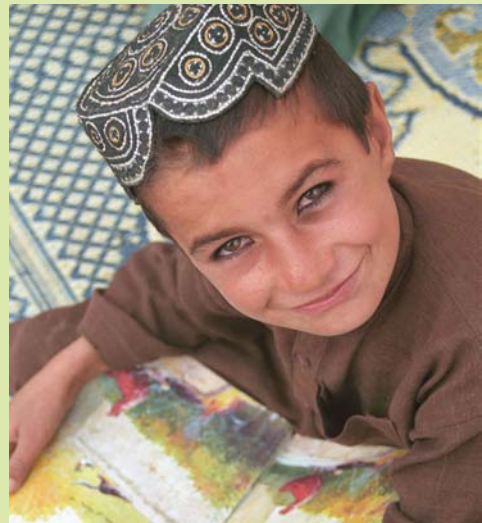


Pakistan Sindh Province

Public Financial Management and Accountability Assessment

Report No. 46323-PK



Government of Sindh and Development Partners



Government of Sindh



The World Bank Group



The European
Commission



UK's Department
for International
Development



Asian Development Bank

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AGA	autonomous government agency
AGP	auditor general of Pakistan
BCC	budget call circular
COFOG	classification of the functions of government
DDO	drawing and disbursement officer
DFID	Department for International Development of the United Kingdom
DSSP	Devolved Social Services Program
FBR	Federal Board of Revenue
FY	fiscal year
GDP	gross domestic product
GFS	government financial statistics
IPSAS	International Public Sector Accounting Standards
MDA	ministry, department, and agency
MTFF	medium-term fiscal framework
NAM	new accounting model
PAC	public accounts committee
PEFA	public expenditure and financial accountability
PFC	Provincial Finance Commission
PFM	public financial management
PFMAA	provincial financial management and accountability assessment
PIFRA	Project to Improve Financial Reporting and Auditing
RRA	Revenue Receipts Audit
SAC	Structural Adjustment Credit
TMA	<i>tehsil</i> municipal administration
ZAC	<i>zila</i> accounts committee

GLOSSARY

<i>nazim</i>	local government political leadership
<i>tehsil</i>	town
<i>zila</i>	district

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Being a joint product of the Development Partners (ADB, The World Bank, DfID and The European Commission) and the Government of Sindh, the formatting guidelines of Asian Development Bank were adopted for this report

Executive Summary

- 1 This report presents the public financial management and accountability assessment (PFMAA) for Pakistan's Sindh province. The assessment uses the public expenditure and financial accountability (PEFA) 2005¹ framework, which comprises 31 performance indicators to evaluate (i) the six core public financial management (PFM) dimensions (credibility of the budget; transparency and comprehensiveness; policy-based budgeting; predictability and control in budget execution; accounting, recording, and reporting; and external scrutiny), and (ii) the extent to which donor practices and the management of donor funds affect the PFM systems in the country. This assessment report highlights the likely impact of PFM weaknesses on budgetary outcomes, aggregate fiscal discipline, the strategic allocation of resources, and efficient service delivery.
- 2 An earlier financial accountability assessment for Sindh, carried out in November 2004, documented substantial areas of good PFM performance and summarized the priority actions required to improve performance in areas that were performing weakly. However, in comparison to the 2004 assessment, this PEFA assessment is based on a high-level set of indicators for assessing each area of the province's PFM. The 2004 assessment should not be used as a baseline for the province's performance as it used the traditional country financial accountability assessment (CFAA) framework instead of the "snapshot" performance measurement indicators that were later approved under the PEFA (June 2005). The underlying key findings of the PEFA-based current assessment—notwithstanding the differences in the CFAA and PEFA approaches—is that the province has indeed improved its PFM performance, though moderately, since the 2004 assessment. It is recommended that the performance improvement ratings identified in the current assessment should be used as the baseline against which future PFM performance in the province be monitored, particularly in the areas of weak performance.
- 3 This current assessment built upon the November 2004 assessment and factored the overall progress achieved in enhancing the province's PFM. As Sindh is a subnational government and the 23 districts in the province are subprovincial governments, the assessment took cognizance of the institutional and related PFM arrangements that underpin subnational governments. It draws on the Subnational Government Guidelines as issued by the PEFA in 2008. This assessment, however, draws the evidence and related conclusions on the province's PFM systems primarily from the perspective of the provincial government and the district or subprovincial governments. Based on the knowledge pool of subprovincial governments since devolution in 2002, the sample size used in the assessment of the subprovincial governments has been limited to two districts of differing size as there are no significant differences between the 23 district governments (other than the Karachi district government) as far as PFM systems are concerned. No information was generated for the two

¹ Public Expenditure and Financial Accountability (PEFA) Secretariat. June 2005. *Public Financial Management Performance Measurement Framework*, Washington D.C.: World Bank. The PEFA includes the European Commission, France, International Monetary Fund, Norway, the Strategic Partnership with Africa, Switzerland, United Kingdom, and the World Bank.

- other levels of government below the level of districts (*taluka*, or town, municipal administrations, and union administrations), given the comparatively very low level of total resources entrusted to these governments—about 4% of total budgetary resources of the province in any single year. Similarly, because the city district government of Karachi has unique features in terms of size and independent PFM systems, no assessment has been made of that government; it requires a separate and distinct assessment.
- 4 The main findings for the six core dimensions of PFM performance and donor practices are discussed in this report. These are based on rating 31 performance indicators for the six PFM areas and donor practices; each indicator is rated from 'A' (best practice) to 'D' (needs significant improvement). The detailed rating methodology and ratings for each of the 31 performance indicators for the provincial and subprovincial governments (district governments) are discussed in Chapter 3 and summarized in Chapter 4.
 - 5 The credibility of the budget dimension covers the extent of budget realism in terms of it being implemented as planned, and is assessed according to four performance indicators: (i) PI-1, aggregate expenditure out-turn compared to original approved budget; (ii) PI-2, composition of expenditure out-turn compared to original approved budget; (iii) PI-3, aggregate revenue out-turn compared to original approved budget; and (iv) PI-4, stock and monitoring of expenditure payment arrears.
 - 6 The revenue out-turn is rated 'B' for provincial revenues; however, the province's performance in terms of budget credibility has been generally unfavorable. Aggregate expenditure out-turn is rated 'C', while expenditure composition ('D') and stock and monitoring of payment arrears ('D+') performed below desirable levels for the provincial government. For subprovincial governments (districts), the performance has been equally lagging for these indicators; the expenditure compositional variance has not been rated. It is expected that if the data were generated from a uniform classification basis of the new chart of accounts over a 3-year period, the problems associated with data accuracy and consistency would have been obviated and would result in better than reported performance for that indicator.
 - 7 The transparency and comprehensiveness criteria measure whether coverage of the budget, including the determination of overall fiscal risk, is adequate, and whether the public has unfettered access to budget and outcomes information. It is assessed according to performance under the following six performance indicators: (i) PI-5, classification of the budget; (ii) PI-6, comprehensiveness of information included in budget documentation; (iii) PI-7, extent of unreported government operations; (iv) PI-8, transparency of intergovernmental fiscal relations; (v) PI-9, oversight of aggregate fiscal risk from other public sector entities; and (vi) PI-10, public access to key fiscal information.
 - 8 Performance at the provincial government level has been generally mixed against the above six indicators. Performance of the province has been good in respect of budget classification ('A' rating), comprehensiveness of information included in budget documentation ('A'), and transparency of intergovernmental fiscal

- relations ('B'). However, performance has been weak in three critical areas: the extent of unreported government operations ('D'), the province's oversight of aggregate fiscal risk from public sector entities ('D'), and ease of access of the public to key fiscal information ('C'). With the full introduction of the new chart of accounts across all districts, the budget classification system now being applied also shows very strong performance in public access at the district level.
- 9 The policy-based budgeting dimension covers the extent to which the budget formulation is in line with the policies of the provincial government, and is evaluated according to (i) PI-11, orderliness and participation in the annual budget process; and (ii) PI-12, multiyear perspective in fiscal planning, expenditure policy, and budgeting.
- 10 Under this policy-based budgeting dimension, the provincial government scored extremely well against the indicator for orderliness and participation in the annual budget process ('A'), although the district governments scored poorly ('C') against the same indicator due to their nonconformance with the requirements of the Sindh Local Government Ordinance 2001, as well as with the budget rules. Because the province has only adopted a limited version of the medium-term fiscal framework (MTFF) and has yet to implement a medium-term budget framework, the score against the multiyear perspective in fiscal planning, expenditure policy, and budgeting indicator has been rated 'C'—a situation indicative of a less than optimal performance in budgetary planning.
- 11 The predictability and control in budget execution dimension covers the extent of systematic and predictable budget implementation and the effectiveness and efficiency of expenditure and revenue management and controls. It is assessed according to the following nine performance indicators: (i) PI-13, transparency of taxpayer obligations and liabilities; (ii) PI-14, effectiveness of measures for taxpayer registration and tax assessment; (iii) PI-15, effectiveness in collection of tax payments; (iv) PI-16, predictability in the availability of funds for commitment of expenditures; (v) PI-17, recording and management of cash balances, debt, and guarantees; (vi) PI-18, effectiveness of payroll controls; (vii) PI-19, competition, value for money, and controls in procurement; (viii) PI-20, effectiveness of internal controls for nonsalary expenditure; and (ix) PI-21, effectiveness of internal audit.
- 12 The provincial government's performance is poor in respect of level of transparency in defining taxpayer obligations and liabilities ('C'), effectiveness of taxpayer registration and assessment ('D+'), and effectiveness of tax collection ('C+'). There is significant room for performance improvement. While the predictability of available financial resources for expenditure commitments ('B+') and the overall management of cash balance, debt, and guarantees ('B') showed good performances at the provincial government level, internal controls and internal audit as well as transparency and controls in public procurement are all weak ('Cs' and 'Ds'). The district-level assessed performance levels all fell well below reasonable standards. Expenditure effectiveness in the province is thus very much undermined by the lack of adequacy in controls and the less than transparent procurement management mechanism.
- 13 The accounting, recording, and reporting dimension covers effectiveness and transparency in maintaining and reporting public finances and the reliability and

- adequacy of financial information for management decision making. It is evaluated according to four performance indicators: (i) PI-22, timeliness and regularity of accounts reconciliation; (ii) PI-23, availability of information on resources received by service delivery units; (iii) PI-24, quality and timeliness of in-year budget reports; and (iv) PI-25, quality and timeliness of annual financial statements.
- 14 While accounts are regularly reconciled, the frequent carryover of material uncleared balances in suspense accounts undermines the performance against the timeliness and regularity of accounts reconciliation indicator, which has been rated 'C+'. Material reconciliation differences have been reported by the auditor general in his audit reports of FY2005 and FY2006. In addition, the quality and timeliness of in-year budget execution reports ('C+' at the provincial government level and 'D+' at the district level as a result of weak scope of report coverage and uneven report quality) is an area to be further strengthened. The Project to Improve Financial Reporting and Auditing (PIFRA) will be supporting the province in this direction. Annual financial statements, in terms of quality and timeliness at the provincial government level, were rated 'B'. The provincial government is transitioning well in preparing and presenting financial statements that are largely consistent with the International Public Sector Accounting Standards (IPSAS). A lag of up to 15 months results at the provincial government level before financial statements (essentially only appropriation accounts) are prepared and presented for audit in a number of districts, and, as these statements are not prepared consistent with any accounting policies, a score of 'D+' applies. The province scored fairly well ('B') in the area of information provision regarding resources received by service delivery units, as the budgeting is being done at the detailed spending level across the province.
- 15 The external scrutiny and audit dimension covers the arrangement for, and extent and scope of, scrutiny of public finances as well as the timeliness and the strength of corrective measures taken, and is evaluated according to three performance indicators: (i) PI-26, scope, nature, and follow-up of external audit; (ii) PI-27, legislative scrutiny of the annual budget law; and (iii) PI-28, legislative scrutiny of external audit reports.
- 16 This is one area where performance across the entire province has been weakest (ratings of 'D+'), particularly due to (i) the time taken before a completed audit report is certified by the auditor general and presented to the governor (in the case of provincial government) or the *nazim* (in the case of the subprovincial governments); and (ii) the lack of vigor in follow-up of audit recommendations through the departmental accounts, or *zila* accounts committees (ZACs). The audit quality has started to improve since the auditor general began using the new risk-based audit methodology as per the Financial Audit Manual that is consistent with the International Standards on Auditing. As regards the legislative scrutiny of external audit reports, performance across the entire province is weak, particularly at the district government level where virtually no scrutiny takes place in the weak institutional settings.
- 17 Donor practices cover the extent to which donor practices and the management of donor funds impact the PFM systems in the country, and are evaluated according to three performance indicators: (i) D-1, predictability of direct budget support; (ii) D-2, donor financial information provided for budgeting and

- reporting on project and program aid; and (iii) D-3, proportion of aid that is managed by use of national procedures.
- 18 The extent to which direct budget support can be predictable depends largely on the form of the instrument that donors use in providing budget support funds to the provincial government. Where the budget support is linked to prior reform actions that the government must take, the onus rests on the government to satisfy the actions for predictability to be assured. Invariably, a number of key reforms agreed between the government and donor partners remain unsatisfied by the expected time of release of the budget support. For Sindh, budget support from the World Bank and European Commission for the proposed Sindh Second Education Reform Program was not forthcoming because the government failed to meet the reform trigger conditions. Also, while reporting to the government on resource flows for project aid is carried out by donors, the lack of detail consistent with the government's own budgeting and reporting mechanism undermines performance against indicator D-2. The government draws its budget entries for foreign-aided projects from its PC-1 (appraisal document), although reporting through "ring-fenced"² project management units is not carried out on the same consistent basis as defined in the government's PC-1. Instead, the donors' reporting requirements become the core reporting arrangements for donor-aided projects. The proportion of aid funds that are managed by use of government systems shows better performance ('B') because most aid (at least 75%) to Sindh province has been received (disbursed in any single year) in the form of budget support rather than project (investment) aid.
- 19 A number of indicators, particularly for subprovincial governments, have not been rated, either because of the lack of complete and evidential data or the inapplicability of the indicator itself. Nonetheless, the outcome of this assessment provides a strategy for improvements and can usefully serve as the baseline against which future PFM performance can be monitored.
- 20 As highlighted in the report, the following summary conclusions have been reached in regard to assessing the impact of the PFM weaknesses on budgetary outcomes in terms of aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery:
- 21 The performance indicators for **aggregate fiscal discipline** raise concerns. PI-1, PI-2, and PI-3 show that the overall budget out-turn is affected by spending less than the original budget intentions. This may have been caused by policy changes during the year or lack of discipline in managing the budget during its execution by line departments. Expenditure control becomes less predictable because of periodic policy pronouncements outside the budget cycle. While revenue out-turns have generally improved, the actual collections fell short of the estimates. The lack of capacity to monitor arrears as shown by PI-4 is an additional concern about the capacity to manage fiscal discipline as agencies may be building significant commitments that are not systematically monitored. The budget development process scores very well in PI-5 and PI-6, whereas PI-7 takes note of the

² Ring-fencing is compartmentalization of project management outside the traditional government institutional processes.

- recurring issues related to accounting for, and reporting of, donor operations in the government fiscal reports. PI-10 shows lack of transparency in fiscal decision making, whereas PI-12 indicates that budgets need to be prepared with due regard to government policy. Weaker performance in the expenditure controls and scrutiny processes (as shown in PI-18 to PI-22, and PI-24, PI-26, and PI-28) reflect a lack of preventive checks and balances in the PFM systems that are required to ensure effective budget execution. Overall liabilities for the government are additionally affected by poor performance in PI-9, as fiscal risks in state-owned enterprises and other local governments are not well monitored.
- 22 For the **strategic allocation of resources**, the introduction of a medium-term perspective in budgetary allocations, coupled with well-articulated sector strategies, would need to be reinforced and sustained. While the legislature is involved in the budget formulation process, lack of legislative scrutiny is likely to reduce pressure on government to allocate and execute the budget in line with its stated policies. The overall quality of in-year budget reports has been improving, except for the lack of capturing expenditure at both the commitment and payment stages. This reduces the ability to effectively monitor the use of resources at the controlling stage (i.e., when a commitment is raised) and to identify problems that may lead to significant changes in the executed budget.
- 23 On **efficient service delivery**, PI-16 highlights the existence of some degree of predictability in the availability of funds for commitment of expenditure. However, the extent to which managers are held accountable for efficient and rules-based management of resources to deliver services is reduced because of control weaknesses identified in PI-20, the nonexistence of internal audit (PI-21), weak procurement capacity (PI-19), the poor follow-up on external audit (PI-26), and weak legislative scrutiny (PI-28). In addition, these weaknesses may provide opportunity for leakages, corrupt procurement practices, or unintended misuse of resources.
- 24 The assessment does highlight the need for reforms in specific areas of budget development, budget execution, internal control, accounting, external audit, and legislative and public oversight. Following this snapshot-based assessment, a summary diagnostic (Annex 1) was carried out (as a follow-on exercise) to assess factors that have hampered performance, and to draw proposals for improvement that may be considered in designing a future PFM reform strategy led by the government of Sindh for the province as a whole. Significant future improvements in a majority of the affected weakly performing areas will depend on the pace of implementation and success of PIFRA-executed reforms in the province, as well as on the successful implementation and completion of the devolution reforms process.

Chapter 1: Introduction

- 1.1 This document reports on the public financial management and accountability assessment (PFMAA) for the province of Sindh using the public expenditure and financial accountability (PEFA, footnote 1) and public financial management (PFM) performance measurement framework. The study was commissioned jointly by the Asian Development Bank (ADB), the World Bank, the Department for International Development of the United Kingdom (DFID), and the European Commission. The government of Sindh steered the process of Sindh's PFMAA through a committee established by the government and notified for the purpose. The membership of the steering committee comprised the secretary of finance, the accountant general, directors general of provincial and district audits, secretary of the provincial assembly, and secretary of the Planning and Development Department. The Finance Department served as the secretariat for the committee, and the special secretary (finance), in the role of secretary of the steering committee, proactively supported the process of the joint-donor PFM accountability assessment effort. Support was also provided by all stakeholders, including provincial departments and district finance and accounts offices, throughout the assessment process. Primary data were gathered during 4 November 2007–28 February 2008; these provided the basis for the snapshot report as well as the resulting analysis.
- 1.2 The assessment was conducted against 31 PFM performance measurement indicators in accordance with the PEFA framework. The framework is premised on the following six critical areas of PFM performance, followed by donor practices indicators:
- (i) **Credibility of the budget.** The extent of budget realism in terms of being implemented as planned.
 - (ii) **Transparency and comprehensiveness.** Whether the coverage of the budget, including the determination of overall fiscal risk, is adequate, and the public has unfettered access to budget and outcomes information.
 - (iii) **Policy-based budgeting.** The extent to which budget formulation is in line with the policies of the provincial government.
 - (iv) **Predictability and control in budget execution.** The degree of systematic and predictable budget implementation and the effectiveness and efficiency of expenditure and revenue management and controls.

- (v) **Accounting, recording, and reporting.** The effectiveness and transparency in maintaining and reporting on the public finances and the reliability and adequacy of financial information for management decision making.
 - (vi) **External scrutiny and audit.** The arrangement for, and extent and scope of, scrutiny of public finances as well as the timeliness and the strength of corrective measures taken.
 - (vii) **Donor practices.** The extent to which donor practices and the management of donor funds affect the PFM systems in the country.
- 1.3 PFM performance has been assessed against each of the 31 indicators by assigning ratings of 'A' to 'D', based on criteria given in the PEFA framework document. An 'A' rating would be good practice up to international standard, and that of 'B' a good achievement. Ratings of 'C' and 'D' identify PFM elements that are in relatively greater need of improvement. An 'N/S' rating indicates 'Not Scored', while 'N/A' indicates 'Not Applicable'. The rationale for each indicator rating has, however, also been covered through some narrative assessment.
- 1.4 The indicators focus on the operational performance of the PFM system rather than on the inputs that enable the PFM system to reach a certain level of performance. The framework does not analyze the actual fiscal or expenditure policy, or whether there is value for money in the service delivery. The indicator assessment is used to identify the areas of PFM where further analysis, evaluation, and/or reforms are needed.
- 1.5 The study benefited from the Subnational Government Guidelines prepared by the PEFA, which are aimed at enabling the coherent application of the guiding principles of the June 2005 PEFA PFM to subnational governments.
- 1.6 The government of Sindh welcomed the PFMAA study as (i) an independent external review on the province's PFM performance, (ii) an opportunity for a stakeholders' review of their performance status in the entire PFM cycle, and (iii) a basis for articulating a strategy for reforms where needed. It welcomed the joint involvement of the donors in carrying out the study to ensure that all donors align their reform support strategies and thus avoid undue duplication and overlap to the maximum extent possible. The study largely focuses on the provincial government's PFM systems; however, a snapshot performance analysis of subprovincial governments (districts) was also undertaken as part of the review, where relevant, to provide an overall performance basis of the province as a whole. The methodology adopted in consultation with the government of Sindh was to use Hyderabad and Mirpurkhas district governments as a representative sample for the district government level.

- 1.7 The task team comprised co-task leaders Emma Xiaoqin Fan, senior public resource management specialist, ADB;³ Ismaila B. Ceesay, lead financial management specialist, World Bank; David Johnson, senior governance advisor, DFID; Peter McDermott, governance advisor, DFID; and Frank Hess, second secretary, European Community. Other members of the task team were Ayesha Ahmed, project management and research analyst (consultant), ADB; Uzma Sadaf, senior procurement specialist, World Bank; Hanid Mukhtar, senior economist, World Bank; and Furqan A. Saleem, financial management specialist, World Bank. Altaf Ahmad, program assistant, World Bank, provided logistical and administrative support. Muhammad Zeeshan Tariq, lead consultant, ADB, and Sher Shah Khan, local consultant, World Bank, led the preparation of the draft report and assisted with developing the final assessment report.
- 1.8 The peer reviewers were Julie Lynn, senior governance advisor, DFID; Sandra Nicoll, principal governance adviser, ADB; Jean Louis Lacube, EuropeAid Cooperation Office, head of Unit E-1 (macroeconomic support), European Commission; Gilles Hervio, director general development, head of Unit B-3 (Economic Cooperation and Poverty-Reduction Strategy Paper), European Commission; Frans Erik Kolls Ronsholt, head of PEFA Secretariat, World Bank; and Joel A. Turkwitz, procurement reform coordinator, World Bank (peer reviewer for Development Assistance Committee of the Organisation for Economic Co-operation and Development Baseline Indicator System).

³ Waqas ul Hasan worked on the project before he departed from ADB in April 2008.

Chapter 2: Background Information for Sindh

2.1 Economic Situation

- 2.1.1 Sindh is endowed with many characteristics of a high-growth region. It is a coastal province, strategically located between Europe and the Far East, with the potential to become one of the largest logistical and business hubs in South Asia. It is the most industrialized province in Pakistan, accounting for 40% of large-scale manufacturing output in the country. It is rich in resources, holding nearly 33% of all mineral deposits in Pakistan. The province contributes significantly towards overall national agriculture production in major crops: 32% in rice, 24% in sugar cane, and 21% in wheat.⁴ With the highest crop yields in the country, it has been the nation's most efficient cereal producer. Karachi, Sindh's provincial capital, was the first city in Asia to have a fully fledged airport, its seaports are among the most developed in the region, and it is well connected by extensive road and rail networks that can be easily extended to India in the east and Central Asia to the north. Sindh has a strong entrepreneurial class, and a large pool of educated workers (although wages are relatively low). It is home to many institutions of higher learning and skill development. With these attributes, Sindh should be on a fast growth track and Karachi should be a flourishing metropolis.
- 2.1.2 The reality, regrettably, has been different. Instead of building on the initial advantages to become the country's growth engine, Sindh has been gradually losing its position of preeminence. Sindh's per capita income was nearly 55% higher than the rest of the country at the time of independence but only 36% higher by the early 1990s; the difference was further reduced to 16% by FY2005. Its share in national gross domestic product (GDP) has fallen in almost all sectors, with the largest declines recorded in large-scale manufacturing, finance and insurance, transport, storage, and communications. In FY2004, there were nearly 610,000 unemployed persons in Sindh, and nearly 500,000 persons are likely to be added to the labor force each year for the next 10 years. Without a sustained growth rate of around 7%–8% per year, the number of unemployed in Sindh could rise to as high as 1.6 million by FY2014.
- 2.1.3 Sindh's development indicators are not only low in absolute terms, but are growing less rapidly relative to the rest of the country. For example, Sindh's literacy rate increased by 5 percentage points to 56% between FY1999 and FY2005, while the corresponding increase for the country was 8 percentage

⁴ Available: www.sindh.gov.pk/dpt/agriculture/index.htm.

points (to 53%). With a 41% net primary school enrollment rate, Sindh underperformed the country by 1 percentage point in FY1999; the gap had widened to 4 percentage points by FY2005. Households with access to roads in Sindh exceeded the national average by 2 percentage points in FY1999; this figure fell below the national average by 7 percentage points in FY2005. Sindh's poverty headcount ratio increased from 23.4% to 40.4% between FY1996 and FY2002, while nationally the headcount ratio increased from 30.1% to 36.4%.⁵

2.2 Budgetary Outcomes

2.2.1 The revenue and expenditure budgets of the Sindh government and its subprovincial governments have grown regularly. The budget growth achievements have closely followed the growth projections highlighted in the province's medium-term fiscal framework in recent years.⁶ However, high dependency on federal and provincial transfers affects the budget (expenditure out-turns), at both the provincial and subprovincial levels.

