Consolidated Fund and Public Account of the Federation and all other matters of the Federal Government connected with or ancillary thereto.

23. Some of the key reforms introduced in management of public finances through PFM Act are as follows:

A. Budget Management

- (i) **Budget strategy paper:** The Federal Government shall approve² the budget strategy paper containing quantified macroeconomic and fiscal projections for the medium, indicating strategic priorities of the government revenue and spending policies and specify indicative levels of spending in various ministries and division. It shall be published as well as placed on the Finance Division's official website.
- (ii) **Annual budget statement:** The Federal Government shall, in respect of every year, cause to be laid before the National Assembly, annual budget statement consistent with Articles 80 and 81 of the constitution including a statement of the purpose and estimates divided into detailed items for each demand for grant.

¹ National Assembly of Pakistan. [The Constitution of the Islamic Republic of Pakistan](#) (accessed 4 November 2019). Articles 78–88, 118–227 and 160–171.

² By 15th March of every year.

- (iii) **Plan based government's expenditures estimates.** All government expenditures, whether from a recurrent or development demand for grant, shall be based on well-defined plans.
- (iv) **Grant – in – aid.** The Federal Government may approve grant – in –aid for individual, public and private institutions, local bodies and other non-political and private institutions as it may consider appropriate in the manner as may be prescribed.
- (v) **Receipt of grants by the government.** Grants made to the government by a foreign government or by any other person shall be received by the Economic Affairs Division and Finance Division on behalf of the government and Finance Division shall, in collaboration with representatives of the donors, reach agreement and issue instructions concerning the management of such grants.
- (vi) **Tax Expenditure.** The Federal Government shall, in respect of every financial year cause to be paid before the National Assemble, Finance Bill consistent with Article 73 of the constitution including a statement of estimated tax expenditures of the Federal Government.
- (vii) **Performance based budget.** (1) The Federal Government shall, in respect of every financial year, cause to be laid before the National Assembly a medium-term performance-based budget along with the Annual budget statement. (2) For each principal accounting officer, the medium-term performance-based budget may include policy and goals, past and future expenditure, outputs and outcomes and related performance indicators and targets.

B. Development Projects

- (i) **Classification, preparation and quality assurances.** Development projects have been classified as; (i) core projects in the national infrastructure requiring complex planning, design and implementation procedures; and (ii) sectoral projects undertaken by specific sectors, ministries and divisions, which are required to enhance the development of that sector or Ministry of Division and do not fall under the above category of core projects. All development projects shall be prepared in conformity with procedures, processes and template defined by planning commission. Cost and benefit analysis and risk assessment of all development project proposals, in excess of a threshold size prescribed by the planning commission, shall be undertaken. Development projects proposals which exceed in their total cost threshold defined by the Planning Commission shall be subject to quality assurance. Such quality assurances shall be undertaken by an individual/body which is independent of the sector/ministry/division that has initiated the preparation of the development project proposals.
- (ii) **Monitoring and evaluation of development projects.** Development projects shall be subject to the following forms of monitoring and evaluation, namely; (a) monitoring of progress during implementation; (b) evaluation of project on completion; and (c) in case of the projects with a total cost exceeding a threshold to be set by the Planning Commission, an independent impact assessment within five years after completion of the projects. Principal accounting officer shall ensure that the maximum possible returns are achieved on each asset falling under the oversight of the ministry and division.

C. Federal Consolidated Fund

- (i) **Control.** As required under Article 78 of the Constitution, all ministries and divisions, their attached departments and subordinate offices and all public entities if so required by their statutes, shall arrange remittances in the Federal Consolidated Fund, without delay, of all revenues including all grants received by the Federal Government, all loans raised by the government and all funds received by it in repayment of any loan and all other funds into the Public Account of the Federation. The operation of the Federal Consolidated Fund and the Public Account of the Federation shall vest in the Finance Division under the overall supervision of the Federal Government.
- (ii) **Excess expenditure.** (1) The expenditure in excess of the amount of budget as well as the expenditure not falling within the scope or intention of any budget grant, unless regularized by a supplementary grant, shall be treated as excess expenditure. (2) Excess expenditure shall not become a charge against the Federal Consolidated Fund except when: (a) the National Assemble approves an additional amount equivalent to overspending as a direct charge against the Federal Consolidated Fund as voted or charged expenditure; or (b) it decides (i) to recover the excess expenditure from the public servants who are found to be involved to incur such an expenditure. In this case, the Finance Division may take appropriate measures; or (ii) to take disciplinary proceedings against the principal accounting officer, (iii) if the Public Account Committee recommends the excess expenditure to stand as a charge to Federal Consolidated Fund, then it shall be included in the statement of excess expenditure required under Article 84 of the constitution.
- (iii) **Consolidated control system.** The Finance Division in consultation with the Auditor General shall approve and issue guidelines related to annual and multi-annual commitment control systems.
- (iv) **Delegation of financial power.** The Finance Division shall approve regulations for the delegation of financial powers based on the following principles, namely: (a) financial power accorded to the principal accounting officers balance financial authority with responsibility for financial propriety as per the applicable financial rules and regulations; (b) financial powers are accorded with the view to enhance public service delivery; and (c) allowing the principal accounting officers to delegate financial powers to sub-ordinate officials. The delegation shall not diminish the responsibility and accountability of the principal accounting officers.
- (v) **Chief finance and account officer.** To assist principal accounting officer in financial management, there shall be chief finance and account officer positioned in Ministries and Divisions and financial advisors' organization shall stand disbanded.
- (vi) **Chief internal auditor.** Within a period not exceeding twelve months from the date of the commencement of this Act, the position of chief internal auditor shall be created who shall work under direct supervision of the principal accounting officer. Appointment, roles and responsibilities of chief internal auditors shall be as may be prescribed under the Civil Servant Act, 1973 and in consultation with the Auditor General.