2.2.2 Budget preparation has historically been primarily short-run, input focused, and incremental, with little prioritization of expenditure for achievement of service delivery goals. The use of the budget as a tool for implementing strategies toward achievement of the government's policy goals has been limited. The Sindh government has remained involved with multiple reforms in various sectors over the past 5 years, including in fiscal and financial management, with the support of international donors. The objectives of the latest reform initiatives include the revamping of the budgetary systems through a shift from the current input-based annual incremental budgeting to medium-term outcome-based program budgeting. This will better support the process of linking budgets to service delivery outcomes under the Sindh Poverty-Reduction Strategy Paper.

2.3 Legal and Institutional Framework for Public Financial Management

2.3.1 The Constitution of the Islamic Republic of Pakistan, as well as federal and provincial assemblies, authorize budget expenditure for services to the people through annual fiscal year votes. The range and composition of the services that will be provided are determined each fiscal year by the respective national and provincial assemblies. The Constitution also provides for charged or obligatory

⁵ World Bank. 2007. *Draft Sindh Economic Report*. Washington D.C.

⁶ Finance Department. 2008. *Budget Analysis 2007-08*. Government of Sindh.

- expenditures on positions required by the Constitution (such as the president, high court judges, chief election commissioner, and the auditor general) as well as for debt servicing. For the district governments, the zila councils are the district equivalents of the federal or provincial assemblies, and they generally perform the same oversight functions.
- 2.3.2 Public sector bodies are well defined in the financial institutional system by major types of entities such as (i) departments of the government administered directly by the federal and provincial governments, and (ii) autonomous bodies that are indirectly administered by their respective governments. Government departments are further divided into centralized accounting agencies and self-accounting agencies. Autonomous bodies are also divided into two further categories: (i) statutory bodies established for nonprofit objectives, and (ii) public sector enterprises. The government of Sindh comprises the chief minister, ministers, provincial secretaries, and a pool of public servants. A governor, appointed by the president of the federation, is the province's equivalent of head of state, while the chief minister is the equivalent of a head of government.
- 2.3.3 The 1973 Constitution is far-reaching in its emphasis on financial management and provides (in articles 79, 166, 168, and 169) for the eventual enactment of the following three enabling legal frameworks:
- (i) **Public finance.** This law is expected to prescribe (a) how budgets will be prepared, (b) monitoring and evaluation mechanisms for assessing the performance of the government vis-à-vis the resources placed at its disposal, and (c) internal controls over finances.
 - (ii) **Public debt management.** This law is expected to prescribe objective criteria for borrowing (both internally and externally) with a view to (a) minimizing the probability of misuse or waste of borrowed resources, (b) restricting the amount of aggregate borrowings both in absolute and relative terms to ensure that debt servicing remains within reasonable limits (sustainability), and (c) ensuring transparency and efficient management of debt.
 - (iii) **Public sector audit.** This law is expected to be structured to provide the basis for independent and competent verification of the truth and fairness of representations of the executive with regard to stewardship of public funds and achievements concerning the use of allocated resources.
- 2.3.4 Pakistan has no separate public finance law. The constitutional provisions are, in themselves, quite detailed and provide the enabling operational basis for public finance management in the federation. However, on an annual basis, an

- appropriation law is promulgated to cover aspects relating to public expenditure in pursuance of the annual budget, and a finance act covering public revenue in pursuance of the annual budget is promulgated annually.
- 2.3.5 In respect of the public debt management law, the federation has promulgated the Fiscal Responsibility and Debt Limitation Law that covers the thrust of what the Constitution envisages. This law is applicable across the federation.
- 2.3.6 As regards the public sector audit law, Pakistan's (Audit and Accounts) Order 1973 P.O. 21 of 1973 was repealed in May 2001 and replaced by two sets of legislation that caused the bifurcation of the audit to the auditor general of Pakistan, and accounts to the controller general of accounts ordinances. The foundation for the two later laws is contained in Article 169 of the Constitution; they govern the audit and accounting processes in Sindh as well as other provinces. The General Financial Rules and the Treasury Rules, which are largely archaic, require updating for consistency with the new modernized government operational and accountability practices.
- 2.3.7 The basic framework for assignment of fiscal powers and distribution of revenues between the federation and provinces (including districts) is laid down in the Constitution. To allow for the distribution of fiscal resources, a divisible pool has been created whereby the net proceeds of specified taxes collected by the federal government are pooled and the federal government and provinces share in the pool on the basis of the periodic National Finance Commission awards. Using a similar mechanism, the province passes on grants to local governments under the Sindh Local Government Ordinance 2001.

Chapter 3: Assessment of Public Financial Management Systems, Processes, and Institutions

3.1 Budget Credibility

PI-1 Aggregate expenditure out-turn compared to original approved budget
 Overall rating: C for provincial government and D+ for district governments

3.1.1 The criteria for assessing the subratings elements and dimensions are as follows:

Score	Minimum Requirements (Scoring Methodology M1) ^a
A	In no more than 1 out of the last 3 years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure.
B	In no more than 1 out of the last 3 years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 10% of budgeted expenditure.
C	In no more than 1 of the last 3 years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure.
D	In 2 or all of the last 3 years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 15% of budgeted expenditure.

^a Method 1 (M1) is used for all single-dimensional indicators and for multidimensional indicators where poor performance on one dimension of the indicator is likely to undermine the impact of good performance on other dimensions of the same indicator (in other words, by the weakest link in the connected dimensions of the indicator). Method M2 is based on averaging the scores for individual dimensions of an indicator.

3.1.2 The ability to implement the budgeted expenditure is a crucial to the government’s ability to deliver public services for the year as expressed in policy statements, output commitments, and work plans. The performance indicator reflects this by measuring the actual total expenditure compared to the originally budgeted total expenditure (as defined in government budget documentation and fiscal reports) but excludes two expenditure categories over which the government will have less direct control: (i) debt service payments, and (ii) donor-funded project expenditure,⁷ the management and reporting of which are typically under the donor agencies’ control to a high degree.

3.1.3 This measure provides an assurance of whether the PFM system is delivering effective fiscal discipline and is responsive to changes in macroeconomic situations in accordance with budget intentions.

⁷ However, due to issues related to donor-funded projects as documented in PI-7(ii), donor-funded project expenditure could not have been completely excluded from the analysis.

3.1.4 Table 1 shows the budgeted estimates for FY2005, FY2006, and FY2007 for the provincial government of Sindh. These figures were generated from the budget documents of the government of Sindh. While the budget documents for FY2008 are available, the audited accounts for the actual expenditure had not been released at the time of the assessment.

3.1.5 The actual expenditure in comparison with the budget estimates shows a variance that in 2 out of the last 3 years the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 10% of budgeted expenditure. As per the public expenditure and financial accountability (PEFA) assessment criteria, the indicator is assessed 'C'.

**Table 1: Provincial Aggregate Expenditure: Budget and Actual
Government of Sindh
(Rating 'C')**

(PRs million)

Particulars	FY2005 ^a	FY2006	FY2007
Budget (original)	132,985	146,414	179,895
Actual	115,373	134,930	156,344
Difference between budget and actual (%)	13.24	7.84	13.09

^a Due to lack of comparable information for FY2005, debt service payments have not been completely excluded from this column. However, the budgeted expenditure and the actual expenditure were about the same, and thus do not affect the conclusion reached.

Source: Annual budget statements of the Sindh Finance Department.

3.1.6 A review was undertaken to assess the extent of the subprovincial government budget realism. The districts of Hyderabad and Mirpurkhas were selected and assessed as representative samples. The outcome of the assessment is indicative of the general prevailing picture in the other 21 districts. Tables 2 and 3 provide aggregate expenditure for each of these two district governments (budget estimates and actual expenditures).

**Table 2: Aggregate Expenditure: Budget and Actual
District Government of Hyderabad
(Rating 'C')**

(PRs million)

Particulars	FY2004	FY2005	FY2006
Budget (original)	3,141	3,044	1,926
Actual	2,822	3,187	1,732
Difference between budget and actual (%)	(10.15)	4.7	(10.1)

() = negative number

Source: Budget documents of the Sindh government and Hyderabad district government.

- 3.1.7 Table 2 shows that the actual expenditure deviated from budgeted estimates by more than 10% in 2 out of the 3 years; therefore the PI-1 for the Hyderabad district government is assessed 'C'.
- 3.1.8 Table 3 for the Mirpurkhas district government shows particularly high variances between actual expenditure and budgeted estimates for FY2004, FY2005, and FY2006. Therefore PI-1 is assessed 'D'.

**Table 3: Aggregate Expenditure: Budget and Actual
District Government of Mirpurkhas
(Rating 'D')**

Particulars	<i>(PRs million)</i>		
	FY2004	FY2005	FY2006
Budget (original)	1,610 .	1,848	1,743
Actual	1,427 ^a	1,160	1,160
Difference between budget and actual (%)	(12)	(37)	(33)

() = negative number

^a Provincial finance commission release

Source: District government, Mirpurkhas

PI-2 Composition of expenditure out-turn compared to original approved budget

Overall rating: 'D' for provincial, and 'N/S' (no score) for district governments

- 3.1.9 The criteria for assessing the subrating elements and dimensions are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	Variance in expenditure composition exceeded overall deviation in primary expenditure by no more than 5 percentage points in any of the last 3 years.
B	Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than 1 of the last 3 years.
C	Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than 1 of the last 3 years.
D	Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in at least 2 out of the last 3 years.

- 3.1.10 Where the composition of expenditure varies considerably from the original budget figures, the budget will not be a useful statement of policy intent. Measurement against this indicator requires an assessment of expenditure out-turns against the original budget at a **subaggregate level**. This is an important indicator to assess the extent of budget realism for different budget heads.

- 3.1.11 To make that assessment, the variance in the primary expenditure composition is calculated and compared to the overall deviation in primary expenditure for each of the last 3 years (using PI-1 assessment). The variance is calculated as the weighted average deviation between actual and originally budgeted expenditure for the budget lines calculated, taken as a percentage of the budgeted expenditure using the absolute value of the deviation.
- 3.1.12 As per the criteria given above and the calculated variance (Table 5), because the indicator is assessed 'D', all 3 years' variance exceeds 10%. It should be noted that the impact of the adoption of the new chart of accounts and the consequent classification differences during the intervening years could be key factors that gave rise to the massive variances in FY2005 and FY2006; FY2006 was the first full year when the provincial government adopted the new chart of accounts. With the new chart of accounts now firmly in place across the entire province, variances are declining and performance is likely to improve in future.

Table 4a: Primary Expenditure and Variance: Budget and Actual

(PRs million)

Head of Account	FY2005 Budget	FY2005 Actual	Variance (%)
General Administration	16,609	9,346	(43.73)
Law and Order	11,447	10,545	(7.88)
Community Services	1,389	2,270	63.43
Social Services	6,292	25,224	300.89
Economic Services	6,954	7,135	2.60
Subsidies	4,113	507	(87.67)
Debt Servicing Investible funds, grants	23,862	26,072	9.26
Other Expenditure	34,237	391	(98.86)
Current Capital Expenditure	7,277	11,798	62.13
Development Expenditure	20,805	22,085	6.15
Total	132,985	115,373	

0 = negative number

Source: Annual budget statements and budget analysis 2007/08, Sindh Finance Department.

**Table 4b: Primary Expenditure: Budget and Actual
Under new chart of accounts**

(PRs million)

Head of Account	Budget			Budget		
	Estimate FY2006	Actual FY2006	Variance (%)	Estimate FY2007	Actual FY2007	Variance (%)
General Public Service	70,395	37,667	(46.49)	77,753	85,389	9.83
Public Order and Safety Affairs	13,953	12,595	(9.73)	18,186	14,567	(19.90)
Economic Affairs	14,216	14,750	3.76	12,340	9,850	(20.18)
Environment Protection	52	40	(23.08)	1,078	118	(89.05)
Housing and Community Amenities	219	311	42.10	411	317	(22.87)
Health (Public Health Services)	4,170	5,910	41.73	5,848	4,106	(29.79)
Recreational, Cultural, and Religion	339	378	11.50	278	194	(30.22)
Education Affairs and Services	4,100	25,010	510.00	12,736	5,427	(57.39)

Social Protection	247	899	263.97	266	602	126.32
Current Capital Expenditure	500	825	65.06	850	141	(83.42)
Development Expenditure	38,224	36,545	(4.39)	50,149	35,624	(28.96)
Total	146,414	134,930		179,895	156,344	

() = negative number

Source: Annual budget statements and budget analysis 2007/08, Sindh Finance Department.

Table 5: Primary Expenditure: Variance from Budget

Year	For PI-1 Total Expenditure Deviation (%)	Total Expenditure Variance (average weighted) (%)	For PI-2 Variance in Excess of Total Deviation (%)
FY2005	13.24	55.36	42.12
FY2006	7.84	41.03	33.18
FY2007	13.09	21.96	8.87

PI-3 Aggregate revenue out-turn compared to original approved budget
Overall rating for provincial own-revenues is 'B', and 'N/S' for district governments.

3.1.13 The criteria for assessing the subrating elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than 1 of the last 3 years.
B	Actual domestic revenue collection was below 94% of budgeted domestic revenue estimates in no more than 1 of the last 3 years.
C	Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in no more than 1 of the last 3 years.
D	Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in 2 or all of the last 3 years.

3.1.14 Accurate forecasting of domestic revenue is a critical factor in determining budget performance, as budgeted expenditure allocations are based on that forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting and achievement. The assessment includes both the overall revenue and the provincially generated own-source revenue.

3.1.15 The government of Sindh depends on federal government transfers to meet 85% of its overall expenditure budget. Table 6 gives a complete picture of the various tax and nontax revenue heads for collection, and the budget estimates for

FY2005, FY2006, and FY2007 versus the actual revenue collection by the government. The main revenue-collecting agencies at the provincial level are the Board of Revenue and the Excise and Taxation Department.

Table 6: Province Own-Source Revenues: Government of Sindh

(PRs million)

Revenue Head	BE ^a	Actual	BE	Actual	BE	Actual
	FY2005	FY2005	FY2006	FY2006	FY2007	FY2007
Tax Revenue – Direct Taxes						
Agriculture Income Tax	400.0	196.6	410.0	197.5	450.0	158.2
Transfer of Property Tax	500.0	599.0	610.0	800.4	700.0	575.8
Land Revenue	—	121.3	110.0	123.0	110.0	113.9
Capital Gains Tax	—	—	—	37.3	—	—
Taxes on Professions, Trades	200.0	163.6	200.0	175.6	210.0	183.9
Subtotal (A)	1,100.0	1,080.4	1,330.0	1,333.9	1,470.0	1,031.8
Tax Revenue – Indirect Taxes						
Provincial Excise	800.0	1,159.8	1,200.0	1,312.3	1,400.0	1,442.7
Stamp Duties	4,000.0	3,775.5	4,200.0	3,937.9	4,800.0	3,761.6
Motor Vehicles	1,600.0	1,636.5	1,791.0	2,055.5	2,000.0	2,060.0
Entertainment Tax	—	—	—	30.5	—	31.7
Betterment Tax	—	—	—	1.5	—	—
Tax on Hotels	80.0	53.5	90.0	165.2	140.0	164.8
Cotton Fee	150.0	126.8	160.0	121.4	185.0	91.6
Electricity Duty	550.0	280.2	400.0	109.4	500.0	733.8
Other Indirect Taxes	2,800.0	3,681.8	3,540.0	4,603.0	4,608.0	4,729.7
Subtotal (B)	9,980.0	10,712.3	11,381.0	12,336.7	13,633.0	13,015.9
Nontax Revenue						
Income from Property and Enterprise	11.0	15.7	1,058.8	11.6	1,243.5	10.7
Total Receipts from General Administration	102.3	68.4	84.0	80.3	101.0	80.2
Total Law and Order Receipts	859.8	594.1	842.5	567.4	910.0	681.3
Receipts from Community Services	127.2	165.3	179.0	228.0	182.0	160.4
Receipts from Social Services	302.6	261.4	307.0	339.3	204.5	261.3
Receipts from Economic Services	608.1	533.2	797.2	699.0	947.0	569.4
Miscellaneous	3,419.0	2,364.4	3,300.0	3,646.0	3,117.0	3,353.5
Subtotal (C)	5,430.0	4,002.5	6,568.5	5,571.6	6,705.0	5,116.7
TOTAL (A+B+C)	16,510.0	15,795.2	19,279.5	19,242.3	21,808.0	19,164.5

^a BE = Budgeted expenditures as per original budget approved by the assembly.

3.1.16 Table 7 shows the variance between revenue projections and actual collection. The variance was 4.33% in FY2005 and declined to 0.19% in FY2006. However, it increased to 12.54% in FY2007. In accordance with the PEFA criteria, the indicator for the province own-source revenue generation is rated 'B'; this is because in only 1 year was the actual revenue collection below 94% of budgeted provincial government's own receipts. It does indicate that the provincial government makes a reasonably fair estimate of its expected revenue receipts as indicated by its budget estimates.

Table 7: Province Own-Revenue Collection

<i>(PRs million)</i>			
Year	FY2005	FY2006	FY2007
Budget estimates	16,510	19,280	21,808
Actual	15,795	19,242	19,164
Variance (%)	95.67	99.81	87.88

PI-4 Stock and monitoring of expenditure payment arrears

Overall rating: D+ for both provincial and district governments

- Subrating element (i): Stock of arrears: 'A' for both the provincial and district governments
- Subrating element (ii): Data on stock of arrears: 'D' for both the provincial and district governments

3.1.17 The PEFA criteria for assessment of PI-4 are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) The stock of arrears is low (i.e., below 2% of total expenditure). (ii) Reliable and complete data on the stock of arrears are generated through routine procedures at least at the end of each fiscal year (and the data include an age profile).
B	(i) The stock of arrears constitutes 2%–10% of total expenditure; there is evidence that it has been reduced significantly (i.e., more than 25%) in the last 2 years. (ii) Data on the stock of arrears are generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions.
C	(i) The stock of arrears constitutes 2%–10% of total expenditure; there is no evidence that it has been reduced significantly in the last 2 years. (ii) Data on the stock of arrears have been generated by at least one comprehensive ad hoc exercise within the last 2 years.
D	(i) The stock of arrears exceeds 10% of total expenditure. (ii) There are no reliable data on the stock of arrears from the last 2 years.

- 3.1.18 Expenditure payment arrears are the expenditure obligations that have been incurred by the government for which payment to the employee, supplier, contractor, or loan creditor is overdue. They constitute a form of nontransparent financing. A high level of arrears can indicate a number of different problems, such as inadequate commitment controls, cash rationing, inadequate budgeting for contracts, underbudgeting of specific items, and lack of information. This indicator is concerned with measuring the extent to which there is a stock of arrears, and the extent to which any systemic problem is being brought under control and addressed.
- 3.1.19 Currently, neither the provincial government nor the subprovincial (district) governments keep any consolidated stock of expenditure payment arrears. However, the provincial government has stated that no liability against annual commitments is carried forward to the next year. According to the government, all annual liabilities against commitments for payments are cleared before the year's end, and, that in exceptional circumstances, if payment arrears are created (attributed mainly to late release of funds to the subprovincial governments) they are settled in the following year, as is the case in some of the subprovincial works contracts. The government reasonably estimates that such arrears for unpaid public works contracts or general supplies represent less than 2% of total expenditures, as they are few and low in value compared to the billions of rupee expenditures budgeted and paid out each year for other matters. However, no reliable data are available on payment arrears and stocktaking. There are also no reflections of such obligations in the annual development program of the provincial and the subprovincial governments. If any recording of such exceptional cases of payment arrears is made, no evidence exists that it has been made formally.
- 3.1.20 It is expected that, with the complete implementation of the Project to Improve Financial Reporting and Auditing (PIFRA), especially at the subprovincial levels, the practice of commitment and obligation recording, control, and management (planned in FY2010) will be introduced to also support keeping stock of payment arrears.
- 3.1.21 As the government of Sindh does not keep a formal record of consolidated stock of the expenditure payment arrears, and there are no available and reliable data—a phenomenon evident across all provinces—a rating of 'D' is applied for both the provincial and district governments of Sindh for subindicator rating (ii). However, due to the very negligible payment arrears (less than 2%) by the close of each fiscal year as stated by the government and supported, on interview, by the auditors, subindicator (i) is rated 'A', yielding an overall rating for PI-4 of 'D+'.

3.2 Comprehensiveness and Transparency

PI-5 Classification of the budget

Overall rating: 'A' for both provincial and district governments

3.2.1 The criteria for rating the indicator are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	The budget formulation and execution are based on administrative, economic, and subfunctional classifications, using government financial statistics (GFS, developed by the International Monetary Fund) classification of the functions of government (COFOG, developed by the United Nations) standards, or a standard that can produce consistent documentation according to those standards. (Program classification may substitute for subfunctional classification if it is applied with a level of detail at least corresponding to subfunctional.)
B	The budget formulation and execution are based on administrative, economic, and functional classification (using at least the 10 main COFOG functions), using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards.
C	The budget formulation and execution are based on administrative and economic classification using GFS standards or a standard that can produce consistent documentation according to those standards.
D	The budget formulation and execution are based on a different classification (e.g., not GFS compatible or with administrative breakdown only).

3.2.2 A robust classification system allows the tracking of spending on the following dimensions: administrative, economic, functional, and program units. Where standard international classification practices are applied, governments can report expenditure in GFS format and track poverty-reducing and other selected groups of expenditure.

3.2.3 The government of Sindh implemented the new accounting model (NAM) in FY2006 and budget and accounts have been prepared since then using the new chart of accounts under the NAM. The 23 districts have also transitioned to the NAM. As this is a major reform initiative undertaken by the federal, provincial, and district governments, it is expected that the desired results from this changeover will become more prominent after complete PIFRA implementation at the subprovincial (district) government levels. With the NAM, it is expected that financial reporting will improve, thus paving the way for better planning and decision making.

3.2.4 The NAM, with the new chart of accounts, uses the classification of functions of GFS and COFOG. Since FY2006 budget formulation and execution are based on

administrative, economic, and subfunctional classification consistent with COFOG and GFS; thus the indicator is assessed 'A' for both provincial and subprovincial governments, based on the criteria given above.

PI-6 Comprehensiveness of information included in budget document

Overall rating: 'A' for provincial and 'N/S' for district governments

3.2.5 Annual budget documentation submitted to the legislature should allow a complete picture of government fiscal forecasts, budget proposals, and out-turn of previous years. The annual budget documentation should include information on the following nine elements:

- (i) Macroeconomic assumptions, including at least estimates of aggregate growth, inflation, and exchange rates.
- (ii) Fiscal deficit, defined according to GFS or other internationally recognized standards.
- (iii) Deficit financing, describing anticipated composition.
- (iv) Debt stock, including details at least for the beginning of the current year.
- (v) Financial assets, including details at least for the beginning of the current year.
- (vi) Prior year's budget out-turn, presented in the same format as the budget proposal.
- (vii) Current year's budget (either the revised budget or the estimated out-turn), presented in the same format as the budget proposal.
- (viii) Summarized budget data for both revenue and expenditure according to the main heads of the classifications used, including data for the current and previous year.
- (ix) Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.

3.2.6 The rating criteria for PI-6 are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	Recent budget documentation fulfils 7-9 of the nine information benchmarks.
B	Recent budget documentation fulfils 5-6 of the nine information benchmarks.
C	Recent budget documentation fulfils 3-4 of the nine information benchmarks.
D	Recent budget documentation fulfils two or less of the nine information benchmarks

3.2.7 The government of Sindh, unlike the other provincial governments, does not produce a white paper as part of the budget documents. For this reason, various macroeconomic factors, such as inflation and the growth rate, are not part of the budget document. Volume I of the province’s Budget Book’s Annual Budget Statement provides complete details of all receipts and disbursements from the public account. For FY2008, however, the government of Sindh has set out Budget Analysis 2007/08, which describes various trends of budgetary allocation including development, the budgeted expenditures for the last 4 years, the current picture of debt and contingent liabilities, and measures of the government to improve various socioeconomic indicators. It also introduces a medium-term fiscal framework (MTFF), which does have limitations in content. The elements listed above, except for (v) and (vi), are not applicable to district governments, which operate under the remit of the provincial government.

3.2.8 The Annual Budget Statement depicts the summary budget data for both revenue and expenditure according to the main classification heads in the new chart of accounts. The annual budget documentation does not include information regarding financial assets—element (v). Furthermore, the budget books do not contain the previous years’ budget out-turns and analysis except for the out-turns of the penultimate fiscal year—element (vi). This means that the prior year out-turn is not included. Accordingly, because only two of the above-listed sets of information on the nine elements are not included in the budget documentation of the provincial government, the indicator is rated 'A'.

PI-7 Extent of unreported government operations

Overall rating: 'D+' for provincial and 'N/A' for district governments

- Subrating element (i): The level of extrabudgetary expenditure (other than donor-funded projects) that is unreported, i.e., not included in fiscal reports: 'A'.
- Subrating element (ii): Income and expenditure information on donor-funded projects that is included in fiscal reports: 'D'.

3.2.9 The rating criteria for the indicator are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) The level of unreported extrabudgetary expenditure (other than donor-funded projects) is insignificant (below 1% of total expenditure). (ii) Complete income and expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in kind, or donor-funded project expenditure is insignificant (below 1% of total expenditure).

B	(i) The level of unreported extrabudgetary expenditure (other than donor-funded projects) constitutes 1%-5% of total expenditure. (ii) Complete income and expenditure information is included in fiscal reports for all loan-financed projects and at least 50% (by value) of grant-financed projects.
C	(i) The level of unreported extrabudgetary expenditure (other than donor-funded projects) constitutes 5%-10% of total expenditure. (ii) Complete income and expenditure information for all loan-financed projects is included in fiscal reports.
D	(i) The level of unreported extrabudgetary expenditure (other than donor-funded projects) constitutes more than 10% of total expenditure. (ii) Information on donor-financed projects included in fiscal reports is seriously deficient and does not even cover all loan-financed operations.

3.2.10 Annual budget estimates, in-year execution reports, year-end financial statements, and other fiscal reports for the public, should cover all budgetary and extrabudgetary activities of the provincial government to give a complete picture of its revenue and expenditure across all categories, and financing. This will be the case if (i) extrabudgetary operations (provincial government activities that are not included in the annual budget law, such as those funded through extrabudgetary funds) are insignificant, or significant expenditures on extrabudgetary activities, if any, are included in fiscal reports; and (ii) activities included in the budget but managed outside the government's budget management and accounting system (mainly donor-funded projects) are insignificant or included in government fiscal reporting.

3.2.11 The budget document of the government of Sindh contains estimates of all budgetary allocations and revised estimates for the last financial year. The revised estimates are the actual expenditures for the first three quarters of the financial year and a projected estimate for the last quarter. The budget documents also contain the accounts (actual expenditures) for all budgetary allocations, including development expenditures for the penultimate year.

3.2.12 Nevertheless, certain offices collect fees and/or user charges (e.g., school tuckshop [canteen] fees) that are not deposited in the treasury. This income and the corresponding expenditure are neither collated nor reported; however, the overall amount is ascertained to be negligible.

3.2.13 The expenditure made through personal ledger accounts is appropriated annually and documented as part of the budget; however, classified accounts of actual expenditure are not always presented in the fiscal reports.

3.2.14 The donor-funded projects are allowed to open and maintain assignment accounts outside the traditional government accounting and reporting system.

Although Sindh's Planning and Development Department maintains allocations and expenditures for all donor-funded projects and actual expenditures are collected monthly and compiled quarterly, these are not reported as part of the government's fiscal reports. Planning and development reports for all donor-funded projects contain information including (i) the total allocation for the project; (ii) the allocation for the year; (iii) revised expenditure estimates for the preceding year and actual expenditures for the year before that; and (iv) dates of loan, credit, or grant signing, its effectiveness, and closing. Sindh's accountant general is not provided with expenditure returns on donor-funded projects for consolidation in the monthly civil accounts of the government, and neither are these projects' expenditures included as part of the government's annual financial statements. There is also concern that disbursements from loan accounts under direct payment procedures are not reported to the accountant general. This has led to the material differences between the province's fiscal balances and its monetary balances held with the State Bank of Pakistan, the fiscal agent of the government.

3.2.15 Since the amount of unreported expenditure in Sindh is insignificant (estimated at well below 1%), other than that relating to donor-funded operations, this dimension (i) is rated 'A'. However, as income and expenditure information captured in the fiscal reports, including information related to donor-financed projects, has always been incomplete, dimension (ii) is rated 'D'. This is clearly a result of not using mainstream government systems for donor-financed investment projects. On the basis of the M1 scoring methodology, the indicator is rated overall as 'D+'. The indicator has not been rated for subprovincial governments as they are not empowered to engage in deficit financing or to contract debt.

PI-8 Transparency of intergovernmental fiscal relations

Overall rating: 'B' for provincial and 'N/A' for district governments

- Subrating element (i): Transparent and rules-based systems in the horizontal allocation among lower-level governments of unconditional and conditional transfers (both budgeted and actual allocations): 'A'.
- Subrating element (ii): Timeliness of reliable information to lower-level governments on their allocations for the coming year: 'C'.
- Subrating element (iii): Extent to which consolidated fiscal data (at least on revenue and expenditure) are collected and reported for general government according to sector categories: 'C'.

Subrating	Minimum Requirements (Scoring Methodology M2)
(i) Transparency and objectivity in the horizontal allocation among subprovincial^a governments	<p>Score 'A': The horizontal allocation of almost all transfers (at least 90% by value) from provincial government is determined by transparent and rules-based systems.</p> <p>Score 'B': The horizontal allocation of most transfers from provincial government (at least 50% of transfers) is determined by transparent and rules-based systems.</p> <p>Score 'C': The horizontal allocation of only a small part of transfers from provincial government (10%-50%) is determined by transparent and rules-based systems.</p> <p>Score 'D': None or hardly any part of the horizontal allocation of transfers from provincial government is determined by transparent and rules-based systems.</p>
(ii) Timeliness of reliable information to subprovincial governments on their allocations	<p>Score 'A': Subprovincial governments are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting processes.</p> <p>Score 'B': Subprovincial governments are provided reliable information on the allocations to be transferred to them ahead of completing their budget proposals, so that significant changes to the proposals are still possible.</p> <p>Score 'C': Reliable information to subprovincial governments is issued before the start of the subprovincial fiscal year, but too late for significant budget changes to be made.</p> <p>Score 'D': Reliable estimates on transfers are issued after subprovincial government budgets have been finalized, or earlier issued estimates are not reliable.</p>
(iii) Extent of consolidation of fiscal data for general government according to sector categories	<p>Score 'A': Fiscal information (ex-ante and ex-post) that is consistent with provincial government fiscal reporting is collected for 90% (by value) of subprovincial government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.</p> <p>Score 'B': Fiscal information (ex-ante and ex-post) that is consistent with provincial government fiscal reporting is collected for at least 75% (by value) of subprovincial government expenditure and consolidated into annual reports within 18 months of the end of the fiscal year.</p> <p>Score 'C': Fiscal information (at least ex-post) that is consistent with provincial government fiscal reporting is collected for at least 60% (by value) of subprovincial government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year.</p> <p>Score 'D': Fiscal information that is consistent with provincial government fiscal reporting is collected and consolidated for less than 60% (by value) of subprovincial government expenditure, or if a higher proportion is covered, consolidation into annual reports takes place with more than 24 months delay, if at all.</p>

^a The original PEFA framework uses "SN" for subnational, which has been adapted to "subprovincial (district) government" for this assessment.

- 3.2.16 Clear criteria, such as formulas, for the distribution of grants among lower-level government entities are needed to ensure transparency and medium-term predictability of funds available for planning and budgeting of expenditure programs by governments. It is also crucial for lower-level governments that they continue to receive firm and reliable information on annual allocations well in advance of the completion of, and preferably before commencement of, their own budget preparation processes.
- 3.2.17 The provincial government of Sindh largely depends (about 85%) on federal transfer from the divisible pool based on the National Finance Commission Awards. Since the own-source revenue of the provincial government of Sindh and district governments (excluding Karachi) is negligible, and the timely flow of federal transfer is uncertain, the predictability of timely financial releases to the provincial line departments of the government and to the local governments in accordance with the Provincial Finance Commission (PFC) is low. ADB, in its Devolution Report 2004, places average fiscal dependence on the provincial government of districts at 82.5% and of *tehsil* (town) municipal administrations (TMAs) at 58%, including the Urban Immovable Property Tax.
- 3.2.18 However, there is a transparent, rules-based system of transferring the financial resources through the National Finance Commission to the provincial government and from the provincial government, under the aegis of the PFC, to the subprovincial governments. The situation has improved considerably since last reported in Sindh PFAA 2004, which assigned a high predictability risk to the determination and disbursement of PFC allocations to the subprovincial and local governments. Since there is no formal system of tracking releases in a regular and consolidated manner, it is difficult to ascertain whether all periodic transfers are made pro rata according to the agreed formula and in a timely manner. For instance, a reported analysis in the press states that releases under the National Finance Commission for the first quarter of FY2008 by the federal government were made on an average of 19% (as against 25% pro rata) with the exception of Balochistan (26%). The PFC's distribution criteria included factors such as population (50%), backwardness (17.5%), tax collection (7.5%), transitional transfer (20%), and performance-based benchmark (5%). The PFC Award 2007/2010 has changed the distribution criteria and introduced division of allocable amount on the basis of population (40%), service infrastructure (35%), development needs (10%), area (5%), and performance (10%).⁸ The criteria, therefore, for horizontal. Distribution from provincial government to lower levels of

⁸ Finance Department, Government of Sindh, Notification No. FD. SO (PFC) / 6(39)/2004-05 (Part-I), Karachi, dated 30 August 2007.

government is clear and transparent, as largely block transfers are made based on the predetermined distribution formula. Therefore, dimension (i) is rated 'A'.

- 3.2.19 Although the salary portion of the committed share of local governments is transferred accordingly and promptly, the situation is quite different and volatile for development expenditure-related releases. This is evident from the report of the Provincial Finance Commission in June 2005, which states a release of 100% under the salary head, whereas 50% was immediately released in the case of nonsalary nondevelopment. The situation of non-timely availability of information about releases to the local governments, particularly in case of development expenditure, results in either the funds lapsing (insufficient time left for initiation of procurement process, tendering, award of contract, and completion of work) or attracting the attention of external auditors for drawing up audit paragraphs stating "award of work in the absence of funds".
- 3.2.20 The PFC Award sets the allocation formulae for vertical and horizontal distribution of provincial resources. Since the provincial government budget is finalized and published before the start of a fiscal year, broad estimates on provincial resources and the divisible pool are available to the local governments (including districts). In applying the 3-year PFC Award, the local governments are allocated their tentative share for the year. Hence, the subprovincial (district) governments get information on the allocations to be transferred to them during their detailed budgeting process. However, the actual and full realization of these allocations depends on receipt of National Finance Commission share and the pace of provincial collections. Dimension (ii) is therefore rated 'C'.
- 3.2.21 Fiscal data for subprovincial and other local governments with those of the provincial government according to sector categories is poorly consolidated. With the implementation of the NAM, the fiscal information that is consistent with provincial government fiscal reporting is collected and consolidated only at the district government level and later reflected in the monthly civil accounts and the finance accounts. The information regarding other sub-subprovincial and/or local government tiers (those below district government levels, excluding Karachi) is not consolidated into the accounts of the provincial government. As part of its overall fiscal reporting on provincewide expenditure, however, the Finance Department collects and collates the expenditures of the entire province for at least 60% of budgeted transfer values within 24 months of the end of the fiscal year. Based on this rate, and the timing of compilation of fiscal data for all levels of government, dimension (iii) is rated 'C'.
- 3.2.22 Being a three-dimensional indicator, the overall rating of the indicator is 'B' for the provincial government, while the subprovincial governments cannot be rated.

PI-9 Oversight of aggregate fiscal risk from other public sector entities

Overall rating: 'D' for provincial and 'N/A' for district governments

- Subrating element (i): Extent of monitoring of autonomous government agencies (AGAs) and public enterprises: 'D'.
- Subrating element (ii): Extent of monitoring of lower level governments' fiscal position: 'D'.

3.2.23 The criteria for assessing the subrating elements and dimensions are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) All major AGAs and public enterprises submit fiscal reports to provincial governments at least 6 monthly, as well as annual audited accounts, and provincial government consolidates fiscal risk issues into a report at least annually. (ii) Subprovincial government cannot generate fiscal liabilities for provincial government, or the net fiscal position is monitored at least annually for all levels of subnational government and provincial government consolidates overall fiscal risk into annual (or more frequent) reports.
B	(i) All major AGAs and public enterprises submit fiscal reports including audited accounts to provincial governments at least annually, and provincial government consolidates overall fiscal risk issues into a report. (ii) The net fiscal position is monitored at least annually for the most important level of subprovincial government, and provincial government consolidates overall fiscal risk into a report.
C	(i) Most major AGAs and public enterprises submit fiscal reports to provincial governments at least annually, but a consolidated overview is missing or significantly incomplete. (ii) The net fiscal position is monitored at least annually for the most important level of subprovincial government, but a consolidated overview is missing or significantly incomplete.
D	(i) No annual monitoring of AGAs and public enterprises takes place, or it is significantly incomplete. (ii) No annual monitoring of fiscal position of subprovincial governments takes place, or it is significantly incomplete.

3.2.24 A provincial government will usually have a formal oversight role in relation to other public sector entities and should monitor and manage fiscal risks with provincial implications arising from activities of subprovincial lower levels of government, AGAs, and public enterprises. These fiscal risks can take the form of debt service defaulting, operational losses caused by unfunded operations, expenditure payment arrears, and unfunded pension obligations.

- 3.2.25 Government should require and receive quarterly financial statements and audited year-end statements from AGAs and public enterprises that it controls, and monitor performance against financial targets. AGAs and public enterprises often report to parent line ministries, but consolidation of information is important for overview and reporting of the total fiscal risk for the provincial government. Where lower-level governments can generate fiscal liabilities for the provincial government, their fiscal position should be monitored at least on an annual basis, again with consolidation of essential fiscal information.
- 3.2.26 It has not been possible to ascertain the exact number of public enterprises within the government of Sindh due to the lack of consolidated information. However, the audit report on the Accounts of Public Sector Enterprises of the government of Sindh for FY2006 indicates that there are 16 public enterprises. The report also confirms the nonavailability of annual accounts for 11 public enterprises, including one which has not been operational since FY1999 and another since FY2002. Furthermore, the report indicates nonavailability of audited accounts of the operational public enterprises ranging between 2 and 21 financial years.
- 3.2.27 A rating of 'D' is applicable to dimension (i) as most of the AGAs and public enterprises neither submit any fiscal reports to the provincial government nor present their annual audited accounts to the provincial government. Moreover, there is no central agency to consolidate any such information in the form of a consolidated fiscal risk report on all AGAs and public enterprises.
- 3.2.28 Whilst the fiscal and financial position is monitored at least annually for all levels of provincial government at the time of budget allocation, there is no evidence to suggest that it leads to either performance measurement against financial targets or consolidation of overall fiscal risk arising from the activities of the provincial governments' AGAs and public enterprises. The AGAs and public enterprises do generate liabilities for provincial government. For example, the provincial government has had to assume the liability for repayment of a loan taken by the Hyderabad Development Authority from the Islamic Development Bank, and certain liabilities related to the Karachi Transport Corporation, the Sindh Road Transport Corporation, and the Sindh Agricultural Surplus Organization.
- 3.2.29 The Sindh Local Government Ordinance 2001 prohibits local governments from borrowing. However, in the absence of effective and efficient local government fiscal discipline, there is a tendency to overcommit future resources. The provincial government considers the district and subdistrict governments as independent government entities and therefore carries out no systematic annual monitoring of their fiscal positions. Where monitoring is carried out, it is mainly

against the backdrop of the budget allocation and execution process for conditional grants. In the circumstances, a rating of ‘D’ is applicable to dimension (ii).

3.2.30 Overall, the indicator is rated ‘D’ on the basis of the weakest link M1 scoring methodology.

3.2.31 Subprovincial and other lower levels of government do not control public sector entities.

PI-10 Public access to key fiscal information

Overall rating: ‘C’ for provincial and ‘D’ for district governments

3.2.32 Transparency will depend on whether information on fiscal plans, positions, and performance of the government is easily accessible to the general public or at least to the relevant interest groups. Elements of information to which public access is essential include

- (i) annual budget documentation,
- (ii) in-year budget execution reports,
- (iii) year-end financial statements,
- (iv) external audit reports,
- (v) contract awards, and
- (vi) resources available to primary service units.

3.2.33 The scoring methodology is as follows:

Score	Minimum requirements (Scoring Methodology M1)
A	The government makes available to the public 5-6 of the six listed types of information.
B	The government makes available to the public 3-4 of the six listed types of information.
C	The government makes available to the public 1-2 of the six listed types of information.
D	The government makes available to the public none of the six listed types of information.

3.2.34 In respect of the provincial government, public access to key fiscal information is characterized by the following:

- Annual budget documentation is available in printed form as well as on the government’s web portal. It contains the summary of details of

appropriations for the year, revised estimates for the last fiscal year, and the actual position for the penultimate year. Further, copies of the budget book are also distributed among the media and representatives of civil society after the budget is approved by the provincial legislature.

- There is no elaborate detail publicly available for in-year budget execution; however, summary monthly civil accounts are available within 15 days of the end of the month and posted to the website of the Finance Department (www.fdsindh.gov.pk) during the succeeding month.
- Annual financial statements are not widely circulated, and external audit reports have a very restricted circulation to the relevant departments of the government, provincial legislature, and the auditing entity.
- Contract awards are not made public. Similarly, information regarding resources placed at the disposal of the service delivery units is not made public, though it is communicated to the service delivery units in time. Nonetheless, compiled information on personnel data will soon be published on the Finance Department’s website.

3.2.35 Accordingly, since only two out of the six listed types of information are made public and are widely circulated, the rating is assessed ‘C’.

3.2.36 In respect of the subprovincial governments, only one of the six elements as defined above is complied with. The rating therefore is assessed ‘D’.

3.3 Policy-Based Budgeting

PI-11 Orderliness and participation in the annual budget process

Overall rating: ‘B+’ for provincial and ‘D+’ for district governments

- Subrating element (i): Existence of and adherence to a fixed budget calendar: ‘A’ for provincial and ‘C’ for district governments.
- Subrating element (ii): Guidance on the preparation of budget submissions: ‘C’ for both provincial and district governments.
- Subrating element (iii): Timely budget approval by the legislature: ‘A’ for provincial and ‘D’ for district governments.

Dimension	Minimum Requirements (Scoring Methodology M2)
(i) Existence of and adherence to a fixed budget calendar	Score 'A': A clear annual budget calendar exists; is generally adhered to; and allows the ministries, departments, and agencies (MDAs) enough time (and at least 6 weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time. Score 'B': A clear annual budget calendar exists, but some delays are often

	<p>experienced in its implementation. The calendar allows MDAs reasonable time (at least 4 weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time.</p> <p>Score 'C': An annual budget calendar exists, but is rudimentary and substantial delays may often be experienced in its implementation, and allows MDAs so little time to complete detailed estimates that many fail to complete them.</p> <p>Score 'D': A budget calendar is not prepared, it is generally not adhered to, or the time allowed for MDAs' budget preparation is clearly insufficient to make meaningful submissions.</p>
(ii) Guidance on the preparation of budget submissions	<p>Score 'A': A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by cabinet (or equivalent) prior to the circular's distribution to MDAs.</p> <p>Score 'B': A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission.</p> <p>Score 'C': A budget circular is issued to MDAs, including ceilings for individual administrative units or functional areas. The budget estimates are reviewed and approved by cabinet only after they have been completed in all details by MDAs, thus seriously constraining cabinet's ability to make adjustments.</p> <p>Score 'D': A budget circular is not issued to MDAs, the quality of the circular is very poor, or cabinet is involved in approving the allocations only immediately before submission of detailed estimates to the legislature, thus having no opportunities for adjustment.</p>
(iii) Timely budget approval by the legislature	<p>Score 'A': The legislature has, during the last 3 years, approved the budget before the start of the fiscal year.</p> <p>Score 'B': The legislature approves the budget before the start of the fiscal year, but a delay of up to 2 months has happened in 1 of the last 3 years.</p> <p>Score 'C': The legislature has, in 2 of the last 3 years, approved the budget within 2 months of the start of the fiscal year.</p> <p>Score 'D': The budget has been approved with more than 2 months delay in 2 of the last 3 years.</p>

3.3.1 The Finance Department is usually the driver of the annual budget formulation process, but effective participation in the budget formulation process by all MDAs as well as the political leadership affects the extent to which the budget will reflect macroeconomic, fiscal, and sector policies. Full participation requires an integrated budgeting process involving all parties in an orderly and timely manner in accordance with a predetermined budget formulation calendar. Clear guidance on the budget process should be provided in the budget circular and budget formulation manual, including indicative budgetary ceilings for administrative units or functional areas.

- 3.3.2 There is a clearly laid out budget calendar at the provincial government level in the form of a budget call circular (BCC), which provides the process timelines for the MDAs to submit statements of new expenditures and budget proposals. Notwithstanding the very minor adherence delays at the intermediate process levels that do not impact upon the overall timeline, the calendar is generally followed by both by the Finance Department and MDAs. More than 6 weeks is given to MDAs to compile their submissions. Dimension (i) is therefore rated 'A' for the provincial government.
- 3.3.3 At the district government level, although there is a clear budget calendar, the process compliance during the budget preparation and submission phase is very weak. Due largely to the dependence of the districts on the approved provincial budget to form a firm basis for completion of their own budgets, significant delays are generally experienced before MDAs can complete their budget estimates. It has traditionally taken up to 3 months into the new fiscal year, on average, for the budget process to be completed by most districts. The budget calendars are also quite rudimentary in themselves. Dimension (i) is therefore rated 'C' for the district governments.
- 3.3.4 A comprehensive and clear budget circular is issued to MDAs. It consists of formats for receipt estimates, expenditure, details of posts and employees, details of supplementary budget statements, budget reappropriation and surrender statements, and performance targets. The BCCs do not include sector expenditure ceilings that have been derived from any form of political consultation, however. Dimension (ii) is accordingly rated 'C' for the provincial government.
- 3.3.5 As regards district governments, despite guidance being provided by the provincial Finance Department, there is no adequate or systematic form of guidance provided by the district Finance Office during the budget process or as part of the budget call circular. The local government budget rules are not followed and, as a result, budgets are presented in a nonuniform manner. As a result, dimension (ii) is rated 'C' for district governments.
- 3.3.6 The provincial government budget is presented to and approved by the provincial assembly in June, at least 2 weeks before the start of a new fiscal year. Therefore, dimension (iii) for the provincial government is rated 'A'.
- 3.3.7 At the district government level, the budgets are prepared well after the start of the fiscal year, inconsistent with the Sindh Local Government Act, and approved by the zila council several months (average of 2-5 months) after the start of the fiscal year. As a result, the dimension (iii) rating for the district governments is 'D'.

3.3.8 Using the M2 scoring methodology, the indicator scores are ‘B+’ for the provincial government and ‘D+’ for the district governments.

PI-12 Multiyear perspective in fiscal planning, expenditure policy, and budgeting

Overall rating: ‘C’ for provincial and ‘N/A’ for district governments

- Subrating element (i): Preparation of multiyear fiscal forecasts: ‘C’.
- Subrating element (ii): Scope and frequency of debt sustainability analysis: ‘A’.
- Subrating element (iii): Existence of sector strategies with multiyear costing of recurrent and development and investment expenditure: ‘D’.
- Subrating element (iv): Links between investment budgets and forward expenditure estimates: ‘D’.

3.3.9 The four dimensions (subratings) are assessed according to the following scoring methodology:

Dimension	Minimum Requirements (Scoring Methodology M2)
(i) Multiyear fiscal forecasts and functional allocations	<p>Score 'A': Forecasts of fiscal aggregates (on the basis of main categories of economic and functional and sector classification) are prepared for at least 3 years on a rolling annual basis. Links between multiyear estimates and subsequent setting of annual budget ceilings are clear and differences explained.</p> <p>Score 'B': Forecasts of fiscal aggregates (on the basis of main categories of economic and functional and sector classification) are prepared for at least 2 years on a rolling annual basis. Links between multiyear estimates and subsequent setting of annual budget ceilings are clear and differences are explained.</p> <p>Score 'C': Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least 2 years on a rolling annual basis.</p> <p>Score 'D': No forward estimates of fiscal aggregates are undertaken.</p>
(ii) Scope and frequency of debt sustainability analysis	<p>Score 'A': Debt sustainability analysis for external and domestic debt is undertaken annually.</p> <p>Score 'B': Debt sustainability analysis for external and domestic debt is undertaken at least once during the last 3 years.</p> <p>Score 'C': Debt sustainability analysis at least for external debt undertaken once during last 3 years.</p> <p>Score 'D': No debt sustainability analysis has been undertaken in the last 3 years.</p>

(iii) Existence of costed sector strategies	<p>Score 'A': Strategies for sectors representing at least 75% of primary expenditure exist with full costing of recurrent and investment expenditure, broadly consistent with fiscal forecasts.</p> <p>Score 'B': Statements of sector strategies exist and are fully costed, broadly consistent with fiscal forecasts, for sectors representing 25%–75% of primary expenditure.</p> <p>Score 'C': Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure, or costed strategies cover more sectors but are inconsistent with aggregate fiscal forecasts.</p> <p>Score 'D': Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure.</p>
(iv) Links between investment budgets and forward expenditure estimates	<p>Score 'A': Investments are consistently selected on the basis of sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.</p> <p>Score 'B': The majority of important investments are selected on the basis of sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.</p> <p>Score 'C': Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases.</p> <p>Score 'D': Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.</p>

3.3.10 Expenditure policy decisions have multiyear implications, and therefore multiyear fiscal forecasts (including reviews of debt sustainability) are needed. Expenditure policy decisions or options should be described in sector strategy documents, which are fully costed. No multiyear fiscal planning and expenditure policy and budgeting is in place at the district government level.

3.3.11 Multiyear fiscal forecasting has recently been introduced at the provincial government level in the shape of the medium-term fiscal framework (MTFF), and this was a World Bank policy action under the Sindh Education Development Policy Credit. The MTFF covers FY2007–FY2010. Efforts are under way to introduce a medium-term budget framework based on economic classifications but no progress has been made so far. Considering the MTFF as a first step towards economic classification-based medium-term fiscal forecasting (involving 3 years of projections), dimension (i) is rated 'C'.

3.3.12 The government of Sindh carries out debt sustainability analysis every year but it is not made part of the budget documents. Under the World Bank-supported Structural Adjustment Credit Reform Program, debt analysis was carried out and

a debt strategy was devised. As a result of this exercise, the government was able to reduce its debt liabilities by PRs2.1 billion in the first 2 years. For the first time, the government has presented detailed debt sustainability analysis as part of the budget analysis for FY2008. Accordingly, dimension (ii) is rated 'A'.

3.3.13 The MTFE does not present forecasts on a functional classification basis, rather it provides future projections for overall provincial and federal revenue receipts and expenditure (classified for salaries, district government shares, and maintenance costs, all on a single-line basis) and one-line aggregate projections of development expenditure. Without adequately costed sector strategies that are linked to the goals and targets for growth, poverty reduction, and human and social development, intertemporal and allocative inefficiencies in public expenditures can undermine social and economic development objectives. In Sindh, there is no coherent integration of the development and the recurrent budgets as these are all stand-alone documents. Since links between sector strategies and multiyear development and recurrent expenditure estimates remain absent for at least 75% of the sectors, and the recurrent cost impact of most investment decisions are not clearly identified, dimension (iii) is rated 'D' under the scoring methodology.