D. Treasury Management and Special Purpose Funds

- (i) **Cash management.** The Finance Division with the approval of Federal Government, shall notify the policy and rules under this Act to prescribe an effective cash management system for all public entities and special purpose funds leading to treasury single account. Federal Government shall maintain its Federal Consolidated Fund Account in the State Bank of Pakistan and it may open it such other bank accounts as may be required by Finance Division, from time to time, in accordance with State Bank of Pakistan Act, 1956 (XXXIII of 1956).
- (ii) **Special purpose funds.** If monies have been appropriated by the National Assembly to establish a special purpose fund, the Finance Division shall notify the rules or regulations and issue directives for eth management and control of a such a fund. Such funds shall be subject to audit by the Auditor General of Pakistan.

E. Accounting and Reporting

- (i) **Controller General of Accounts.** The Controller General of Accounts shall perform his functions in accordance with the provision of the Controller General of Accounts (Appointment, Functions and Powers) Ordinance, 2001 (XXIV of 2001).
- (ii) **Midyear reporting of budget documents.** Federal Government shall place before the National Assembly a midyear review report and also publish on the official website. The report shall provide the budget and actual comparison of the revenue, expenditure and financing.
- (iii) **Yearend government performance monitoring report.** Starting from the financial year 2021–2022, the Federal Government shall place within six months of the close of financial year, before National Assembly, a government performance monitoring report detailing (i) budget and expenditure by outputs, and (ii) planned and delivered key performance targets.

24. **Risk mitigation plan.** Based on this assessment, a risk mitigation plan is given below along-with the risk mitigation actions taken by government since 2012.

PEFA Area	Risk Mitigation Actions	Priority
Credibility of Budget	<ul style="list-style-type: none"> ➤ Through PFM Act, 2019 the budget preparation process has been streamlined. ➤ There is a need to implement this process as laid down in the PFM Act 	High
Comprehensiveness and Transparency	<ul style="list-style-type: none"> ➤ Federal Government to ensure the publish and submission of reports as required under section 34 and 35 of PFM Act. ➤ There is a need to have strong and clearly defined cash management policy, timely and comprehensive reporting, streamlined payroll and pension system. 	High
Policy Based Budget	<ul style="list-style-type: none"> ➤ Existence and Adherence of a fixed budget calendar ➤ Clarity / Comprehensiveness of and political involvement in the guidance on the preparation of budget submission 	Medium

PEFA Area	Risk Mitigation Actions	Priority
	➤ Timely budget approval by legislature	
Predictability and control in budget execution	➤ Budgeting process to be executed in accordance with section 3 to 12 of PFM Act	High
Accounting, recording and reporting	<ul style="list-style-type: none"> ➤ Federal Government to ensure that Public Sector Entities complied with the provisions of relevant laws and section 38 and 39 of PFM Act. ➤ Federal Government to ensure that Office of Controller General of Account performs its duties in line with statute to ensure that Federal Government can publish and submit to competent authority its reports as required under the PFM Act. ➤ Public Sector Companies to follow the International Financial Reporting Standards (IFRS). 	High
External Security and Audit	<ul style="list-style-type: none"> ➤ External Audit of the Public Sector Entities to be conducted as per applicable / relevant Status. ➤ Capacity building of Office of Auditor General of Pakistan (AGP) be made to improve the quality of government audit. ➤ AGP to ensure that the audit of all the government agencies to be conducted regularly and pending of long outstanding audit observations be cleared. 	High