3.3.14 The projection made for FY2008 in the MTFE has links to the annual budget of FY2008. The achievements are closely linked with the projected targets for revenue receipts and expenditure but development expenditure has risen by 66% against the projected 15%. There is, however, no coherent integration of the development and the recurrent budgets as these are all stand-alone documents. In the circumstances, program costing is, at best, fragmented. As a result, dimension (iv) is rated 'D'.

3.3.15 Overall, therefore, the indicator is rated 'C'.

3.4 Predictability and Control in Budget Execution

PI-13 Transparency of taxpayer obligations and liabilities

Overall rating: 'C' for provincial and 'N/A' for district governments

- Subrating element (i): Clarity and comprehensiveness of tax liabilities: 'C'.
- Subrating element (ii): Taxpayer access to information on tax liabilities and administrative procedures: 'C'.
- Subrating element (iii): Existence and functioning of a tax appeals mechanism: 'C'.

3.4.1 The three dimensions (subratings) are assessed according to the following scoring methodology:

Dimension	Minimum Requirements (Scoring Methodology M2)
(i) Clarity and comprehensiveness of tax liabilities	<p>Score 'A': Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved.</p> <p>Score 'B': Legislation and procedures for most, but not necessarily all, major taxes are comprehensive and clear, with fairly limited discretionary powers of the government entities involved.</p> <p>Score 'C': Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questionable due to substantial discretionary powers of the government entities involved.</p> <p>Score 'D': Legislation and procedures are not comprehensive and clear for large areas of taxation and/or involve important elements of administrative discretion in assessing tax liabilities.</p>
(ii) Taxpayer access to information on tax liabilities and administrative procedures	<p>Score 'A': Taxpayers have easy access to comprehensive, user-friendly, and up-to-date information on tax liabilities and administrative procedures for all major taxes, and the revenue administration supplements this with active taxpayer education campaigns.</p> <p>Score 'B': Taxpayers have easy access to comprehensive, user-friendly, and up-to-date information on tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited.</p> <p>Score 'C': Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due to coverage of selected taxes only, lack of comprehensiveness, and/or not being up to date.</p> <p>Score 'D': Taxpayer access to up-to-date legislation and procedural guidelines is seriously deficient.</p>
(iii) Tax appeals mechanism	<p>Score 'A': A tax appeals system of transparent administrative procedures with appropriate checks and balances, implemented through independent institutional structures, is completely set up and effectively operating with satisfactory access and fairness, and its decisions are promptly acted upon.</p> <p>Score 'B': A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness, or effective follow up on its decisions need to be addressed.</p> <p>Score 'C': A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent, and effective.</p> <p>Score 'D': No functioning tax appeals system has been established.</p>

- 3.4.2 Effective assessment of tax liability is subject to the overall control environment that exists in the revenue administration system, but is also very dependent on the direct involvement and cooperation of the taxpayers from the individual and corporate private sector. Their contribution to ensuring overall compliance with tax policy is encouraged and facilitated by a high degree of transparency of tax liabilities, including clarity of legislation and administrative procedures, access to information in this regard, and the ability to contest administrative rulings on tax liability. A good tax collection system encourages compliance and limits individual negotiation of tax liability by ensuring that tax legislation is clear and comprehensive and that it limits discretionary powers.
- 3.4.3 The tax revenue of the province is based on two types of taxes: federal taxes, and provincial taxes. The federal taxes—such as income tax, sales tax, customs duty, and federal excise—are collected by the federal government and charged to a common pool, and agreed shares of the provinces are subsequently transferred to the respective provincial governments. A portion of these taxes is eventually disbursed to the subprovincial governments in accordance with the PFC distribution formula. Provincial taxes are levied by the provincial government and are collected and deposited to the common divisible pool of the province. These include, but are not limited to, provincial excise, transfer of property tax, motor registration, land revenue, entertainment and agriculture tax, and stamp duties.
- 3.4.4 Legislation and procedures are clear for all types of federal and provincial taxes. In the case of federal taxes, the enabling procedures are contained in the Customs Act 1969 (amended June 2005), the Federal Excise Act 2005 and Federal Excise Rules 2005, the Income Tax Ordinance 2001 (amended June 2006), and the Sales Tax Act 1990.
- 3.4.5 In case of provincial taxes (the focus of this assessment), the enabling legislation includes the Sindh Land Tax and Agriculture Income Tax Ordinance 2000, Sindh Land Tax and Agricultural Income Tax Rules 2001, Sindh Urban Immovable Property Tax Act 1958, Sindh Finance Act 1977 and 1994, Sindh Cotton Control Rules 1966, Stamps Act 1899, Sindh Prohibition Rules 1979, Sindh Motor Vehicles Taxation Act 1958, Motor Vehicle Ordinance 1965, Motor Vehicles Rules 1969, Sindh Mining Concession Rules 2002, Revenue Act 1967, Cantonment Urban Immovable Property Tax and Entertainment Duty Order 1979, Electricity Duty Rules 1964, and Sugar Cane Development Cess Rules 1964.
- 3.4.6 However, substantial discretion exists in both types of taxes. Specifically, in respect of the provincial government, revenue receipts audit reports for FY2003, FY2005, and FY2006 highlight the continuous misuse of discretion by the tax assessment officers resulting in nonrealization of property tax (among others),

- nonissuance of demand notices, and cases of underassessment. The legislation and procedures for most of the taxes are reasonably comprehensive and clear, but the fairness of the system is debatable due to the prevalent practice of exercising discretionary powers in exempting penalties, and in making fair and objective tax liability assessments. Accordingly, subrating element (i) is rated 'C' in respect of the provincial tax revenue systems.
- 3.4.7 The Federal Board of Revenue (FBR) is the responsible agency for collecting federal taxes. Post-reforms, the FBR has a fully functional taxpayer education and facilitation wing which caters to the requirement of bringing up-to-date information to the taxpayers in a user-friendly manner on a regular basis. The wing is entrusted to develop and update a dissemination strategy (including publications, newsletters, media, seminars, and workshops) from time to time. The FBR has introduced a "tax assistant"—a calculator for self-determining tax liability by a taxpayer, and electronic filing of tax returns. However, proactive education of taxpayers and easy access to user-friendly information on tax liability is absent in the case of the provincial taxation system. Nevertheless, taxpayers have access to some information on tax liabilities and administrative procedures, although these are not regularly updated. As a result, subrating element (ii) for provincial revenue collection is rated 'C'.
- 3.4.8 On federal taxes, a tax appeals system of transparent administrative procedures is completely set up; however, the system of checks and balances is predominantly weak. The appeals mechanism is mainly executed internally—i.e., it is not independent. Being an internal system, desired efficiency, transparency, and fairness cannot be ensured. Another appeals mechanism through alternate dispute resolution, which is more independent than the internal system, is gaining momentum. However, the decisions of these cases are implemented more slowly than is the case in the internal appeals mechanism.
- 3.4.9 In the case of the provincial tax appeals system, appeals can be made to the next level of the tax assessor. Therefore, if the taxpayer wishes to appeal against the excise and taxation officer, he or she can appeal to the director of excise and taxation. If the taxpayer is not satisfied with the decision on his or her appeal, the next level of appeal is the civil court of relevant jurisdiction. However, the appeals system gives these authorities a great deal of discretion. The existing system of appeals needs a massive overhaul in order to be fair, transparent, and effective. Subrating element (iii) is therefore assessed 'C' for provincial taxes.
- 3.4.10 The Local Government Ordinance 2001 devolves many tax and nontax receipts to local government. Nevertheless, the district government revenue assignments are not historically buoyant. The new levies, like the Health and Education Cesses, are yet to be implemented in many districts and the collections at the

moment are negligible.⁹ Hence, in the absence of significant collections by district governments, the performance cannot be assessed against this indicator.

PI-14 Effectiveness of measures for taxpayer registration and tax assessment

Overall rating: 'D+' for provincial and 'N/A' for district governments

- Subrating element (i): Controls in the taxpayer registration system: 'D'.
- Subrating element (ii): Effectiveness of penalties for noncompliance with registration and tax declaration: 'D'.
- Subrating element (iii): Planning and monitoring of tax audit programs: 'C'.

Dimension	Minimum Requirements (Scoring Methodology M2)
(i) Controls in the taxpayer registration system	<p>Score 'A': Taxpayers are registered in a complete database system with comprehensive direct links to other government registration systems and financial sector regulations.</p> <p>Score 'B': Taxpayers are registered in a complete database system with some links to other government registration systems and financial sector regulations.</p> <p>Score 'C': Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Links to other registration and licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers.</p> <p>Score 'D': Taxpayer registration is not subject to any effective controls or enforcement systems</p>
(ii) Effectiveness of penalties for noncompliance with registration and tax declaration	<p>Score 'A': Penalties for all areas of noncompliance are set sufficiently high to act as deterrence and are consistently administered.</p> <p>Score 'B': Penalties for noncompliance exist for most areas, but are not always effective due to insufficient scale and/or inconsistent administration.</p> <p>Score 'C': Penalties for noncompliance generally exist, but substantial changes to their structure, levels, or administration are needed to give them a real impact on compliance.</p> <p>Score 'D': Penalties for noncompliance are generally nonexistent or ineffective (i.e., set far too low to have an impact, or rarely imposed).</p>
(iii) Planning and monitoring of tax audit programs	<p>Score 'A': Tax audits and fraud investigations are managed and reported on according to a comprehensive and documented audit plan, with clear risk assessment criteria for all major taxes that apply self-assessment.</p> <p>Score 'B': Tax audits and fraud investigations are managed and reported on according to a documented audit plan, with clear risk assessment criteria for audits in at least one major tax area that applies self-assessment.</p> <p>Score 'C': There is a continuous program of tax audits and fraud</p>

⁹ The government of Sindh did devolve user charges in education and health functions to the district government on May 3 2006 through notification FD.SO (ResII) BCC-NAM/12(2) / 2006.

	<p>investigations, but audit programs are not based on clear risk assessment criteria.</p> <p>Score 'D': Tax audits and fraud investigations are undertaken on an ad hoc basis, if at all.</p>
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- 3.4.11 Maintenance of a taxpayer database premised on a unique taxpayer identification number is an important element of any tax control system, and is most effective if linked to other government registration systems. Revenue administrations should ensure compliance with registration requirements through occasional surveys of potential taxpayers, e.g., by selective physical inspection of business premises and residences.
- 3.4.12 For all federal tax revenues there is a complete database of taxpayers. However, the tax databases are not integrated with each other or with the databases of various important organizations such as utility service providers (electricity, gas, or water), and the National Database Registration Authority.
- 3.4.13 For provincial taxes—managed under the Board of Revenue system—the records are largely manually maintained and only sometimes as spreadsheet files. The records are not linked to any other automated tax database within the provincial revenue systems or other important databases. Accordingly, subrating element (i) is rated ‘D’ for provincial taxes.
- 3.4.14 Ensuring that taxpayers comply with their procedural obligations of taxpayer registration and tax declaration is usually encouraged by penalties that may vary with the seriousness of the fault. Effectiveness of such penalties is determined by the extent to which penalties are sufficiently high to have the desired impact, and are consistently and fairly administered.
- 3.4.15 In the case of federal taxes, the penalties are well defined. Since the federal taxes mainly cover the well-regulated sectors (registered companies and businesses, importers, exporters, industrialists, the salaried class, and services sector), the compliance level is much higher in comparison to the provincial taxes.
- 3.4.16 A review of the provincial Revenue Receipts Audit (RRA) reports reveals that all penalties are well defined but the underlying level of compliance is negligible in the absence of substantial recoveries. For instance, the latest RRA Report FY2005 highlights nonrecovery of PRs51 million from cantonment boards, PRs50 million from property taxes, and PRs23 million on account of surcharge and license fees. The auditors estimated that about 30% of assessable revenue was suppressed mainly due to noncompliance and underassessment. Accordingly, subrating element (ii) is rated ‘D’ for provincial taxes.

3.4.17 Inevitable resource constraints mean that audit selection processes must be refined to identify taxpayers and taxable activities that involve the largest potential risk of noncompliance. Indicators of risk are the frequency of amendments to returns and additional tax assessed from tax audit work. Collection and analysis of information on noncompliance and other risks is necessary for focusing tax audit activities and resources towards specific sectors and types of taxpayers that have the highest risk of revenue leakages. More serious issues of noncompliance involve deliberate attempts at tax evasion and fraud, which may involve collusion with representatives of the revenue administration. The ability of the revenue administration to identify, investigate, and successfully prosecute major evasion and fraud cases on a regular basis is essential for ensuring that taxpayers comply with their obligations.

3.4.18 The planning and monitoring of tax audit programs are nonexistent, except for the basic process adopted by the external auditors (the auditor general of Pakistan), and tax audits and fraud investigations are undertaken on an ad hoc basis, if at all. The Board of Revenue and Excise and Taxation Department lack capacity to plan and monitor tax audit programs. Subrating element (iii) is therefore rated 'C' for provincial taxes, because although there is a some form of continuous program of tax audits and fraud investigations, audit programs are not based on clear risk assessment criteria.

3.4.19 Under the M2 scoring methodology, the overall rating for provincial taxes is assessed 'D+'.

PI-15 Effectiveness in collection of tax payments

Overall rating: 'C+' for provincial and 'N/A' for district governments

- Subrating element (i): Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year which was collected during that fiscal year (average of the last 2 fiscal years): 'C'.
- Subrating element (ii): Effectiveness of transfer of tax collections to the treasury by the revenue administration: 'A'.
- Subrating element (iii): Frequency of complete accounts reconciliation between tax assessments, collections, arrears records, and receipts by the treasury: 'C'.

3.4.20 The following criteria are applied to determine the rating for each dimension:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) The average debt collection ratio in the two most recent fiscal years was 90% or above, or the total amount of tax arrears is insignificant (i.e., less than 2% of total annual collections).

	(ii) All tax revenue is paid directly into accounts controlled by the treasury, or transfers to the treasury are made daily. (iii) Complete reconciliation of tax assessments, collections, arrears, and transfers to treasury takes place at least monthly within 1 month of the end of the month.
B	(i) The average debt collection ratio in the two most recent fiscal years was 75%–90% and the total amount of tax arrears is significant. (ii) Revenue collections are transferred to the treasury at least weekly. (iii) Complete reconciliation of tax assessments, collections, arrears, and transfers to treasury takes place at least quarterly within 6 weeks of the end of the quarter.
C	(i) The average debt collection ratio in the two most recent fiscal years was 60%–75% and the total amount of tax arrears is significant. (ii) Revenue collections are transferred to the treasury at least monthly. (iii) Complete reconciliation of tax assessments, collections, arrears, and transfers to treasury takes place at least annually within 3 months of end of the year.
D	(i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e., more than 2% of total annual collections). (ii) Revenue collections are transferred to the treasury less regularly than monthly. (iii) Complete reconciliation of tax assessments, collections, arrears, and transfers to treasury does not take place annually or is done with more than 3 months' delay.

3.4.21 Accumulation of tax arrears can be a critical factor undermining high budgetary out-turns, while the ability to collect tax debt lends credibility to the tax assessment process and reflects equal treatment of all taxpayers, whether they pay voluntarily or need close follow up.

3.4.22 As was highlighted in the RRA reports on the provincial revenues, tax arrears remains at almost 30% of collectibles during any reference year. With the tax collection ratio at about 70%–75%, subrating element (i) is rated 'C'.

3.4.23 Suppression of collected taxes does not generally take place as taxes are swiftly transferred to the treasury in a "treasury single account". The daily scrolls of taxes paid into the government's account with the State Bank of Pakistan and National Bank of Pakistan are received daily at the Karachi Treasury and booked to provincial Account 1 Revenue Receipts. These two banks are the only fiscal agents of the government who can collect government taxes. On the basis of this, subrating element (ii) is rated 'A'.

3.4.24 Although revenue reconciliation is undertaken on a continuous basis by the accountant general, completion of reconciliation is generally delayed by an average of 3 months after the close of a fiscal year and before the books are closed. According to the rating methodology, the rating for subrating element (iii) is 'C'.

3.4.25 Under the MI (weakest link) scoring methodology, the indicator is rated ‘C+’.

PI-16 Predictability of available funds for expenditure commitments

Overall rating: ‘B+’ for provincial and ‘C+’ for district governments

- Subrating element (i): Extent to which cash flows are forecasted and monitored: ‘B’ for both provincial and district governments.
- Subrating element (ii): Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment: ‘A’ for both provincial and district governments.
- Subrating element (iii): Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs: ‘B’ for provincial and ‘C’ for districts.

3.4.26 The criteria for assessing the subrating elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) A cash flow forecast is prepared for the fiscal year, and updated monthly on the basis of actual cash inflows and outflows. (ii) MDAs are able to plan and commit expenditure for at least 6 months in advance in accordance with the budgeted appropriations. (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way.
B	(i) A cash flow forecast is prepared for the fiscal year and updated at least quarterly, on the basis of actual cash inflows and outflows. (ii) MDAs are provided reliable information on commitment ceilings at least quarterly in advance. (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a fairly transparent way.
C	(i) A cash flow forecast is prepared for the fiscal year, but is not (or only partially and infrequently) updated. (ii) MDAs are provided reliable information 1-2 months in advance. (iii) Significant in-year budget adjustments are frequent, but undertaken with some transparency.
D	(i) Cash flow planning and monitoring are not undertaken or are of very poor quality. (ii) MDAs are provided commitment ceilings for less than 1 month, or there is no reliable indication at all of actual resource availability for commitment. (iii) Significant in-year budget adjustments are frequent and not done in a transparent manner.

3.4.27 In accordance with the work plans, effective execution of the budget requires that the spending MDAs receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. This

indicator assesses the extent to which the Finance Department provides reliable information on the availability of funds to MDAs that manage budget heads.

3.4.28 The cash flow forecasting system of the government of Sindh starts around the end of the first quarter for the following fiscal year, with the circulation of the budget call circular (BCC).¹⁰ Release of nondevelopment and development budgets are made quarterly with the first installment released in the first week of the fiscal year. The government budget receipts, like the other three provinces of Pakistan, are heavily dependent on the federal government fiscal transfers. Table 8 illustrates the federal and provincial percentage contribution to government revenue budgets for FY2003–FY2007. The enormous dependence on federal transfers poses high risk to the predictability in the availability of funds for commitment of expenditure by government departments and agencies. The same risk is even greater at the subprovincial level, in view of the almost total dependence on the provincial government.

Table 8: Federal and Provincial Government Percentage Share in Government of Sindh Budgets

Share	FY2003	FY2004	FY2005	FY2006	FY2007
Federal Share (%)	85.25	85.30	84.99	85.18	85.91
Provincial Share (%)	14.75	14.70	15.01	14.82	14.09

Source: Budget Analysis 2007–08, Finance Department, government of Sindh.

3.4.29 A rating of ‘B’ is applicable to subrating element (i) as the Finance Department prepares a detailed cash flow forecast for the fiscal year and formally updates it at least quarterly on the basis of actual cash inflows and outflows. The government confirms preparation of “quarterly and annually” on the basis of the actual receipts from the receipts generating departments as well as receipts of federal transfers.

3.4.30 The front-loaded half-yearly releases in respect of recurrent expenditures enable the administrative departments to plan and meet the expenditure commitments throughout the financial year. Unfortunately, because of the lack of proper advance procurement planning by administrative departments, particularly for development budget expenditures, actual spending on development budgets generally falls short of the planned expenditures in a given fiscal year. One hundred percent of salary expenditures (about 80% of total recurrent expenditures) are released, on a front-loaded basis, for a whole year. A rating of ‘A’ is therefore applicable to subrating element (ii) as the administrative departments can predict availability of the budget appropriations well in advance

¹⁰ The BCC for 2008–09 circulated vide memo No. FD/B&E-I / 4–1 / 59 /BCC / 2008–09, Government of Sindh, Finance Department, Karachi, dated 21 September 2007.

of actual expenditures, except that the administrative departments' internal planning to commit expenditure is weak.

- 3.4.31 A rating of 'B' is applicable to subrating element (iii), as the in-year adjustments to budget allocations take place once or twice a year and are undertaken in a fairly transparent manner—they are cleared by the Office of the Chief Minister. The in-year adjustments are made through either reappropriations or supplementary grants. The Sindh Budget Manual defines reappropriations as “the transfer of savings from one unit of appropriation to meet excess expenditure anticipated under another unit within the same item in the authenticated schedule,” and supplementary grants as “a grant voted by the Legislative Assembly on a supplementary statement of expenditure presented to it within the current financial year.” Both adjustments have clear guidelines requiring formal approval of the relevant competent authority. The cases of supplementary grants require approval from the provincial assembly and these are submitted with the budget approval for the new financial year and voted on separately. Invariably, however, supplementary grants are made first by the government during the fiscal year and then presented afterwards to the assembly along with the budget proposals for the new fiscal year for approval.
- 3.4.32 The subprovincial governments are more dependent on the government of Sindh for funds than the government of Sindh is on the Government of Pakistan, except for direct support grants that the national government makes directly to subprovincial governments. The subprovincial governments' main source of revenues are proceeds under the PFC awards (para 3.2.18). The PFC disbursements are received monthly, and are in turn accordingly allocated to the spending units. The direct support grant, or one-sixth of the general sales tax share, is received in lieu of the abolished Octroi and Zila Tax, without any retention in the PFC, by district governments, tehsil municipal administrations (TMAs), union administration, and the Sindh Local Government Board. The subprovincial government cash flow forecast system is still evolving. Whilst the process of budget making is, by and large, congruent with that of the government of Sindh, anecdotally it depends on the informal indication of the government to determine strategic allocation. For the subprovincial governments, the same rating as for the provincial government applies in all dimensions, except for subrating element (iii) which is rated 'C' because significant in-year budget adjustments, under the authority of the district nazims, are frequent, although these are undertaken with some element of transparency.

3.4.33 The overall rating of the indicator for the provincial government level is assessed 'B+' on the basis of the M1 (weakest link) methodology, and for the district government 'C+'.

PI-17 Recording and management of cash balances, debt and guarantees

Overall rating: 'B' for provincial and 'N/A' for district governments

3.4.34 The three dimensions assessed and their respective subratings are as follows:

- Subrating element (i): Quality of debt data recording and reporting: 'B'.
- Subrating element (ii): Extent of consolidation of the government's cash balances: 'B'.
- Subrating element (iii): Systems for contracting loans and issuance of guarantees: 'C'.

3.4.35 The criteria for assessing the subratings elements are as follows:

Dimension	Minimum Requirements (Scoring Methodology M2)
(i) Quality of debt data recording and reporting	<p>Score 'A': Domestic and foreign debt records are complete, updated, and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (covering debt service, stock, and operations) are produced at least quarterly.</p> <p>Score 'B': Domestic and foreign debt records are complete, updated, and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (covering debt service, stock, and operations) are produced at least annually.</p> <p>Score 'C': Domestic and foreign debt records are complete, updated, and reconciled at least annually. Data quality is considered fair, but some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally or with limited content.</p> <p>Score 'D': Debt data records are incomplete and inaccurate to a significant degree.</p>
(ii) Extent of consolidation of the government's cash balances	<p>Score 'A': All cash balances are calculated daily and consolidated.</p> <p>Score 'B': Most cash balances calculated and consolidated at least weekly, but some extrabudgetary funds remain outside the arrangement.</p> <p>Score 'C': Calculation and consolidation of most government cash balances takes place at least monthly, but the system used does not allow consolidation of bank balances.</p> <p>Score 'D': Calculation of balances takes place irregularly, if at all, and the system used does not allow consolidation of bank balances.</p>

<p>(iii) Systems for contracting loans and issuance of guarantees</p>	<p>Score 'A': Provincial government's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity.</p> <p>Score 'B': Provincial government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity.</p> <p>Score 'C': Provincial government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria, or overall ceilings.</p> <p>Score 'D': Provincial government's contracting of loans and issuances of guarantees are approved by different government entities, without a unified overview mechanism.</p>
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3.4.36 Debt management, in terms of contracting, servicing, and repayment, and the provision of government guarantees, are often major elements of overall fiscal management. Poor management of debt and guarantees can create unnecessarily high debt-service costs and can create significant fiscal risks. The maintenance of a debt data system and regular reporting on the main features of the debt portfolio and its development are critical for ensuring data integrity and related benefits such as accurate debt-service budgeting, timely service payments, and well-planned debt rollover.

3.4.37 The provincial debt portfolio essentially comprises federal loans, which are in three major categories: foreign exchange loans, rupee loans or cash development loans, and counterpart fund rupee loans. The government of Sindh is pursuing a fiscal and financial reform agenda in which effective management of debt and contingent liabilities assumes special importance. Accordingly, expensive cash development loans were prematurely retired through less-costly foreign loans from the World Bank and ADB.

3.4.38 Subrating element (i) is rated 'B' as the resource wing of the Finance Department maintains appropriate debt records that are reconciled, updated, and complete. Domestic and foreign debt records are reconciled quarterly. Data is considered of fairly high standard, though minor reconciliation problems occur occasionally. Comprehensive management and statistical reports are produced at least annually and reported in a transparent manner. The Sindh Finance Department website (www.fdsindh.gov.pk), amongst others, maintains information on the debt portfolio of the provincial government including the reconciliation status, future repayment timelines, foreign exchange rates applicable, and mark up on development loans and advances.

3.4.39 Subrating element (ii) is rated 'B' as the Finance Department receives daily, though unreconciled, cash balances calculation from the State Bank of Pakistan. The accountant general office also provides an unreconciled but consolidated monthly status of cash balances for the government of Sindh, and a quarterly fiscal monitoring review is carried out at federal government level to take on issues relating to reconciliations of fiscal balances as well as between fiscal and monetary balances. The government also has a fiscal monitoring committee which apparently has not been meeting regularly in recent times. While the complete accuracy of the cash balances can be questioned, the fact that there is a functioning institutional arrangement and practice to monitor liquidity on a consolidated basis is a step in the right direction. The government maintains its bank accounts, i.e., both consolidated fund and public account, through Government Account Number 1.

3.4.40 Subrating element (iii) is rated 'C', as the provincial government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but not decided on the basis of clear guidelines, criteria, or overall ceilings. Article 167 of the Constitution authorizes the government of Sindh to borrow, domestically, upon the security of the Provincial Consolidated Fund within certain limits as may be prescribed by the provincial assembly. However, such borrowing powers of the province are restricted by a condition that, unless there exists no outstanding repayment arrears against a loan already made or guaranteed by the Government of Pakistan, the government of Sindh cannot borrow without the consent of the national government. Furthermore, contracting of foreign debt is exclusively controlled by the government of Pakistan, and the government of Sindh cannot borrow from foreign sources except through, and with the explicit approval of, the federal government.¹¹ The Federal Debt Responsibility and Limitation Act requires the federal government to reduce and limit federal debt to 65% of gross domestic product (GDP) by 2012, and this law is extended, at least in practical implementation, to provincial governments, including Sindh. District governments do not contract debt in any form as stipulated under the Sindh Local Government Ordinance 2001.

3.4.41 The overall rating of the indicator is 'B' for the government of Sindh on the basis of the M2 scoring methodology.

PI-18 Effectiveness of payroll controls

Overall rating: 'C+' for both provincial and district governments

3.4.42 The four dimensions assessed and their respective subratings are as follows (same for both governments):

¹¹ Finance Department. 2008. *Budget Analysis 2007-08*. Government of Sindh, pp 77.

- Subrating element (i): Degree of integration and reconciliation between personnel records and payroll data: 'C'.
- Subrating element (ii): Timeliness of changes to personnel records and payroll: 'B'.
- Subrating element (iii): Internal controls over changes to personnel records and payroll: 'C'.
- Subrating element (iv): Existence of payroll audits to identify control weaknesses and/or ghost workers: 'C'.

3.4.43 The criteria for assessing the subratings elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation. (ii) Required changes to the personnel records and payroll are updated monthly, generally in time for the following month's payments. Retroactive adjustments are rare (if reliable data exists, it shows corrections in a maximum of 3% of salary payments). (iii) Authority to change records and payroll is restricted and results in an audit trail. (iv) A strong system of annual payroll audits exists to identify control weaknesses and/or ghost workers.
B	(i) Personnel data and payroll data are not directly linked but the payroll is supported by full documentation for all changes made to personnel records each month and checked against the previous month's payroll data. (ii) Up to 3 months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally. (iii) Authority and basis for changes to personnel records and the payroll are clear. (iv) A payroll audit covering all provincial government entities has been conducted at least once in the last 3 years (whether in stages or as one single exercise).
C	(i) A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place at least every 6 months. (ii) Up to 3 months' delay occurs in processing changes to personnel records and payroll for a large part of changes, which leads to frequent retroactive adjustments. (iii) Controls exist, but are not adequate to ensure full integrity of data. (iv) Partial payroll audits or staff surveys have been undertaken within the last 3 years.
D	(i) Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database, or by lacking reconciliation between the three lists. (ii) Delays in processing changes to payroll and nominal roll are often significantly longer than 3 months and require widespread retroactive adjustments. (iii) Controls of changes to records are deficient and facilitate payment errors. (iv) No payroll audits have been undertaken within the last 3 years.

- 3.4.44 The wage bill is usually one of the biggest items of government expenditure and susceptible to weak control and corruption. The link between the personnel database and the payroll is a key control. Any amendments required to the personnel database should be processed in a timely manner through a change report and should result in an audit trail, and payroll audits should be undertaken regularly to identify any ghost workers, fill data gaps, and identify control weaknesses.
- 3.4.45 The payroll system of the government of Sindh is being automated under the PIFRA project at an appreciable pace, as per information provided by the Sindh accountant general. Currently, a payroll of 210,666 employees of the roughly¹² 421,990 employees, or about 85% of government employees, is being prepared through the government integrated financial management information system, including fresh cases of pension and General Provident Fund. Fast-track measures are under way for implementing the system throughout the province.
- 3.4.46 Subrating element (i) is rated 'C' because, although a personnel database may not be fully maintained across the entire province, reconciliation of the payroll with personnel records takes place at least every 6 months. The integrity of the payroll will be further increased when a computerized human resources management information system¹³ is introduced to support automatic reconciliation. Personnel records are currently managed manually although processing of payroll is increasingly being automated with in-built controls for better data reliability. The government of Sindh is cognizant of the problem, and the provincial information technology department is in the process of initiating the development of the human resources management information system. With the gradual but substantial progress being achieved in the area of collection and validation of historical personnel data for payroll, pensions, and General Provident Fund processing across the entire province under the PIFRA regime, the weaknesses inherent in the lack of integration and automatic reconciliation of personnel data with payroll data will be eliminated.
- 3.4.47 The records at the Sindh Accountant General Office confirm that changes made up to the 10th of the month, are however, incorporated in the payroll run for that month that starts around the 25th of the month. There is a transparent and documented process for changes to the payroll, with no provision and evidence of any retroactive corrections. However, given the reconciliation issues and partial completeness of personnel databases mentioned above, a rating of 'B' is applicable to subrating element (ii).

¹² The PC1 for HRMIS indicates the total number to be around 450,000.

¹³ PC-1 for the Development of Human Resource Management System for Government of Sindh Project has recently been submitted to the Planning and Development Department.

3.4.48 Subrating element (iii) is rated 'C', as the NAM Accounting Policies and Procedures Manual provides clear guidelines for changes in records. These are applied largely for those employees whose emoluments are automated and precludes employees in locations where the PIFRA has yet to achieve site productivity. The change (or F02) form requires authentication by the official concerned in the case of gazetted officers (grade 17 and above), and the drawing and disbursement officer (DDO) otherwise, thus resulting in an audit trail. In the absence of total coverage of employers under the PIFRA regime, the status will remain unfavorable.

3.4.49 Subrating element (iv) is rated 'C' as the auditor general of Pakistan (AGP) conducts audits, including payroll audits. The Audit Report on the Accounts of Government of Sindh for FY2005 made observations relating to pay and allowances.¹⁴ In the absence of an automated system of payroll processing that could be audited by an information computer-based audit (due to the number of payroll transactions), the Accountant General Office can only conduct manual payroll audits as an internal control measure but with limited scope.

3.4.50 The overall rating of the indicator is assessed 'C+' for the provincial government as well as district governments (both operating on the same basis and on a centralized payroll architecture) on the basis of the M1 (weakest link) scoring methodology.

PI-19 Competition, value for money, and controls in procurement

Overall rating: 'C' for provincial and 'N/S' for district governments

- Subrating element (i): Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold): 'D'.
 - Subrating element (ii): Extent of justification for use of less-competitive procurement methods: 'B'.
 - Subrating element (iii): Existence and operation of a procurement complaints mechanism: 'C'.
- 3.4.51 Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively and efficiently. Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs for, and value for money in, delivery of programs and services by the government. This indicator focuses on the quality and transparency of the procurement regulatory

¹⁴ Of the 11 paras titled "cases of irregular payment of salaries", paras 15.16 and 15.19 are payroll-specific.

framework in terms of establishing the use of open and fair competition as the preferred procurement method and defines the alternatives to open competition that may be appropriate when justified in specific situations. An overall strong control environment of the PFM systems benefits the procurement system to a large extent. An effective and efficient regulatory framework, internal controls in the implementing agencies, complemented by the checks through external audits, greatly enhances transparency and accountability of agencies in the procurement process.

3.4.52 The three subrating elements are assessed under the scoring methodology as follows:

Dimension	Minimum Requirements (Scoring Methodology M2)
(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	<p>Score 'A': Accurate data on the method used to award public contracts exists and shows that more than 75% of contracts above the threshold are awarded on the basis of open competition.</p> <p>Score 'B': Available data on public contract awards shows that more than 50% but less than 75% of contracts above the threshold are awarded on the basis of open competition, but the data may not be accurate.</p> <p>Score 'C': Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate.</p> <p>Score 'D': Insufficient data exists to assess the method used to award public contracts, or the available data indicates that use of open competition is limited.</p>
(ii) Justification for use of less-competitive procurement methods	<p>Score 'A': Other less-competitive methods when used are justified in accordance with clear regulatory requirements.</p> <p>Score 'B': Other less-competitive methods when used are justified in accordance with regulatory requirements.</p> <p>Score 'C': Justification for use of less-competitive methods is weak or missing.</p> <p>Score 'D': Regulatory requirements do not clearly establish open competition as the preferred method of procurement.</p>
(iii) Existence and operation of a procurement complaints mechanism	<p>Score 'A': A process (defined by legislation) for submission and timely resolution of procurement process complaints is operative and subject to oversight of an external body with data on resolution of complaints accessible to public scrutiny.</p> <p>Score 'B': A process (defined by legislation) for submitting and addressing procurement process complaints is operative, but lacks the ability to refer resolution of the complaint to an external higher authority.</p> <p>Score 'C': A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints.</p> <p>Score 'D': No process is defined to enable submitting and addressing of complaints regarding the implementation of the procurement process.</p>

3.4.53 This indicator has been covered by a separate study based on the Development Assistance Committee of the Organisation for Economic Co-operation and Development Baseline Indicator System for procurement. Its findings are summarized in the following paragraphs.

3.4.54 Sindh started to reform its public procurement systems in the mid-1990s when stakeholder consultations commenced with the aim of streamlining various directives, manuals, and codes into an integrated procurement framework. In 2002 a provincial law to this effect was drafted but could not be finalized. Recently, a procurement reform initiative in the province gained impetus from the actions taken at the federal level, and, with a view to harmonization, Sindh adopted federal procurement ordinance and rules as an interim measure on 30 November 2006. Since then, in order to create better alignment with international best practice, the government of Sindh has prepared a road map for procurement reforms which builds on the following elements:

- (i) revision of the regulatory framework to introduce a separate consultancy sector rule;
- (ii) preparation of standard bidding documents, implementing regulations, and sector-specific standard bidding documents;
- (iii) a staffing plan and operationalization of the authority;
- (iv) a long-term training strategy;
- (v) a reform management strategy; and
- (vi) e-procurement readiness.

3.4.55 While the rules are being revised, public procurement regulation is in a state of flux, given the lack of implementation of the rules due to various capacity, readiness, acceptance, and enforcement issues. Another action for added transparency is the annulment of the obscure preregistration system, and introduction of pre- or post-qualification. Differing interpretations and varying implementations have, however, diminished the benefits of this directive, and positive impacts on public procurement are yet to be seen.

3.4.56 A key constraint to procurement reforms is the capacity of the Sindh Public Procurement Regulatory Authority to take custody of the rules, to revise and disseminate them, and to train the implementing agencies.

3.4.57 Given the limited dissemination of the new rules, some departments are still using the Public Works Department Manual adopted by the Works and Service Department for works, and the Sindh Purchase Manual 1991 for goods. In either case, thresholds are defined for open competition, and all departments publish

their procurement notices in newspapers as well as on the government website. The effectiveness of open competition could be deemed limited to some extent given the requirement of departmental preregistration, or inadequate response time, but such details are addressed in the Procurement Assessment Baseline Indicator System Report.

- 3.4.58 The latest publicly available audit report on the accounts of the government of Sindh is for FY2005. Although it pertains to the period before the province's adoption of the Sindh Local Government Ordinance 2001, it reflects upon the systemic capacity to implement erstwhile and familiar rules. There are only four reported cases (less than 1% of contracts awarded) where advertisement was not made for contracts that exceeded the nationally established monetary threshold for small purchases. Given the absence of a comprehensive database (insufficient data) to document and assess the use of open competition, despite an indication from audit reports of just four documented cases of lack of advertisement, subrating element (i) has been rated 'D'.
- 3.4.59 The newly adopted rules specify the thresholds for adopting less-competitive procedures. The existing Works and Service and Purchase manuals also give procedures and thresholds for less-competitive procurements. Feedback given in the interviews and random review of procurement records in irrigation, Works and Services, Information Technology, and Agriculture departments show that these procedures are followed. An integrated database of the Sindh Public Procurement Regulatory Authority, once functional, would act as a central repository of all such information. Based on the provided information, the rating of subrating element (ii) is 'B'.
- 3.4.60 Indicator 10 of the Procurement Development Assistance Committee Baseline Indicator System study gives the details of the functional complaints mechanism. Generally the aggrieved party approaches the higher-level authority within the procuring entity; the Office of the Director General monitoring is also entrusted with handling complaints, although the procedural details and its impacts on the procurement process are not defined. The absence of a comprehensive and well-documented system does not ensure that the complaints are efficiently reviewed and resolved in a reasonable amount of time. The rating for subrating element (iii) is therefore 'C'.
- 3.4.61 Based on the assessment of subrating elements, the overall rating for the provincial government is 'C'. No rating has been assigned to the district governments in light of incomplete information and evidence.

PI-20 Effectiveness of internal controls for nonsalary expenditure

Overall rating: 'C' for both the provincial and district governments

3.4.62 The three assessed dimensions and their respective subratings are as follows (same for both governments):

- Subrating element (i): Effectiveness of expenditure commitment controls: 'C'.
- Subrating element (ii): Comprehensiveness, relevance, and understanding of other internal control rules and procedures: 'C'.
- Subrating element (iii): Degree of compliance with rules for processing and recording transactions: 'C'.

3.4.63 The criteria for assessing the subratings elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations (as revised). (ii) Other internal control rules and procedures are relevant, and incorporate a comprehensive and generally cost-effective set of controls which are widely understood. (iii) Compliance with rules is very high and any misuse of simplified and emergency procedures is insignificant.
B	(i) Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations for most types of expenditure, with minor areas of exception. (ii) Other internal control rules and procedures incorporate a comprehensive set of controls which are widely understood, but may in some areas be excessive (e.g., through duplication in approvals) and lead to inefficiency in staff use and unnecessary delays. (iii) Compliance with rules is fairly high, but simplified or emergency procedures are used occasionally without adequate justification.
C	(i) Expenditure commitment control procedures exist and are partially effective, but they may not comprehensively cover all expenditures or they may occasionally be violated. (ii) Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance. (iii) Rules are complied with in a significant majority of transactions, but use of simplified or emergency procedures in unjustified situations is an important concern.
D	(i) Commitment control systems are generally lacking, or they are routinely violated. (ii) Clear, comprehensive control rules and procedures are lacking in other important areas. (iii) The core set of rules are not complied with on a routine and widespread basis due to direct breach of rules or unjustified routine use of simplified or emergency procedures.

- 3.4.64 An effective internal control system is one that (i) is relevant (i.e., based on an assessment of risks and the controls required to manage the risks), (ii) incorporates a comprehensive and cost-effective set of controls (which address compliance with rules in procurement and other expenditure processes, prevention and detection of mistakes and fraud, safeguard of information and assets, and quality and timeliness of accounting and reporting), (iii) is widely understood and complied with, and (iv) is circumvented only for genuine emergency reasons. Evidence of the effectiveness of the internal control system should come from government financial controllers, regular internal and external audits, or other surveys carried out by management. One type of information could be error or rejection rates in routine financial procedures.
- 3.4.65 The Sindh internal control system comprises a large number of rules and regulations, including, amongst others, the Treasury Orders 1922 and the Subsidiary Rules made thereunder, Sindh Fiscal Transfer Rules 2004, the Sindh Civil Servants (Advance Increments) Rules 1976, the Sindh Government Servants Benevolent Fund Ordinance 1960 and the Rules 1960, the Sindh Government Servants Benevolent Fund Part I (Disbursement) Rules 1965 and Part II (Disbursement) Rules 1966, the Sindh General Provident Fund Rules 1938, the Sind Civil Servants (Advance Increments) Rules 1976, Revision of Basic Pay Scales and Fringe Benefits of Civil Employees (BPS 1 to 22) of the Sindh Government 2001, the Sindh Civil Servants (Efficiency and Discipline) Rules 1973, Sindh District Government and Tehsil Municipal Administration (Budget) Rules 2002, Sindh Union Administration (Budget) Rules 2002, Fundamental Rules and Supplementary Rules, the Sindh Government Rules of Business 1986, and the Secretariat Instructions 1994. As per reports of the auditor general, the effectiveness of internal control systems is quite deficient, and is old and mostly obsolete. The controls should manage the various risks confronted by the public resources and should be more focused towards prevention of any losses rather than detection and correction after the incidence of such losses.
- 3.4.66 A rating of 'C' is applicable to subrating element (i) as expenditure commitment control procedures exist, but are only partially effective and may be occasionally violated. The findings of PI-1 and PI-2 are pointers to the prevailing situation as actual expenditures have, in a number of cases, exceeded the budgeted expenditures at some of the controlling levels. This has been largely due to use of manual appropriation registers to control commitment authorizations, and, with human discretionary influence, commitment control can be overridden. With the PIFRA system rollout completed in Sindh, the use of automatic commitment control will be invoked.

- 3.4.67 A rating of 'C' is applicable to subrating element (ii) as the audit reports indicate generally weak internal controls with cases of laxity in exercise of internal controls and violation of authorized procedures for processing transactions, splitting of expenditure to avoid sanctions by the competent authority (circumvention), nondeduction of house rent, grant of unauthorized increments to employees, nonaccounting of purchases in the stock register, and nonavailability and maintenance of prescribed records for audit.
- 3.4.68 A rating of 'C' is applicable to subrating element (iii) as rules are complied with in a significant majority of transactions, but the substantial use of simplified or emergency procedures in unjustified situations is an important concern. Departmental accounts committee responses to audit queries of noncompliance with procedures point, in a number of cases, to emergency transactions that may well be doubtful in nature.
- 3.4.69 The overall rating of the indicator is assessed 'C' on the basis of the M1 (weakest link) methodology for the provincial government.
- 3.4.70 The subprovincial (district) governments demonstrate further weakness in comparison to government of Sindh internal control system and processes. Without going into assessment of the subrating elements for the district governments, some of the key weaknesses as identified by the Audit Report 2004/05 are reproduced to illustrate the status of effectiveness of the internal controls for nonsalary expenditure: "duties and responsibilities of the key officers for activities in the chain of command with respect to internal control do not exist; monitoring systems to assess the expenditure by DDOs, Finance Department, and principal accounting officer, with respect to monthly and quarterly expenditure statements and evaluation for appropriate action is not functioning; targets for activities and system of monitoring and evaluation of the outputs and outcomes is lacking; follow-up actions are not taken on audit observations; records are not maintained as prescribed; mechanism for effecting recoveries, losses, and wastages and its accountability is lacking; no system of redress of complaints exists; and the system of assessment of functional performance and activity report is ineffective."¹⁵ However, with PIFRA-based information technology systems implemented in 100% of the districts so that appropriation and commitment control can now be enforced (though implementation of work-flow arrangements in those districts is still incomplete), the current situation has begun to improve dramatically. Therefore, at the subprovincial level, the rating of each of the three subrating elements is also assessed 'C'.

¹⁵ Auditor General of Pakistan. Audit Report on the Accounts of District Government Mirpurkhas and Hyderabad, Audit Year 2004-05, pp 15 and 22 respectively.

PI-21 Effectiveness of internal audit

Overall rating: 'D' for both the provincial and district governments

3.4.71 The three assessed dimensions and their respective subratings are as follows (same for both governments):

- Subrating element (i): Coverage and quality of the internal audit function: 'D'.
- Subrating element (ii): Frequency and distribution of reports: 'D'.
- Subrating element (iii): Extent of management response to internal audit findings: 'D'.

3.4.72 The criteria for assessing the subrating elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) Internal audit is operational for all provincial and district government entities, and generally meets professional standards. It is focused on systemic issues (at least 50% of staff time). (ii) Reports adhere to a fixed schedule and are distributed to the audited entity, Ministry of Finance, and the supreme audit institution. (iii) Action by management on internal audit findings is prompt and comprehensive across provincial government entities.
B	(i) Internal audit is operational for the majority of provincial government entities (measured by value of revenue and expenditure), and substantially meets professional standards. It is focused on systemic issues (at least 50% of staff time). (ii) Reports are issued regularly for most audited entities and are distributed to the audited entity, the Finance Department, and the supreme audit institution. (iii) Prompt and comprehensive action is taken by many (but not all) managers.
C	(i) The function is operational for at least the most important provincial government entities and undertakes some systems review (at least 20% of staff time), but may not meet recognized professional standards. (ii) Reports are issued regularly for most government entities, but may not be submitted to the Finance Department and the supreme audit institution. (iii) A fair degree of action is taken by many managers on major issues but often with delay.
D	(i) There is little or no internal audit focused on systems monitoring. (ii) Reports are either nonexistent or very irregular. (iii) Internal audit recommendations are usually ignored (with few exceptions).

3.4.73 Regular and adequate feedback to management is required on the performance of the internal control systems through an internal audit function (or equivalent systems monitoring function). Such a function should meet international standards in terms of (i) an appropriate structure, particularly with regard to professional independence; (ii) a sufficiently broad mandate, access to information, and power to report; and (iii) the use of professional audit methods,

including risk assessment techniques. The function should be focused on reporting on significant systemic issues in relation to reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations, and contracts.

3.4.74 The internal audit function of the government of Sindh is insufficient, and there has been no progress in the area since the Sindh Provincial Financial Accountability Assessment 2004. The Institute of Internal Auditors defines internal audit as “an independent, objective, assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined, approach to evaluate and improve effectiveness of risk management, control, and governance processes.”¹⁶ In the government, like the other provinces, the pre-audit carried out is generally perceived as internal audit, “although pre-audit is an accounting function, and the checks exercised at this stage are almost the same which would be exercised at the post-audit stage.”¹⁷ There appears to be lack of interest in an institutionalized, efficient, and effective internal audit function at provincial and subprovincial levels. Whilst the Sindh Local Government Ordinance 2001 (Ordinance No XXVII of 2001) expressly provides for an internal audit function,¹⁸ none of the 23 districts of Sindh have complied with the legal requirement. An amendment was made to the Sindh Local Government Ordinance in 2007 making it mandatory to establish the function, although no practical steps have so far been taken to this effect.

3.4.75 A rating of ‘D’ is applicable to subrating element (i) as there is no internal audit focused on systems monitoring. The accountant general office views the pre-audit function that it conducts as internal audit, which clearly does not meet professional and internationally accepted standards of internal auditing. There is also an assumption that internal auditing is functional within the AGAs and public enterprises of the government of Sindh; however, the AGP’s findings in the FY2005 audit report that 11 of the 16 public enterprises do not even have

¹⁶ International Monetary Fund. 2002. *The Role of Internal Audit in Government Financial Management: An International Perspective*. pp6.

¹⁷ Muhammad Akram Khan. *Certification Audit in Pakistan*. Director General (Training). Department of the Auditor General of Pakistan.

¹⁸ Sindh Local Government Ordinance Section 115-A: "Internal Audit: (1) Nazim of each District Government and Taluka or Town Municipal Administration shall appoint an Internal Auditor as may be prescribed. (2) Internal audit shall be an independent, objective assurance and consulting activity designed to add value and improve a local government’s operations and shall help the local government accomplish the objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. (3) The internal auditor shall serve as a principal support person to respective nazim of district government or taluka or town municipal administration by providing information to him and members of the respective council on local government performance."

audited accounts for multiple years (ranging from 2 to 21 years), thus invalidating the assumption that an internal audit function exists at all.

3.4.76 A rating of 'D' is applicable to subrating elements (ii) and (iii) also, as management reports are not generated and no follow-up actions are taken.

3.4.77 The overall rating of the indicator is therefore assessed 'D' on the basis of the M1 (weakest link) scoring methodology. A rating of 'D' is also applicable to the district governments for subrating elements (i), (ii), and (iii) as none of the 23 districts has operationalized the internal audit function despite the legal requirements under the Sindh Local Government Ordinance.

3.5 Accounting, Recording, and Reporting

PI-22 Timeliness and regularity of accounts reconciliation

Overall rating: 'C+' for both the provincial and district governments

3.5.1 The two dimensions assessed and their respective subratings are as follows (same for both governments):

- Subrating element (i): Regularity of bank reconciliations: 'B'.
- Subrating element (ii): Regularity of reconciliation and clearance of suspense accounts and advances: 'C'.

3.5.2 The criteria for assessing the subrating elements are as follows:

Dimension	Minimum Requirements (Scoring Methodology M2)
(i) Regularity of bank reconciliations	Score 'A': Bank reconciliation for all provincial and district government bank accounts takes place at least monthly at aggregate and detailed levels, usually within 4 weeks of the end of period. Score 'B': Bank reconciliation for all treasury-managed bank accounts takes place at least monthly, usually within 4 weeks from the end of the month. Score 'C': Bank reconciliation for all treasury-managed bank accounts takes place quarterly, usually within 8 weeks of the end of the quarter. Score 'D': Bank reconciliation for all treasury-managed bank accounts takes place less frequently than quarterly, or with backlogs of several months.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	Score 'A': Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within 1 month from end of period and with few balances brought forward. Score 'B': Reconciliation and clearance of suspense accounts and advances take place at least annually within 2 months of end of period. Some accounts have uncleared balances brought forward. Score 'C': Reconciliation and clearance of suspense accounts and advances

	<p>take place annually, in general within 2 months of the end of the year, but a significant number of accounts have uncleared balances brought forward. Score 'D': Reconciliation and clearance of suspense accounts and advances take place either annually with more than 2 months' delay, or less frequently.</p>
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3.5.3 Reliable reporting of financial information requires constant checking and verification of the recording practices of accountants. Two critical types of reconciliation are (i) reconciliation of accounting data, held in the government's books, with government bank account data held by provincial and commercial banks in such a way that no material differences are left unexplained; and (ii) clearing and reconciliation of suspense accounts and advances, i.e., of cash payments made from which no expenditures have yet been recorded.

3.5.4 The accounting system in Sindh is undergoing major reforms supported by the PIFRA through implementation of the NAM in an automated (SAP R/3) environment. Anecdotally, accounts reconciliation is an area of progressive improvement with the treasury-managed bank accounts being reconciled monthly by the Finance Department. The Accountant General Office reconciles the accounts for the government of Sindh with similar timelines, excluding the district government accounts. A fiscal monitoring committee, headed by the secretary finance, monitors the reconciliations through quarterly meetings. The overall figures of 85% for expenditure and 91% for receipts reconciliation in FY2003 have improved to averages of 98% for overall expenditure and 99% for receipts reconciliation in FY2007.¹⁹ Table 9 reflects the quarterly expenditures, receipts, and suspense account reconciliation for the government of Sindh for FY2007. Historically, there have been continuous gaps between the accounts reconciliation through the Finance Department and Sindh accountant general; these differences are expected to be addressed, to a large extent, through the planned link between the Finance Department and the accountant general office production servers under the PIFRA. In addition, interfacing the PIFRA systems with the banks as planned will enhance the potential of reducing any reconcilable differences between the fiscal and monetary balances.

¹⁹ Based on Sindh Finance Department data.

Table 9: Reconciliation Status of the Government of Sindh, FY2007

Item	(%)			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Expenditure Reconciliation	100	100	98	95
Receipt Reconciliation	100	100	98	96
Suspense Account Reconciliation	100	100	100	100

Source: Resource Wing, Finance Department

- 3.5.5 A rating of 'B' is applicable to subrating element (i) as the treasury-managed bank accounts reconciliations take place monthly within 4 weeks from the end of the month.
- 3.5.6 A rating of 'C' is applicable to subrating element (ii) as the suspense accounts reconciliation and clearance takes place at least annually with uncleared balances of some accounts brought forward.
- 3.5.7 The overall rating of the indicator is assessed 'C+' for the government of Sindh and the district governments on the basis of the M2 methodology.
- 3.5.8 Serious gaps in the timeliness and regularity of accounts reconciliation exist at the subprovincial government level. Therefore, both dimensions of the indicator show weak performance. The completion of the rollout of the PIFRA across the entire province is expected to strengthen the capacity of subprovincial governments to further improve on their performance. The district accounts offices will then be fully connected to the computerized system to allow for real-time reconciliation of fiscal balances across appropriations. Similarly, with interface connectivity of district accounts officers with the banks planned in the coming year, real-time reconciliation of fiscal and monetary balances can be made.

PI-23 Information on resources received by service delivery units

Overall Rating: 'B' for both provincial and district governments

3.5.9 The criteria for assessing the subrating elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country. The information is compiled into reports at least annually.
B	Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by either primary schools or primary health clinics across most of the country with information compiled into reports at least annually; or special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by both primary schools and primary health clinics across most of the country (including by representative sampling).
C	Special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the country, or by primary service delivery units at local community level in several other sectors.
D	No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years.

3.5.10 Problems frequently arise in front-line service delivery units providing services at the community level (such as schools and health clinics) in obtaining resources that were intended for their use, whether in terms of cash transfers, distribution of materials in kind, or provision of centrally recruited and paid personnel. The intended resource provision may not be explicit in budget documentation but is likely to form part of line ministries' internal budget estimates preparation. Front-line service delivery units, being furthest in the resource allocation chain, may be the ones to suffer most when overall resources fall short of budget estimates, or when higher-level organizational units decide to redirect resources to other purposes. There may be significant delays in transfers of resources to the unit, whether in cash or in kind. Tracking of such information is crucial in order to determine if the PFM systems effectively support front-line service delivery.

3.5.11 The indicator is measured by assessing the collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (with a focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is

responsible for the operation and funding of those units. To score well, routine data collection or accounting systems should provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country, and the information should be compiled into reports at least annually.

- 3.5.12 Adoption of PIFRA SAP/R3 is strengthening the government of Sindh's capacity to provide information on resources received by service delivery units. The FY2007 and FY2008 budgets have been prepared at the spending unit level, facilitating DDOs' direct access to information on resources that are intended for their use. The budget for FY2006 was also largely prepared at the spending level, particularly for health and education spending departments. Resource transfers to service delivery units as well as their reporting at the lowest expenditure line items have now become possible, and Sindh has taken the lead amongst all provinces in this respect. All resource receiving units and their spending DDOs maintain records of all the budgeted resources allocated to them, and they also keep memorandum records of expenditures made against those resources immediately after they raise bills for payment.
- 3.5.13 The entity element in the new chart of accounts enables reporting of transactions by the organizational unit which initiates the transaction. The DDO is the lowest organizational level at which budgetary control occurs and information is collected and reported and is the equivalent of a cost center.
- 3.5.14 A rating of 'B' is applicable to the dimension as the timely information feedback (financial reporting) on resource use by spending units remains incomplete due to the lack of full stability of the PIFRA system connectivity across the province. With full connectivity at the provincial government level, however, the feedback process is complete and all spending units, including health and education sectors, receive monthly budget execution information generated through the office of the accountant general.
- 3.5.15 The installed accounting systems provide reliable information on all types of resources received in cash and in kind by either primary schools or primary health clinics across most of the province and this information is compiled into reports at least annually. On the basis of the above, both the provincial and district governments' ratings against the indicator are assessed 'B'.

PI-24 Quality and timeliness of in-year budget reports

Overall rating: 'C+' for provincial and 'D+' for district governments

- 3.5.16 The three dimensions assessed and their subratings are as follows:

- Subrating element (i): Scope of reports in terms of coverage and compatibility with budget estimates: ‘C’ for provincial and ‘C’ for district governments.
- Subrating element (ii): Timeliness of the issue of reports: ‘A’ for provincial and ‘A’ for district governments.
- Subrating element (iii): Quality of information: ‘C’ for provincial and ‘D’ for district governments.

3.5.17 The criteria for assessing the subratings elements are as follows:

Score	Minimum requirements (Scoring Methodology M1)
A	(i) Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages. (ii) Reports are prepared quarterly or more frequently, and issued within 4 weeks of the end of period. (iii) There are no material concerns regarding data accuracy.
B	(i) Classification allows comparison to budget but only with some aggregation. Expenditure is covered at both commitment and payment stages. (ii) Reports are prepared quarterly, and issued within 6 weeks of the end of the quarter. (iii) There are some concerns about accuracy, but data issues are generally highlighted in the reports and do not compromise overall consistency or usefulness.
C	(i) Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both). (ii) Reports are prepared quarterly (possibly excluding first quarter), and issued within 8 weeks of the end of the quarter. (iii) There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness.
D	(i) Comparison to the budget may not be possible across all main administrative headings. (ii) Quarterly reports are either not prepared or often issued with more than 8 weeks' delay. (iii) Data is too inaccurate to be of any real use.

3.5.18 The ability to “bring in” the budget requires timely and regular information on actual budget performance to be available both to the Finance Department (and cabinet), to monitor performance and if necessary to identify new actions to get the budget back on track; and to the MDAs, to manage the affairs for which they are accountable. The indicator focuses on the ability to produce comprehensive reports from the accounting systems on all aspects of the budget (i.e., flash reports on release of funds to MDAs are not sufficient).

- 3.5.19 The government of Sindh is progressing towards getting timely and regular information on actual budget performance, for timely corrective actions as and when required. There are missing links that require attention and correction, and the PIFRA appears to be enabling the government to fill the gaps through linking of the budgets with payment processing, accounting, and financial reporting. Lack of synchronization of budgeting and accounting codes was one factor limiting the production of reliable information on budget performance, but this has been remedied. The Finance Department and accountant general servers have been linked to facilitate smooth online budget implementation.
- 3.5.20 A rating of 'C' is applicable to subrating element (i) for both provincial and district governments as expenditure is captured at payment stage rather than being booked at commitment stage at both the provincial and district government levels. Currently, the in-year accounts (monthly civil accounts) are only regularly (within 15 days of the end of each calendar month) provided to the Finance Department at the provincial level and to the executive district officer (finance and planning) at the district level, and there is no evidence that the individual departments are, as a routine, provided with their respective budget execution statements, except on demand. Only at the provincial government level are monthly fiscal reports prepared in a form that compares budgeted receipts and expenditures with actuals. Even here, the information is provided at the major and minor function levels, although information is also available at the detailed object levels. At the district government level, all 23 districts have been connected to the PIFRA automated systems, although a lot remains to be done to ensure system stability and completeness of source data.
- 3.5.21 A rating of 'A' is applicable to subrating element (ii) for both provincial and district governments. Currently, the accountant general at the provincial level and the district accounts officer at the district level prepare monthly civil accounts according to the new chart of accounts, and provide these to the Finance Department on a monthly basis within 15 days after the end of each month.
- 3.5.22 A rating of 'C' is applicable to subrating element (iii) for provincial and 'D' for district governments as there are concerns about the accuracy of data due to the existence of unreconciled transactions and the quality of information received, particularly from district accounts officers at the district level, being merely abstracts of expenditure. PIFRA systems rollout throughout the province would enhance the integrity of the data, as reports could then be generated at the detailed object levels with greater accuracy when system stability is improved.
- 3.5.23 The rating of the indicator is assessed 'C+' for the provincial and 'D+' for the district governments on the basis of the M1 (weakest link) scoring methodology.

PI-25 Quality and timelines of annual financial statements

Overall rating: 'B' for provincial and 'D+' for district governments

3.5.24 The three dimensions assessed have the following subratings:

- Subrating element (i): Completeness of the financial statements: 'B' for provincial and 'C' for district governments.
- Subrating element (ii): Timeliness of submission of the financial statements: 'B' for provincial and 'C' for district governments.
- Subrating element (iii): Accounting standards used: 'B' for provincial and 'D' for district governments.

3.5.25 The criteria for assessing the subrating elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) A consolidated government statement is prepared annually and includes full information on revenue, expenditure, and financial assets and liabilities. (ii) The statement is submitted for external audit within 6 months of the end of the fiscal year. (iii) International Public Sector Accounting Standard (IPSAS) or corresponding national standards are applied for all statements.
B	(i) A consolidated government statement is prepared annually. It includes, with few exceptions, full information on revenue, expenditure, and financial assets and liabilities. (ii) The consolidated government statement is submitted for external audit within 10 months of the end of the fiscal year. (iii) IPSAS or corresponding national standards are applied.
C	(i) A consolidated government statement is prepared annually. Information on revenue, expenditure, and bank account balances may not always be complete, but the omissions are not significant. (ii) The statements are submitted for external audit within 15 months of the end of the fiscal year. (iii) Statements are presented in consistent format over time with some disclosure of accounting standards.
D	(i) A consolidated government statement is not prepared annually, essential information is missing from the financial statements, or the financial records are too poor to enable audit. (ii) If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year (iii) Statements are not presented in a consistent format over time, or accounting standards are not disclosed.

3.5.26 Consolidated year-end financial statements are critical for transparency in the PFM system. To be complete, they must be based on details for all independent

departments and de-concentrated units. In addition, the ability to prepare year-end financial statements in a timely fashion is a key indicator of how well the accounting system is operating, and the quality of the records being maintained. In order to be useful and to contribute to transparency, financial statements must be understandable to the reader, and deal with transactions, assets, and liabilities in a transparent and consistent manner. This is the purpose of financial reporting standards. Some countries have their own public sector financial reporting standards, set by government or other authorized body. To be generally acceptable, such national standards are usually aligned with international standards such as IPSAS.

- 3.5.27 The Sindh Accountant General Office prepares annual appropriation and finance accounts reflecting information on revenue, expenditure, and financial assets and liabilities. For FY2006 audited financial statements and FY2007 draft financial statements, the Sindh accountant general has adopted and begun the implementation of IPSAS-based financial reporting, using IPSAS 2 Cash Flow Statement as the presentation format for the provincial government. With a few exceptions (third party transactions and public enterprise and state-owned enterprise consolidations), the statements conform to appropriate international standards as adopted by the Government of Pakistan. Although subprovincial governments prepare their own annual financial statements—albeit with a few exceptional issues in the case of revenue, expenditure, and bank account balances as well as reconciliation weaknesses—these are not prepared on the basis of IPSAS. The provincial government’s rating for subrating element (i) is ‘B’, while for the district governments it is ‘C’.
- 3.5.28 A rating of ‘B’ is applicable to the provincial government in respect of subrating element (ii) as the annual financial statements are submitted to external auditors (the auditor general of Pakistan) within 10 months of the end of the financial year. As regards the subprovincial governments (districts), subrating element (iii) is rated ‘C’ as the financial statements are ready and presented for audit within 15 months of the end of the fiscal year.
- 3.5.29 A rating of ‘B’ is applicable to the provincial government in respect of subrating element (iii) as the statements are presented in a consistent format over time with some disclosure of accounting standards. This has been particularly the case since FY2006 when IPSAS materially compliant financial statements with significant disclosures have been prepared and presented for audit. These statements are consistent with approved national standards. As for subprovincial governments (districts), subrating element (iii) is rated ‘D’ as the statements (mainly in the form of appropriation accounts) are not presented in a consistent format over time and accounting standards are not disclosed. The Audit Report

for the Audit Year 2004/05 for both Hyderabad and Mirpurkhas districts highlight the “non-maintenance of District Fund and Public Account and non-preparation of Finance Accounts in violation of Section 107 of the SLGO, 2001”.²⁰ However, a general program is under way for the adoption of accounts in a form specified in its NAM and aligned with IPSAS. It was in 2005 that the AGP notified the adoption of IPSAS across the government. For the financial statements of FY2008, it is planned that governments, including district governments, will fully transition to the IPSAS financial reporting framework which is, in all material respects, aligned to the NAM reporting framework.

3.5.30 The overall rating of the indicator is ‘B’ for the provincial government and ‘D+’ for the district governments using the M1 (weakest link) scoring methodology.

3.6 External Scrutiny and Audit

PI-26 Scope, nature, and follow-up of external audit

Overall rating: ‘D+’ for both the provincial and district governments

3.6.1 The three dimensions assessed and their respective subratings (same for both governments) are as follows:

- Subrating element (i): Scope and/or nature of audit performed (including adherence to auditing standards): ‘C’.
- Subrating element (ii): Timeliness of submission of audit reports to legislature: ‘D’.
- Subrating element (iii): Evidence of follow up on audit recommendations: ‘D’.

3.6.2 The criteria for assessing the subratings elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) All entities of provincial and district government are audited annually covering revenue, expenditure, and assets and liabilities. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues. (ii) Audit reports are submitted to the legislature within 4 months of the end of the period covered and, in the case of financial statements, from their receipt by the audit office. (iii) There is clear evidence of effective and timely follow up.
B	(i) Provincial and district government entities representing at least 75% of total expenditures are audited annually, at least covering revenue and expenditure. A wide

²⁰ Auditor General of Pakistan. Audit Report on the Accounts of District Government Hyderabad and Mirpurkhas, Audit Year 2004-05, pp iv and iii respectively.

	<p>range of financial audits are performed and generally adhere to auditing standards, focusing on significant and systemic issues.</p> <p>(ii) Audit reports are submitted to the legislature within 8 months of the end of the period covered and, in the case of financial statements, from their receipt by the audit office.</p> <p>(iii) A formal response is made in a timely manner, but there is little evidence of systematic follow up.</p>
C	<p>(i) Provincial and district government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction-level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only.</p> <p>(ii) Audit reports are submitted to the legislature within 12 months of the end of the period covered (for audit of financial statements from their receipt by the auditors).</p> <p>(iii) A formal response is made, though delayed or not very thorough, but there is little evidence of any follow up.</p>
D	<p>(i) Audits cover provincial and district government entities representing less than 50% of total expenditures, or audits have higher coverage but do not highlight the significant issues.</p> <p>(ii) Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors).</p> <p>(iii) There is little evidence of response or follow up.</p>

3.6.3 A high-quality external audit is an essential requirement for creating transparency in the use of public funds. Key elements of the quality of actual external audit comprise the scope and/or coverage of the audit; adherence to appropriate auditing standards including independence of the external audit institution (refer to International Organization of Supreme Audit Institution [INTOSAI], and International Federation of Accountants [IFAC] and International Auditing and Assurance Standards Board [IAASB]); focus on significant and systemic PFM issues in its reports; and performance of the full range of financial audit criteria such as reliability of financial statements, regularity of transactions, and functioning of internal control and procurement systems. Inclusion of some aspects of performance audit (such as value for money in major infrastructure contracts) would also be expected of a high-quality audit function.

3.6.4 The scope of audit mandate should include extrabudgetary funds and autonomous agencies. The latter may not always be audited by the supreme audit institution, as the use of other audit institutions may be foreseen. The scope indicates the entities and sources of funds that are audited in any given year. Where capacity of the supreme audit institution is limited, the audit program may be planned by the supreme audit institution in line with legal audit obligations on a multiyear basis in order to ensure that the most important or

- risk-prone entities and functions are covered annually, whereas other entities and functions may be covered less frequently.
- 3.6.5 The Auditor General Ordinance 2001 explains the constitutional mandate of the auditor general of Pakistan, whereby he or she is responsible for auditing all government formations and government enterprises (applicable to public funds only). The PIFRA has updated auditing methods and a district audit function has been established since 2004.
- 3.6.6 A rating of 'C' is applicable to subrating element (i) for the provincial and district governments in Sindh as government entities representing at least 50% expenditure are audited annually. The audit covers expenditure through a wide range of financial audit and some aspects of performance audit. The auditor general of Pakistan has approved the new Financial Audit Manual, which follows the modern risk-based certification audit approach,²¹ and staff have been trained to target the FY2008 audits using the Financial Audit Manual as the basis across the entire province by all audit formations.
- 3.6.7 A rating of 'D' is applicable to subrating element (ii) as the audit reports are submitted to the legislature more than 12 months from the end of the period covered for provincial and district governments. The audit reports for FY2005 were certified only in April 2007, 22 months after the end of the fiscal year, not counting the additional delay before the reports were submitted to the legislature. The situation is even worse for subprovincial governments as the zila councils receive audit reports well over 2 years, on average, after the end of the fiscal year.
- 3.6.8 A rating of 'D' is applicable to subrating element (iii) in view of the enormous delay in the formal response, making the follow up almost irrelevant. The provincial assembly of Sindh's record confirms pending audit reports of over 5 years. In addition, the weaknesses of the departmental accounts committees in following up and settling audit paragraphs continue unabated. The situation is even more unfavorable at the district level where there are minimal departmental accounts committee meetings held to review audit reports and take the necessary corrective action. The zila accounts committees of Hyderabad and Mirpurkhas districts, for example, have not been functional.²²
- 3.6.9 The overall rating of the indicator is assessed 'D+' for provincial and district governments on the basis of the M1 (weakest link) scoring methodology.

²¹ World Bank. 2007. *Pakistan, Public Sector Accounting and Auditing, A Comparison to International Standards*. pp xii.

²² Auditor General of Pakistan, Audit Report on the Accounts of District Government Mirpurkhas and Hyderabad, Audit Year 2004-05, pupil and iv, respectively.

PI-27 Legislative scrutiny of the annual budget law

Overall rating: 'D+' for both the provincial and district governments

3.6.10 The four dimensions assessed and their respective subratings are as follows:

- Subrating element (i): Scope of the legislature's scrutiny: 'B' for both provincial and district governments.
- Subrating element (ii): Extent to which the legislature's procedures are well established and respected: 'B' for provincial and 'C' for district governments.
- Subrating element (iii): Adequacy of time for the legislature to provide a response to budget proposals for both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined): 'D' for both provincial and district governments.
- Subrating element (iv): Rules for in-year amendments to the budget without ex-ante approval by the legislature: 'B' for both provincial and district government.

3.6.11 The criteria for assessing the subrating elements are as follows:

Score	Minimum requirements (Scoring Methodology M1)
A	<p>(i) The legislature's review covers fiscal policies, medium-term fiscal framework, medium-term priorities, and details of expenditure and revenue.</p> <p>(ii) The legislature's procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures.</p> <p>(iii) The legislature has at least 2 months to review the budget proposals.</p> <p>(iv) Clear rules exist for in-year budget amendments by the executive, set strict limits on extent and nature of amendments, and are consistently respected.</p>
B	<p>(i) The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue.</p> <p>(ii) Simple procedures exist for the legislature's budget review and are respected.</p> <p>(iii) The legislature has at least 1 month to review the budget proposals.</p> <p>(iv) Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations.</p>
C	<p>(i) The legislature's review covers details of expenditure and revenue, but only at a stage where detailed proposals have been finalized.</p> <p>(ii) Some procedures exist for the legislature's budget review, but they are not comprehensive and only partially respected.</p> <p>(iii) The legislature has less than 1 month to review the budget proposals.</p> <p>(iv) Clear rules exist, but they may not always be respected, or they may allow extensive administrative reallocation as well as expansion of total expenditure.</p>

D	<p>(i) The legislature’s review is nonexistent or extremely limited, or there is no functioning legislature.</p> <p>(ii) Procedures for the legislature’s review are nonexistent or not respected.</p> <p>(iii) The time allowed for the legislature’s review is clearly insufficient for a meaningful debate (significantly less than 1 month).</p> <p>(iv) Rules regarding in-year budget amendments may exist but are either very rudimentary and unclear or they are usually not respected.</p>
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3.6.12 The power to give the government authority to spend rests with the legislature, and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and debate the law, that power is not being effectively exercised and will undermine the accountability of the government to the electorate. Assessing the legislative scrutiny and debate of the annual budget law will be informed by consideration of several factors, including the scope of the scrutiny, the internal procedures for scrutiny and debate, and the time allowed for that process. The PFM framework, therefore, looks for legislative scrutiny to be comprehensive, well-informed by summary and detailed information, and involve in-depth review by specialized committees. The legislature should have at least 2 months to review the budget proposals and there should be clear rules for in-year budget amendments by the executive and strict limits that are consistently respected on the extent and nature of amendments.

3.6.13 The budget making is a well-established and thorough process in the government of Sindh. The planning process starts around the end of the first quarter of the current financial year. The budget call circular for FY2009 has been circulated by the Finance Department (letter No. FD/B&E-I / 4-1 / 59 /BCC / 2008-09 dated 21 September 2007). The draft of the budget is first submitted for consideration of the cabinet and then for approval by the Sindh Assembly.

3.6.14 A rating of ‘B’ is applicable to subrating element (i) in respect of the provincial government as the assembly’s review essentially only covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue. The other provinces in Pakistan follow the practice of submitting a detailed white paper to the legislature, which includes fiscal policies and analysis, medium-term fiscal framework, and medium-term priorities, as well as details of expenditure and revenue, but this practice is not followed in Sindh. The situation at the district council level is more or less similar; thus a rating of ‘B’ also applies to district governments.

3.6.15 A rating of ‘B’ is applicable to subrating element (ii) in respect of the provincial government as simple procedures exist for the legislature’s budget review (rules

114-128²³) and these are respected. The same rules provide for a system of standing and select committees (rules 129-156); however, rule 114(4) expressly bars review of the budget by specialized committees.²⁴ As regards district governments, dimension (ii) is rated 'C' because, while procedures do exist under the budget rules for the zila councils, compliance is uneven.

3.6.16 The Sindh Assembly's historical budget review trend confirms a duration of less than 1 month for legislative review. Table 10 shows the actual times for the Sindh Assembly's review of the budget proposals, from the date of summoning of the budget session to the date of proroguing. The range confirms 10-14 days for legislative review.

Table 10: Actual Time of Sindh Assembly Budget Proposal Review

Financial Year	Date of Budget Session Summoning	Date of Budget Session Proroguing	Legislative Review
FY2004	16 Jun 03	25 Jun 03	10 days
FY2005	16 Jun 04	29 Jun 04	14 days
FY2006	10 Jun 05	22 Jun 05	13 days
FY2007	15 Jun 06	27 Jun 06	13 days
FY2008	15 Jun 07	27 Jun 07	13 days

Source: Sindh Assembly Secretariat

3.6.17 The time allowed for the provincial assembly's review (significantly less than 1 month), prima facie is clearly insufficient for a meaningful debate, even after taking into account the consultation period before the summoning of the budget session. In the case of zila councils (districts), a period of 1-2 weeks is generally kept for discussion on the budget after it is presented by the nazim. Therefore, a rating of 'D' applies for both the provincial and district governments in respect of subrating element (iii).

3.6.18 A rating of 'B' is applicable to subrating element (iv) for both provincial and district governments as clear rules exist for in-year budget amendments by the executive and these are usually respected, but they allow extensive administrative reallocations. All expenditures so made are submitted to the legislature with the following year's budget proposal, as supplementary grants, and voted on separately. This procedure has been approved by the legislature as binding.

²³ Rules of Procedure of the Provincial Assembly of Sindh, made by the Governor under Article 67 read with Article 127 of the Constitution of Islamic Republic of Pakistan.

²⁴ "The budget shall not be referred to a Standing Committee or Select Committee and no motion in respect thereof shall be made except as provided in this Chapter."

3.6.19 The overall rating of the indicator is assessed 'D+' for the provincial government and 'D+' for the district governments on the basis of the M1 (weakest link) scoring methodology.

PI-28 Legislative scrutiny of external audit reports

Overall rating: 'D+' for provincial government and 'D' for district governments

3.6.20 The three dimensions assessed and their respective subratings are as follows:

- Subrating element (i): Timeliness of examination of audit reports by the legislature (for reports received within the last 3 years): 'D' for provincial and 'D' for district governments.
- Subrating element (ii): Extent of hearings on key findings undertaken by the legislature: 'B' for provincial and 'D' for district governments.
- Subrating element (iii): Issuance of recommended actions by the legislature and implementation by the executive: 'B' for provincial and 'D' for district governments.

3.6.21 The criteria for assessing the subratings elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) Scrutiny of audit reports is usually completed by the legislature within 3 months from receipt of the reports. (ii) In-depth hearings on key findings take place consistently with responsible officers from all or most audited entities, which receive a qualified or adverse audit opinion. (iii) The legislature usually issues recommendations on action to be implemented by the executive, and evidence exists that they are generally implemented.
B	(i) Scrutiny of audit reports is usually completed by the legislature within 6 months from receipt of the reports. (ii) In-depth hearings on key findings take place with responsible officers from the audited entities as a routine, but may cover only some of the entities, which received a qualified or adverse audit opinion. (iii) Actions are recommended to the executive, some of which are implemented, according to existing evidence.
C	(i) Scrutiny of audit reports is usually completed by the legislature within 12 months from receipt of the reports. (ii) In-depth hearings on key findings take place occasionally, cover only a few audited entities, or may include Finance Department officials only. (iii) Actions are recommended, but are rarely acted upon by the executive.
D	(i) Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. (ii) No in-depth hearings are conducted by the legislature.

(iii) No recommendations are being issued by the legislature.

- 3.6.22 The legislature has a key role in exercising scrutiny over the execution of the budget that it approved. A common way in which this is done is through a legislative committee, i.e., public accounts committee (PAC), that examines the external audit reports and questions responsible parties about the findings of the reports. The effective and efficient operation of the committee depends on adequate financial and technical resources, and on adequate time being allocated to keep up to date on reviewing audit reports. The PAC may also recommend actions and sanctions to be implemented by the executive, in addition to adopting the recommendations made by the external auditors.
- 3.6.23 The PFM framework related to this indicator examines the timeliness of examinations of audit reports by the PAC (for reports received within the last 3 years), the extent of hearings on key findings undertaken by the PAC, and the issuance of recommended action by the PAC and implementation by the executive.
- 3.6.24 The PACs in Sindh (including the zila accounts committee [ZAC]—the district equivalent of the provincial PAC) have a long history of backlogs of audit report and accounts reviews, and of nonfunctionality. The ad hoc PAC appointed in October 2000 discovered that audit reports since FY1984 were pending consideration and considered the accounts for FY1993–FY2000. The latest accounts considered by the PAC that was constituted in September 2003 pertain to FY2002. At the district level, the ZACs have not, systematically, considered the accounts and audit reports of the district governments since 2002. A rating of ‘D’ is therefore applicable to subrating element (i) for both provincial and district governments as examination of audit reports by the legislature does not take place, or usually takes more than 12 months to complete.
- 3.6.25 A rating of ‘B’ is applicable to subrating element (ii) in respect of the provincial government as the PAC, while not conducting the review on a timely basis, holds in–depth hearings on key findings with responsible officers from some of the audited entities as a routine, particularly those on which a qualified or adverse audit opinion was received. The caveat is that, due to the abnormal time lag between the audit report and legislative scrutiny, as mentioned above, there is likelihood that the responsible officials are no longer in the service to answer to the audit queries under consideration. For the district governments, the rating is clearly ‘D’ as virtually no hearings are ever held. The ZACs, according to audit reports, have been established but have generally not commenced functioning.

3.6.26 A rating of 'B' is applicable to subrating element (iii) for the provincial government as the recommendations issued by the PAC are taken seriously by the executive and some follow-up actions are pursued by the principal accounting officers with feedback to the PAC, as and when the PAC functions. This was evident from the report of the PAC that was reviewed, although the backlog of reports remains enormous. The district government rating is yet another 'D' as hearings are not held for any recommendations to be issued.

3.6.27 For the provincial government, the overall rating is therefore 'D+', and for the district governments the overall rating is 'D', both on the basis of the M1 (weakest link) scoring methodology.

3.7 Donor Practices

D-1 Predictability of direct budget support

Overall rating: 'C+' (provincial government only)

3.7.1 The two dimensions assessed, and their respective subrating elements are as follows:

- Subrating element (i): Annual deviation of actual budget support from the forecast provided by the donor agencies at least 6 weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body): 'C'.
- Subrating element (ii): In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates): 'A'.

3.7.2 The criteria for assessing the subratings elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) In no more than 1 out of the last 3 years has direct budget support out-turn fallen short of the forecast by more than 5%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in 2 of the last 3 years.
B	(i) In no more than 1 out of the last 3 years has direct budget support out-turn fallen short of the forecast by more than 10%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in 2 of the last 3 years.
C	(i) In no more than 1 out of the last 3 years has direct budget support out-turn fallen short of the forecast by more than 15%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the

	beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50% in 2 of the last 3 years.
D	(i) In at least 2 of the last 3 years has direct budget support out-turn fallen short of the forecast by more than 15%, or no comprehensive and timely forecast for the year(s) was provided by the donor agencies. (ii) The requirements for score C (or higher) are not met.

3.7.3 Direct budget support constitutes an important source of revenue for provincial government in many countries. Poor predictability of inflows of budget support affects the government's fiscal management in much the same way as the impact of external shocks on domestic revenue collection. Both shortfalls in the total amount of budget support and delays in the in-year distribution of the inflows can have serious implications for the government's ability to implement its budget as planned.

3.7.4 A rating of 'C' is applicable to subrating element (i), as the direct budget support out-turn for FY2008 has fallen short of the forecast by more than 15% as a result of nonactualization of the budget support operation related to the World Bank-supported Second Sindh Education Development Support Credit. This was due largely to the government not meeting the agreed trigger conditions. Budget support is, otherwise, forecasted in a timely manner, and is predictable and honored by donors over the prior 2 fiscal years. This indicator applies only to the provincial government.

3.7.5 A rating of 'A' is applicable to subrating element (ii) as the disbursement agreements have been agreed with donors before the beginning of the fiscal year and the actual disbursement delays have not exceeded 25% in 2 of the last 3 years. About 91.5%²⁵ of donor support to the government of Sindh comes from the International Development Association (World Bank) and ADB, and mostly in the form of budget support without any delays in disbursement. The European Commission, in collaboration with the World Bank, has also provided budget support to the government of Sindh under the auspices of the Sindh Education Reform Program.

3.7.6 The overall rating of the indicator is assessed 'C+' on the basis of the M1 (weakest link) methodology.

D-2 Donor financial information provided for budgeting and reporting on project and program aid

Overall rating: 'C+' (provincial government only)

²⁵ Finance Department. 2008. *Budget Analysis 2007-08*. Government of Sindh, , p. 80.

3.7.7 The two assessed dimensions and their related subratings are as follows:

- Subrating element (i): Completeness and timeliness of budget estimates by donors for project support: 'A'.
- Subrating element (ii): Frequency and coverage of reporting by donors on actual donor flows for project support: 'C'.

3.7.8 The criteria for assessing the subratings elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) All donors (with the possible exception of a few donors providing insignificant amounts) provide budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification. (ii) Donors provide quarterly reports within 1 month of the end of the quarter on all disbursements made for at least 85% of the externally financed project estimates in the budget, with a breakdown consistent with the government budget classification.
B	(i) At least half of the donors (including the five largest) provide complete budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification. (ii) Donors provide quarterly reports within 1 month of the end of the quarter on all disbursements made for at least 70% of the externally financed project estimates in the budget with a breakdown consistent with the government budget classification.
C	(i) At least half of the donors (including the five largest) provide complete budget estimates for disbursement of project aid for the government's coming fiscal year, at least 3 months prior its start. Estimates may use donor classification and not be consistent with the government's budget classification. (ii) Donors provide quarterly reports within 2 months of the end of the quarter on all disbursements made for at least 50% of the externally financed project estimates in the budget. The information does not necessarily provide a breakdown consistent with the government budget classification.
D	(i) Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least 3 months prior its start. (ii) Donors do not provide quarterly reports within 2 months of the end of the quarter on disbursements made for at least 50% of the externally financed project estimates in the budget.

3.7.9 Predictability of the disbursement of donor support for projects and programs affects the implementation of specific line items in the budget. Support can be delivered in a wide range of ways, with varying degrees of government involvement in planning and management of resources. A lower degree of government involvement leads to problems in budgeting for the resources (including presentation in the budget documents for legislative approval) and in

reporting of actual disbursement and use of funds (which will be entirely the donor's responsibility where aid is provided in kind).

- 3.7.10 A rating of 'A' is applicable to subrating element (i) as the budget estimates are forecasted by the donors and project authorities, and annual inputs are consolidated by the provincial Planning and Development Department, outlining the foreign project assistance and the government of Sindh counterpart share, for preparation of the development budget of the province. The disbursement is broadly received in accordance with the schedule. Almost all pledged and committed donor project aid is received according to schedule and factored into the government's budget on the basis of the government's chart of accounts. Investment projects funded by donors, however, have tended to be largely disbursed under "ring-fenced" arrangements and hence do not use the government chart of accounts in terms of donor reports on disbursements. However, the donor aid funds are included in the government budget using the government's chart of accounts classification and based essentially on the projects' PC-1s (the government own-feasibility document).
- 3.7.11 A rating of 'C' is applicable to subrating element (ii) as the Planning and Development Department receives the monthly reports (not from donors but from project implementing entities) and consolidates these quarterly. The World Bank, in particular, provides "client connection" facilities to project implementing agencies as well as to the federal Economic Affairs Division which serves as a clear basis for project disbursements from ADB but not on the basis of the government's chart of accounts classification.
- 3.7.12 The overall rating of the indicator is assessed 'C+' on the basis of the M1 (weakest link) scoring methodology.

D-3 Proportion of aid that is managed by use of national procedures

Overall rating: 'B' (provincial government only)

3.7.13 The criteria for assessing the rating are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	90% or more of aid funds to provincial government are managed through national procedures.
B	75% or more of aid funds to provincial government are managed through national procedures.
C	50% or more of aid funds to provincial government are managed through national procedures.
D	Less than 50% of aid funds to provincial government are managed through national procedures.

3.7.14 The requirement that national authorities use different donor-specific procedures for the management of aid funds diverts capacity away from managing the national systems. This is compounded when different donors have different requirements. The use of national procedures for banking, authorization, procurement accounting, disbursement, and reporting arrangement for donor funds, as well as for government funds, can help to focus efforts on strengthening the national procedures to mutual benefit.

3.7.15 A rating of 'B' is applicable to the dimension, as more than 75% of the aid funds to the government of Sindh are managed through national procedures. The aid funds received by the provincial government through budget support are managed through national procedures, and externally aided projects are managed on a "ring-fenced" basis through donor's preferred management systems. Since annual disbursements on donor-funded projects (investment projects using donor-preferred systems) constitute less than 25% of all donor aid to the government, much of the donor assistance is integrated into the

government-owned budget management system. As a policy, the government of Sindh concurs to make the national procurement procedures subservient to the donors' preferred procedures for externally aided projects.²⁶

²⁶ Government of Sindh Planning and Development Department's notification P&D / F.AID/PROC-1/1995 dated 27 November 1995 directs that, "for implementation of foreign donor assisted projects, the procurement procedures prescribed in the project's legal documents and donor agency's procurement guidelines will apply to all contracts for goods and works financed in whole or in part by the respective donor agency / agencies, and take precedence over any other conflicting procurement rules and procedures."

3.8 Central Government Practices

CG-1 Predictability of central government transfers

Overall government rating: 'A' ('A' for federal transfers and 'A' for provincial transfers)

3.8.1 The three dimensions assessed and their respective ratings are as follows:

- Subrating element (i): Annual deviation of actual central transfers from the original amount provided by respective federal and provincial governments to the provincial and district government entity: 'A' (for both federal and provincial transfers).
- Subrating element (ii): Annual deviation of allocated grants: 'A' (for both federal and provincial transfers).
- Subrating element (iii): In-year timeliness of federal and provincial transfers (compliance with agreed distribution timetables): 'A' (for both federal and provincial transfers).

3.8.2 The federal government transfers and shared revenues constitute an important source of revenue for the provincial and hence subprovincial governments in Sindh. Where predictability of inflows of these transfers is poor, fiscal management, particularly at the provincial government level, as well as the ability of both provincial and subprovincial governments to deliver services, is impaired. Shortfalls in the total amount of federal transfers and the delays in the in-year distribution of the inflows can have serious implications for the provincial and subprovincial governments' ability to implement their budgets as planned. Shortfalls in allocated or conditional grants can have an additional effect on particular sectors, e.g., health or education.

3.8.3 The criteria for assessing the subrating elements are as follows:

Score	Minimum Requirements (Scoring Methodology M1)
A	(i) In no more than 1 out of the last 3 years have federal or provincial transfers fallen short of the estimate by more than 5%. (ii) Variance in provision of allocated grants exceeded overall deviation in total transfers by no more than 5 percentage points in any of the last 3 years. (iii) A disbursement timetable forms part of the agreement between federal and provincial governments and between provincial and subprovincial governments, and this is agreed by all stakeholders at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in more than 1 of the last 3 years.
B	(i) In no more than 1 out of the last 3 years have federal or provincial transfers fallen

	<p>short of the estimate by more than 10%.</p> <p>(ii) Variance in provision of allocated grants exceeded overall deviation in total transfers by no more than 5 percentage points in no more than 1 of the last 3 years</p> <p>(iii) A disbursement timetable forms part of the agreement between federal and provincial governments and between provincial and subprovincial governments and this is agreed by all stakeholders at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in 2 of the last 3 years.</p>
C	<p>(i) In no more than 1 out of the last 3 years have federal or provincial transfers fallen short of the estimate by more than 15%.</p> <p>(ii) Variance in provision of allocated grants exceeded overall deviation in total transfers by no more than 10 percentage points in no more than 1 of the last 3 years.</p> <p>(iii) A disbursement timetable forms part of the agreement between federal and provincial governments and between provincial and subprovincial governments and this is agreed by all stakeholders at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50% in 2 of the last 3 years, or no disbursement timetable is agreed.</p>
D	<p>(i) In at least 2 of the last 3 years federal or provincial transfers have fallen short of the estimate by more than 15%.</p> <p>(ii) Variance in provision of allocated grants exceeded overall deviation in total transfers by no more than 10 percentage points in at least 2 of the last 3 years.</p> <p>(iii) The requirements for score C (or higher) are not met.</p>

3.8.4 As highlighted under PI-3 (aggregate revenue out-turn compared to original approved budget), the shortfall in overall provincial revenue was largely as a result of the province's own-revenue shortfalls instead of fiscal transfers under the National Finance Commission Rules. Table 6, read in conjunction with Tables 7 and 8 over the three reference years, clearly indicates this phenomenon. As a result, subrating element (i) of the indicator is rated 'A' since in none out of the 3 years was the federal transfer less than the estimated amount by more than 5%. Similarly, the provincial transfers to the subprovinces (districts and/or tehsils) under the PFC follow the same pattern, as the budgets of these subprovincial governments are finalized well after the federal and provincial government budgets are approved.

3.8.5 Subrating element (ii) is also rated 'A' for both federal and provincial transfers on the strength of the fact that all federal or provincial conditional grants approved in their respective budgets are transferred to the provincial government (from the federal government) and to the district governments (from the provincial government) as long as the underlying agreed conditions are met. In general, less than 5% of conditional grants approved in the budget of higher-tier governments are not transferred to the lower tiers of government as the transfer

conditions were mostly met in all of the 3 years under reference, according to the provincial Finance Department.

- 3.8.6 Timeliness of fiscal transfers is critical for both the provincial and district governments own budget credibility. Again, as revealed in tables under PI-2, PI-3, and PI-16, the actual reported fiscal transfers were received during the respective budget years and the share of the federal receipts constituted a fairly constant and predictable percentage (about 85%) of the overall revenue base for the provincial government. Since fiscal transfers to the provincial government (from the federal government) and to the subprovincial governments (from the federal and provincial governments) are normally front-loaded (quarterly or half-yearly) as of the start of the fiscal year, the rating of subrating element (iii) is 'A' for both federal and provincial transfers.
- 3.8.7 Overall, therefore, using the MI scoring methodology, the indicator is rated 'A'.

Chapter 4: Summary of Performance Indicators

4.1 The table shows, separately and where applicable, the overall rating for each indicator as well as the corresponding detailed scores of each related subindicator for the provincial and district governments.

Item	Province Overall	Province Dimension rating				District Overall	District Dimension rating			
		i	ii	iii	iv		i	ii	iii	iv
A. PFM OUT-TURNS: Budget Credibility										
PI-1 Aggregate expenditure out-turn compared to original approved budget	C	C	-	-	-	D+	D+	-	-	-
PI-2. Composition of expenditure out-turn compared to original approved budget	D	D	-	-	-	N/S	N/S	-	-	-
PI-3. Aggregate revenue out-turn compared to original approved budget	B	B	-	-	-	N/S	N/S	-	-	-
PI-4. Stock and monitoring of expenditure payment arrears	D+	A	D	-	-	D+	A	D	-	-
B. KEY CROSSCUTTING ISSUES: Comprehensiveness and Transparency										
PI-5. Classification of the budget	A	A	-	-	-	A	A	-	-	-
PI-6. Comprehensiveness of information included in budget document	A	A	-	-	-	N/S	N/S	-	-	-
PI-7. Extent of unreported government operations	D+	A	D	-	-	N/A	N/A	N/A	-	-
PI-8. Transparency of intergovernmental fiscal relations	B	A	C	C	-	N/A	N/A	N/A	-	-
PI-9. Oversight of aggregate fiscal risk from other public sector entities	D	D	D	-	-	N/A	N/A	N/A	-	-
PI-10. Public access to key fiscal information	C	C	-	-	-	D	D	-	-	-
C. BUDGET CYCLE										
C (i) Policy-Based Budgeting										
PI-11. Orderliness and participation in the annual budget process	B+	A	C	A	-	D+	C	C	D	-
PI-12. Multiyear perspective in fiscal planning, expenditure policy, and budgeting	C	C	A	D	D	N/A	N/A	N/A	N/A	N/A
C(ii) Predictability and Control in Budget Execution										
PI-13. Transparency of taxpayer	C	C	C	C	-	N/A	N/A	N/A	N/A	-

Item	Province Overall	Province Dimension rating				District Overall	District Dimension rating			
		i	ii	iii	iv		i	ii	iii	iv
obligations and liabilities							A	A	A	
PI-14. Effectiveness of measures for taxpayer registration and tax assessment	D+	D	D	C	-	N/A	N/A	N/A	N/A	-
PI-15. Effectiveness in collection of tax payments	C+	C	A	C	-	N/A	N/A	N/A	N/A	-
PI-16. Predictability in the available funds for expenditure commitments	B+	B	A	B	-	C+	B	A	C	-
PI-17. Recording and management of cash balances, debt, and guarantees	B	B	B	C	-	N/A	N/A	N/A	N/A	-
PI-18. Effectiveness of payroll controls	C+	C	B	C	C	C+	C	B	C	C
PI-19. Competition, value for money, and controls in procurement	C	D	B	C	-	N/S	N/S	N/S	N/S	-
PI-20. Effectiveness of internal controls for nonsalary expenditure	C	C	C	C	-	C	C	C	C	-
PI-21. Effectiveness of internal audit	D	D	D	D	-	D	D	D	D	-
C(iii) Accounting, Recording, and Reporting										
PI-22. Timeliness and regularity of accounts reconciliation	C+	B	C	-	-	C+	B	C	-	-
PI-23. Information on resources received by service delivery units	B	B	-	-	-	B	B	-	-	-
PI-24. Quality and timeliness of in-year budget reports	C+	C	A	C	-	D+	C	A	D	-
PI-25. Quality and timeliness of annual financial statements	B	B	B	B	-	D+	C	C	D	-
C(iv) External Scrutiny and Audit										
PI-26. Scope, nature, and follow-up of external audit	D+	C	D	D	-	D+	C	D	D	-
PI-27. Legislative scrutiny of the annual budget law	D+	B	B	D	B	D+	B	C	D	B
PI-28. Legislative scrutiny of external audit reports	D+	D	B	B	-	D	D	D	D	-
D. Donor Practices										
D-1. Predictability of direct budget support	C+	C	A	-	-	-	-	-	-	-
D-2. Donor financial information provided for budgeting and reporting on project and	C+	A	C	-	-	-	-	-	-	-

Item	Province Overall	Province Dimension rating				District Overall	District Dimension rating			
		i	ii	iii	iv		i	ii	iii	iv
program aid										
D-3. Proportion of aid that is managed by use of national procedures	B	B	-	-	-	-	-	-	-	-
Central Government Practices (for Federal Government only)										
CG-1. Predictability of central government transfers	A	A	A	A	-	-	-	-	-	-

4.2 The performance indicator-based assessment does highlight the need for reforms in specific areas of budget development, budget execution, internal control, accounting, external audit, and legislative and public oversight. Following this assessment, a preliminary summary diagnostic analysis (Annex 1) was carried out (as a separate follow-on exercise) to assess the factors that have hampered performance and to draw proposals for improvement that may be considered in designing a future government of Sindh-led PFM reform strategy for the province as a whole. However, significant future improvements in a majority of the affected weakly performing areas will depend on the pace of implementation and success of PIFRA-executed reforms in the province, as well as on the successful implementation and completion of the devolution reforms program.

Chapter 5: Government Reform Programs

5.1 Description of Recent and Ongoing Reform Measures

- 5.1.1 The government of Sindh, like other provincial governments, is engaged in wide-ranging reforms that are addressing key systemic issues, although with varying levels of success. With the aim of improving efficiency, effectiveness, and transparency in service delivery, efforts are under way to strengthen public financial management, procurement management, civil services, and overall public sector management.

5.2 Institutional Factors Supporting Reform Planning and Implementation

- 5.2.1 Sindh initiated its reforms program under the integrated umbrella of the Sindh Reforms Program in 2002, supported by the World Bank's Sindh Structural Adjustment Credit (SAC). The initial focus remained intensely on the three main pillars: (i) fiscal restructuring and financial management reforms; (ii) improving service delivery for basic social services; and (iii) regulatory reforms, privatization, and infrastructure improvements. The fiscal and financial restructuring reforms program under the SAC was broad-based and dealt with wide-ranging issues including tax and revenue reforms, procurement reforms, debt management, and restructuring and reforms in the service delivery mechanism, particularly in respect of civil services reforms.
- 5.2.2 However, with discontinuation of the SAC umbrella in 2004, reform momentum has slowed considerably. Different organs of the provincial government are implementing various reform programs, but these interventions are neither well coordinated nor are they well integrated into a structured and focused reform program for the province. Thus procurement reforms are now being carried out by the Planning and Development Department, debt management reforms are being carried out by the Finance Department, capacity building of district and other local governments is being carried out under the Decentralization Support Program, and resource management and tax reforms are being executed under the Devolved Social Services Program (DSSP) and under the Decentralization Support Program at the local government level. The Decentralization Support Program and DSSP are interventions funded by ADB and are aimed at reinforcing

the reforms process. A quick snapshot of these important interventions is discussed below.

Public Financial Management–Related Regulatory Reforms

- 5.2.3 The government of Sindh has focused on strengthening its PFM regulatory framework. It notified the Sindh Fiscal Transfer Rules 2004 in accordance with the provisions of the Sindh Local Government Ordinance 2001. The Rules of Business for the Sindh government were updated on 31 August 2006. The Budget Rules for local governments were developed by the Decentralization Support Program (Sindh) in 2003.
- 5.2.4 The government of Sindh enacted legislation that established the Public Procurement Regulatory Authority in August 2006. Procurement rules of the federal government were adopted in 2005, and modified in 2006. Recently, the government, with the assistance of the World Bank, launched an Institutional Development Fund grant–financed project to strengthen procurement systems in the province. Elaborate rules and implementing regulations would be formulated under this technical assistance. The Decentralization Support Program has also drafted procurement rules and guidelines for the local governments, and these are in the process of being notified.

Capacity–Building Interventions

- 5.2.5 A number of trainings were carried out as a part of the ADB capacity–building technical assistance in almost all districts of Sindh. Prescribed formats under Sindh Local Government Ordinance 2001, including the budget call letter and budget statement format, were developed and included in all of these capacity–building programs. A user manual was also developed in this exercise and disseminated to all the executive district officers (finance and planning) and DDOs in the province. However, no post–intervention impact assessment has been carried out to assess the level of competencies developed as a result of the capacity–building exercise. The European Commission also commissioned a technical assistance project to conduct a financial management capacity survey in Sindh, and a report was submitted in December 2007. The outcome of this survey will be used to support a coherent PFM capacity–building program in the province.

Streamlining Provincial Finance Commission Transfers

- 5.2.6 To achieve the objective of buy-in from the local governments, a lot depends on the equitable and judicious pronouncement of the Provincial Finance Commission (PFC), which determines the fiscal transfer shares of each local government in the province. The Decentralization Support Program supported the initiation of a formula-based distribution arrangement for fiscal transfers under the PFC. The latest PFC award provides a reasonable distribution of financial resources based on factors such as population (50%), backwardness (17.5%), tax collection (7.5%), transitional transfer (20%), and performance-based benchmark (5%). Additional grants for TMAs were also allocated for improving social sector service delivery through ADB's DSSP.

Strengthening Internal Controls in Public Financial Management Systems

- 5.2.7 Based on the Sindh Public Financial Accountability Assessment report of 2004, and as part of the Sindh Reform Program managed by the Sindh Finance Department, the process of establishing an internal audit function and introducing an internal audit cadre in the province has been initiated. The improvement of the internal control processes of the line departments can be better facilitated by the introduction of the function of finance and accounting officers along with the establishment of the internal audit function. The provincial and district fiscal monitoring committees have since been established, but these committees have met quite infrequently. Focused interventions to improve the workings of these committees is an urgent requirement in order to support the drive towards achieving the cardinal objective of improving PFM systems in the province for better service delivery. There is a move to introduce and design an expenditure tracking system in the province, supported by the Decentralization Support Program.

Revenue Reforms

- 5.2.8 One of the key areas of PFM is determining and measuring how effective, efficient, and predictable the revenue planning, collection, and management system is in the province. Under the Decentralization Support Program, agricultural income tax surveys were conducted along with other studies to assess revenue potential with the aim of broadening the provincial tax base. These tax reform initiatives of the Sindh government mainly focused on the property tax and stamp duties and have led to an increase of more than 50% (PRs5.3 billion to PRs8.2 billion) in tax collections between 2000 and 2002. The collections exceeded PRs18 billion in 2006.

Fiscal and Financial Reporting

5.2.9 The PIFRA, being a countrywide PFM project, is the core of the financial management reform program in Sindh. With all of the 23 PIFRA district sites in the province of Sindh currently productive and active, the reform measures related to budgeting, payment processing, accounting, financial reporting, and auditing are being progressively implemented. A new chart of accounts that is essentially compliant with the International Monetary Fund Government Finance Statistics 2001 has been adopted across the provincial and district governments in Sindh. This has started to produce outcomes, as better and more reliable financial and fiscal information for informed decision making is being utilized at those computer-based sites and by the Finance Department. Also, the timeliness of financial reporting is improving and it is anticipated that during FY2009 the entire province will be operating on a stable state-of-the-art financial management architecture that will better support fiscal management in the province. By this time, the required basis for reliable, accurate, comprehensive, and timely financial and fiscal reporting will be achieved, which in turn will enhance the efficiency of service delivery. The project will extend to all district headquarters and local governments in the province and thus cater for the better management and control of poverty-reducing expenditure in those areas. In effect, it may be concluded that the thrust of the PFM improvement platform in the province, as with other provinces in the federation, is the successful completion of the PIFRA project. This project supports the strengthening of the institutional and human resources capacity across the country in a well coordinated and sequenced manner and will remain effective until December 2010.

Annex 1: Preliminary Summary Matrix for the Weakly Performing Public Financial Management Areas and the Way Forward

(Provincial Government Focused)

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
PI-1 and PI-2 PFM Out-turns (Rating 'C' & 'D' Respectively) PI-3: Rating 'B'	Aggregate expenditure out-turn compared to original approved budget <i>PI-1 Rating: 'C'</i>		One of the key factors of higher expenditure out-turns in comparison to the original budgets is the low predictability of federal transfers to the province which makes this a higher fiduciary risk. Dependence on availability of resources for expenditures from the federal government shall be reduced by rationalizing taxes and bringing in tax reforms, which in turn will increase the local tax base. Other improvement measures include (i) proper categorization of expenditures across functional classification levels in the budget document as well as on actual expenditure reporting; (ii) across-the-board implementation of the Project to Improve Financial Reporting and Auditing (PIFRA) which will reduce accounting classification errors; (iii) prudent resources allocation which should be aligned with the changing sector requirements; (iv) decentralization of authority to the spending units once projects are costed, approved, and included in the PSDP; (v) reducing the number and stages of approval while ensuring transparency and efficiency in service delivery; and (vi) limiting in-year reappropriations. <i>Responsibility: Board of Revenue, Excise and Taxation, Finance Department, Project to Improve Financial Reporting and Auditing (PIFRA), Principal Accounting Officers, Drawing and Disbursement Officers, District Accounts Officers</i>
	Composition of expenditure out-turns compared to original approved budget <i>PI-2 Rating: 'D'</i>	Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in all 3 years examined	
	Aggregate revenue out-turn compared to original approved budget <i>PI-3 Rating: 'B'</i>		

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
<p>PI-4 Stock and Monitoring of Expenditure Payment Arrears</p> <p>Rating: 'D+'</p>	<p>Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year). Prerequisite is the availability of data for monitoring the stock of expenditure payment arrears.</p> <p>Rating: 'D+'</p>	<p>There is no reliable data on the stock of arrears from the last 3 years. Commitment or obligation accounting has yet to be adopted but some districts and tehsil municipal administration (TMAs) do carry forward expenditures incurred to be paid in the following fiscal year as there may be fewer funds available to finance such expenditures by the current year end. While this is the case, there is no formal recording and reporting of the related expenditure arrears.</p>	<p>Full implementation of the new accounting model (NAM)/SAP system, which includes commitment accounting Project to Improve Financial Reporting and Auditing (PIFRA) and year-end reporting of outstanding commitments.</p> <p>The system should enable separate identification of the payment of arrears in the subsequent fiscal year from other routine payments pertaining to current fiscal year Project to Improve Financial Reporting and Auditing (PIFRA).</p> <p>Responsibility: Finance Department, Accountant General, District Governments, Project to Improve Financial Reporting and Auditing (PIFRA) Directorate</p>
<p>PI-7 Extent of Unreported Government Operations</p> <p>Rating: 'D+'</p>	<p>The level of unreported extrabudgetary expenditure, excluding donor-funded projects</p> <p>Rating: 'D+'</p>	<p>The prevalence of PLAs as well as the assignment accounts related to domestically funded programs undermines the level of comprehensiveness of fiscal reports. Of particular significance is the lack of information in fiscal reports relating to donor-funded investment operations since most of these are "ring fenced" and do not feature as part of core government activities that are captured in sufficient detail.</p>	<p>All the public accounts needs to be brought into the common accountant general reporting system.</p> <p>Assignment and personal ledger accounts are (mainly) outside the accountant general system of scrutiny or reporting and should be mainstreamed.</p> <p>Responsibility: Finance Department, Accountant General, Principal Accounting Officers</p>

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
PI-9 Oversight of Aggregate Fiscal Risk <i>Rating: 'D'</i>	Extent of monitoring of autonomous government agency (AGAs) and public enterprises <i>Rating: 'D'</i>	autonomous government agency (AGAs) and public enterprises do not submit any fiscal reports to the provincial government, nor do they present their annual audited accounts, resulting in the provincial government's inability to consolidate a report on financial risk arising from autonomous government agency (AGAs) and public enterprises.	Prepare a consolidated financial picture of the public enterprises under the control of the provincial government and assess contingent liabilities. The Finance Department should have an adequate enterprise monitoring wing established for the purpose of consolidating fiscal position and related risks. Institutional strengthening of Finance and Planning and Development departments both at the provincial as well as subprovincial levels, for effective enforcement of budget and financial rules and regulations. <i>Responsibility: Finance Department, Planning and Development</i>
	Extent of monitoring of lower-level governments' fiscal position <i>Rating: 'D'</i>	The provincial government considers the district and subdistrict governments as independent government entities and therefore carries out no systematic annual monitoring of their fiscal positions. Where monitoring is carried out, it is mainly against the backdrop of the budget allocation and execution process for conditional grants.	The Finance Department should have an adequate enterprise monitoring wing established for the purpose of consolidating fiscal position and related risks. <i>Responsibility: Finance Department</i>
PI-10 Public Access to Key Fiscal Information <i>Rating: 'C'</i>	Public access to (i) annual budget documentation, (ii) in-year budget execution reports, (iii) year-end financial statements, (iv) external audit reports, (v) contract awards, and (vi) resources available to primary service units. <i>Rating: 'C'</i>	Government of Sindh satisfies only two of the six requirements under this indicator: annual budget documents, and in-year reports; the remaining information relating to allocation of resources for primary service delivery units, financial statements, year-end audited financial statements, and award of contracts are not made public.	Adopt and implement Federal Act for Freedom of Information. Implement provision of Sindh Local Government Ordinance regarding dissemination of key information for public at large. <i>Responsibility: Finance Department, District Coordination Officers, Executive District Officers (Finance)</i>

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
<p>PI-12 Multiyear Perspective in Fiscal Planning, Expenditure Policy, and Budgeting</p> <p><i>Rating: 'C'</i></p>	<p>(i) Preparation of multiyear fiscal forecasts and functional allocations <i>Rating: 'C'</i></p> <p>(ii) Scope and frequency of debt sustainability analysis <i>Rating: 'A'</i></p> <p>(iii) Existence of sector strategies with multiyear costing of recurrent and investment expenditure <i>Rating: 'D'</i></p> <p>(iv) Links between investment budgets and forward expenditure estimates <i>Rating: 'D'</i></p>	<p>Medium-term fiscal framework has been prepared for the first time enabling forecasting of forward estimates. However, proper costing is still a challenge since this is a pioneer effort.</p>	<p>Regularly update medium-term fiscal framework (MTFF) on rolling basis with forward estimates properly costed.</p> <p>Medium-term budgetary framework needs to be institutionalized and linked to the medium-term fiscal framework (MTFF).</p> <p><i>Responsibility: Finance Department, Planning and Development, District Governments</i></p>
<p>PI-13 Transparency of Taxpayer Obligations and Liabilities</p> <p><i>Rating: 'C'</i></p>	<p>Clarity and comprehensiveness of tax liabilities</p> <p><i>Rating: 'C'</i></p>	<p>Tax liabilities are in principle well defined but there are certain shortcomings and also discretionary powers (discretion in assessments, penalties, and waivers) with the tax assessment officials.</p>	<p>Review of legislation and procedures to make tax obligations clearer and more comprehensive.</p> <p>Reduce elements of administrative discretion in assessing tax liabilities through monitoring and surveillance as well as by tightening the laws.</p> <p>Automate tax database.</p> <p><i>Responsibility: Board of Revenue, Excise and Taxation</i></p>
	<p>Taxpayer access to information on tax liabilities and administrative procedures.</p> <p><i>Rating: 'C'</i></p>	<p>The main provincial taxes are collected by the Board of Revenue and Excise and Taxation. The information is difficult to access (not widely circulated), and taxpayer education and widespread dissemination of information is lacking.</p>	<p>Taxpayer education programs should be initiated to alert them to their potential tax liabilities and tax administration procedures as effective tools in implementing tax reforms.</p> <p><i>Responsibility: Board of Revenue, Excise and Taxation, Finance Department</i></p>

Annex 1: Preliminary Summary Matrix for the Weakly Performing Public Financial Management Areas and the Way Forward

	<p>Existence and functioning of a tax appeals mechanism</p> <p><i>Rating: 'C'</i></p>	<p>A tax appeals system of administrative procedures exists but needs to be modernized to ensure greater fairness, transparency, and effectiveness.</p>	<p>Review the appeal processes for effectiveness, transparency, and fairness, and accordingly disseminate the revised mechanisms widely.</p> <p>Provide taxpayers with accurate knowledge of their tax liabilities through transparent and integrated databases for all forms of taxes.</p> <p><i>Responsibility: Board of Revenue, Finance Department</i></p>
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PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
PI-14 Effectiveness of Measures for Taxpayer Registration and Tax Assessment <i>Rating: 'D+'</i>	Controls in the taxpayer registration system <i>Rating: 'D'</i>	Taxpayers are registered manually. The system is also not linked with other registration authorities.	Tax automation for all taxes should be initiated. Appropriate surveys of taxpayers' potential should be conducted regularly. <i>Responsibility: Excise and Taxation, Board of Revenue, Finance Department</i>
	Effectiveness of penalties for noncompliance with registration and declaration obligations <i>Rating: 'D'</i>	Penalties for noncompliance exist, but level of compliance in recovery is minimal.	Tax reforms including system for periodic review of annual rental and property value taxes should be introduced along with legal reforms for taxation, ensuring greater compliance by introducing stronger punitive actions while making the entire system more transparent and efficient. <i>Responsibility: Excise and Taxation, Board of Revenue, Finance Department</i>
	Planning and monitoring of tax audit and fraud investigation programs <i>Rating: 'C'</i>	Planning and monitoring of tax audit programs are rare.	Introduce improved internal control measures. Automate and integrate tax databases. Introduce a comprehensive tax audit regime on modern lines following a risk-based approach for comprehensive tax audit. <i>Responsibility: Excise and Taxation, Board of Revenue, Auditor General, Finance Department</i>
PI-15 Effectiveness in Collection of Tax Payments <i>Rating: 'C+'</i>	The collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last 3 fiscal years) <i>Rating: 'C'</i>	Collection ratio during the last years was, according to the scoring methodology, between 60% and 75%, accordingly 'C' was assigned.	Automation of all taxes including property tax, motor vehicle tax, UIPT, and land records needs to be initiated so that arrears can be reliably computed and internal controls introduced. <i>Responsibility: Excise and Taxation, Board of Revenue</i>
	Effectiveness of transfer of tax collections to the treasury by the revenue administration <i>Rating: 'A'</i>		

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
	<p>Frequency of complete accounts reconciliation between tax assessments, collections, arrears records, and receipts by the treasury</p> <p><i>Rating: 'C'</i></p>	<p>Completion of reconciliation is generally delayed by an average of 3 months after the close of a fiscal year and before the books are closed.</p>	<p>Computerize taxes related to properties, motor vehicles, and land, and develop interfaces with the Project to Improve Financial Reporting and Auditing (PIFRA) accounting system.</p> <p>Improve the account management of taxpayers by assigning responsibilities and providing incentives to staff.</p> <p><i>Responsibility: Excise and Taxation, Board of Revenue, Project to Improve Financial Reporting and Auditing (PIFRA)</i></p>
<p>PI-18 Effectiveness of Payroll Controls</p> <p><i>Rating C+</i></p>	<p>Degree of integration and reconciliation between personnel records and payroll data</p> <p><i>Rating: 'C'</i></p>	<p>There is no system of automated linkage between the human resources records and payroll processing. No integrated HRMIS database is in existence.</p>	<p>Establish an HRMIS database for all government personnel. The government of Sindh IT Department has initiated PC-1 for development of HRMIS. Due diligence for its interface, compatibility, and integration into the payroll systems being utilized by Sindh accountant general is a key critical success factor, and is necessary to avoid duplication.</p> <p>Processing of payrolls should be based on the data up-take from HRMIS.</p> <p>The practice of accounting offices producing the payroll and inputting the human resources data at the same time should be discontinued in due course, as being less consistent with good internal control practices.</p> <p><i>Responsibility: Accountant General, District Accounts Officers, Finance Department, Principal Accounting Officers, Information Technology Department</i></p>
	<p>Timeliness of changes to personnel records and the payroll</p> <p><i>Rating: 'B'</i></p>		

	<p>Internal controls over changes to personnel records and the payroll</p> <p><i>Rating: 'C'</i></p>	<p>Internal controls exist only in the case of those employees whose emoluments are automated and precludes employees in locations where the PIFRA has yet to achieve site productivity. In the absence of total coverage of employees under the Project to Improve Financial Reporting and Auditing (PIFRA) regime, the status will remain not favorable.</p>	<p>Fast-track rollout of the Project to Improve Financial Reporting and Auditing (PIFRA) at provincial and subprovincial levels.</p> <p><i>Responsibility: Accountant General, District Accounts Officers, Finance Department, Principal Accounting Officers</i></p>
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PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
	<p>Existence of payroll audits to identify control weaknesses and/or ghost workers</p> <p><i>Rating: 'C'</i></p>	<p>In the absence of an automated system of payroll processing that could be audited by a computer-based audit (due to the multiplicity of payroll transactions), the accountant general office can only conduct manual payroll audits as an internal control measure but with limited scope.</p>	<p>Rollout of an automated system of payroll processing for all government personnel.</p> <p>Payroll audits should be further strengthened, in view of its huge share in total recurrent budget expenditures.</p> <p><i>Responsibility: Accountant General, Finance Department</i></p>
<p>PI-20 Effectiveness of Internal Controls for Nonsalary Expenditure</p> <p><i>Rating: 'C'</i></p>	<p>(i) Effectiveness of expenditure commitment controls</p> <p><i>Rating: 'C'</i></p>	<p>Expenditure commitment control procedures exist, but are partially effective and may be occasionally violated. The findings of PI-1 and PI-2 are pointers to the prevailing situation as actual expenditures have, in a number of cases, exceeded the budgeted expenditures at some of the controlling levels.</p>	<p>Since the reform agenda of the government of Sindh and the Project to Improve Financial Reporting and Auditing (PIFRA) cover major issues, continued and full commitment is needed for their success.</p> <p>Update the financial rules and treasury rules by including enforcement of internal controls, deleting obsolete items, using new terminology, and relevance for new accounting model (NAM), etc. Human capacity development at district accounts officer level, and provision of all relevant rules and regulations in a timely fashion.</p> <p><i>Responsibility: Accountant General, Finance Department</i></p>

	<p>(ii) Comprehensiveness, relevance, and understanding of other internal control rules and procedures</p> <p><i>Rating: 'C'</i></p>	<p>The audit reports indicate generally weak internal controls.</p>	<p>Capacity development at the accounts offices is needed in terms of appropriate staff strength, their certification and training, and provision of infrastructure and equipment.</p> <p>Devise an effective incentive mechanism to boost the morale of the trained and certified accounting personnel that are needed.</p> <p><i>Responsibility: Accountant General, Finance Department</i></p>
	<p>(iii) Degree of compliance with rules for processing and recording transactions</p> <p><i>Rating: 'C'</i></p>	<p>Departmental accounts committee responses to audit queries of noncompliance with procedures point, in a number of cases, to emergency nature of transactions that may well be doubtful in nature.</p>	<p>Strengthening the internal control system of the government of Sindh with expressed limits on emergency transactions and swift accountability for noncompliance.</p> <p><i>Responsibility: Accountant General, Finance Department</i></p>

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
<p style="text-align: center;">PI-21 Effectiveness of Internal Audit</p> <p style="text-align: center;"><i>Rating: 'D'</i></p>	<p>(i) Coverage and quality of the internal audit function</p> <p><i>Rating: 'D'</i></p>	<p>Internal audit, focusing on systems, is almost nonexistent. In fact, internal audit is being understood erroneously as a pre-audit function.</p>	<p>Fast-track promulgation of internal audit legislation for the government of Sindh. The draft Sindh Government Internal Audit Ordinance has been under review by the government since 2004.</p> <p>Institutional development of an internal audit function in all line departments and agencies with prioritized and extensive human capacity development at provincial and subprovincial levels.</p> <p>Finalize the issue of duality of control in the district accounts offices and make uniform control over all staff in district accounts offices.</p> <p>Urgent attention to filling of all internal audit positions under the SLGO and prioritized availability of adequate resources to operationalize the function.</p> <p><i>Responsibility: Accountant General, Finance Department</i></p>
	<p>(ii) Frequency and distribution of reports</p> <p><i>Rating: 'D'</i></p>	<p>Reports are neither existent nor frequent as the function does not, technically, exist.</p>	<p>As above</p>
	<p>(iii) Extent of management response to internal audit findings</p> <p><i>Rating: 'D'</i></p>	<p>No recommendations are made to which responses are to be made as the function of internal audit does not, technically, exist.</p>	<p>As above</p>
<p>PI-22 Timeliness and Regularity of Accounts Reconciliation</p> <p style="text-align: center;">Overall rating 'C+'</p>	<p>(i) Regularity of bank reconciliations</p> <p><i>Rating: 'B'</i></p>		

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
	<p>(ii) Regularity of reconciliation and clearance of suspense accounts and advances</p> <p><i>Rating : 'C'</i></p>	<p>The suspense accounts reconciliation and clearance takes place at least annually with some accounts' uncleared balances brought forward.</p>	<p>The issue needs more frequent attention to reconcile.</p> <p><i>Responsibility: Accountant General, Finance Department</i></p>
<p>PI-24 Quality and Timeliness of In-year Budget Reports</p> <p><i>Rating: 'C+' </i></p>	<p>(i) Scope of reports in terms of coverage and compatibility with budget estimates</p> <p><i>Rating for provincial level: 'C'</i> <i>Rating for subprovincial level: 'C'</i></p>	<p>The in-year accounts are only regularly provided to the Finance Department/EDO (F&P), and there is no evidence that the individual departments are, as a routine, provided with their respective budget execution statements.</p> <p>Only at the provincial government level are monthly fiscal reports prepared in a form that compares budgeted receipts and expenditures with actuals. Even here, the information is provided at the major and minor function levels, although information is also available at the detailed object levels.</p>	<p>Fast-track rollout of the Project to Improve Financial Reporting and Auditing (PIFRA) to all district governments in Sindh. At the subprovincial level, only 11 out of the 23 districts have been connected to the Project to Improve Financial Reporting and Auditing (PIFRA) automated systems, and seven districts are at different stages of productivity.</p> <p>The internal controls in the accounting offices should be strengthened to maintain the accuracy of information during compilation of reconciled drawing and disbursement officer (DDO) data.</p> <p>Currently, drawing and disbursement officers (DDOs) reconcile their records with the accounts office concerned. The information is compiled separately in departments and by the accountant general and is to be reconciled again at the aggregate level. This departmental information compiled by the accountant general should be sent to the departments concerned for managerial purposes so that the department does not need to compile its own information in a duplicate effort.</p> <p><i>Responsibility: Accountant General, Finance Department, District Accounts Officers</i></p>

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
	(ii) Timeliness of the issue of reports <i>Rating for provincial level: 'A'</i> <i>Rating for subprovincial level: 'A'</i>		
	(iii) Quality of information <i>Rating for provincial level: 'C'</i> <i>Rating for subprovincial level: 'D'</i>	There are concerns on accuracy of data due to existence of unreconciled transactions and the quality of information received, particularly from district accounts offices at the subprovincial level, being merely abstracts of expenditure.	Fast-tracking Project to Improve Financial Reporting and Auditing (PIFRA) systems rollout throughout the province would enhance the integrity of the data, as reports could then be generated at the detailed object levels with greater accuracy. <i>Responsibility: Accountant General, Finance Department, District Accounts Officers</i>
PI-26 Scope, Nature, and Follow-up of External Audit <i>Rating: 'D+'</i>	(i) Scope and nature of audit performed (including adherence to auditing standards) <i>Rating: 'C'</i>	The audit covers expenditure through a wide range of financial audit and some aspects of performance audit without reliance on modern risk-based certification audit approach. The auditor general of Pakistan (AGP) has approved the new Financial Audit Manual, addressing the issue.	Implementation of new Financial Audit Manual which inculcates the risk-based audit approach with audit activities concurrently carried out during the reporting period. Enhance audit capacity and ensure adequately qualified senior audit staff are assigned to carry out audits. Continued training and human capacity development of staff for effective and seamless transition to modern risk-based certification audit approach. <i>Responsibility: Accountant General, Project to Improve Financial Reporting and Auditing (PIFRA) Regional Director</i>

	<p>(ii) Timeliness of submission of audit reports to legislature</p> <p><i>Rating : 'D'</i></p>	<p>The audit reports for FY2005 were certified only in April 2007, 22 months after the end of the fiscal year, not counting the additional delay before the reports were submitted to the legislature. The situation is even worse for subprovincial governments as the <i>zila</i> councils receive audit reports well over 2 years, on average, after the end of the fiscal year.</p>	<p>Introduction of time-bound accountability system for timely submission of audit reports to legislature.</p> <p>Training and human capacity development of public servants as well as political authorities at the provincial and subprovincial levels, to create awareness about the significance of timely audit and external scrutiny to foster commitment to action.</p> <p><i>Responsibility: Accountant General, Project to Improve Financial Reporting and Auditing (PIFRA) Regional Director</i></p>
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PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
	<p>(iii) Evidence of follow up on audit recommendations</p> <p><i>Rating: 'D'</i></p>	<p>There is enormous delay in the formal response, making the follow up almost irrelevant. In addition, the weaknesses of the departmental accounts committees in following up and settling audit paragraphs continue unabated. The situation is even more unfavorable at the subprovincial level where there are minimal departmental accounts committee meetings held to review audit reports and take the necessary corrective action. The zila accounts committees of Hyderabad and Mirpurkhas districts, for example, have not been functional.</p>	<p>Strengthen the Public Accounts Committee (PAC) Secretariat through enhanced staffing and training.</p> <p>Establish departmental accounts committees in all districts and monitor performance against specified milestones.</p> <p>Establish zila accounts committees in all districts and provide induction training to members.</p> <p>Enlist internal audit to be responsible for following up deficiencies identified by external audit.</p> <p>Provincial assembly to seek periodic reports on compliance.</p> <p><i>Responsibility: Nazims, Finance Department, Public Accounts Committee, Local Government Department</i></p>
PI-27 Legislative Scrutiny of the Annual Budget Law Overall Rating 'D+'	<p>(i) Scope of the legislature's scrutiny</p> <p><i>Rating: 'B'</i></p>		
	<p>(ii) Extent to which the legislature's procedures are well established and respected</p> <p><i>Rating for provincial level: 'B'</i> <i>Rating for subprovincial level: 'C'</i></p>	<p>At subprovincial level procedures do exist under the budget rules for the zila councils, but these are invariably not respected.</p>	<p>Enhanced accountability mechanism for noncompliance.</p> <p>Training and human capacity development of public servants as well as political authorities, at all subprovincial levels, to create awareness with the Budget Rules and to foster commitment to action.</p> <p><i>Responsibility: Nazims, Finance Department</i></p>

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
	<p>(iii) Adequate time for the legislature to provide a response to budget proposals for both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined)</p> <p><i>Rating for provincial and district levels: 'D'</i></p>	<p>The budget is passed by the assembly in fewer days against the criteria of at least a month, and the legislature is not involved in reviewing the budget call circular. No defined arrangements exist at zila councils that supports sufficient time for review.</p>	<p>Use estimates and appropriation committees.</p> <p>Increase the time available for the legislature to examine the budget in the context of estimates and appropriations committees examining government departments on their actual results and budget projections.</p> <p>Develop systems and processes and ensure adequate time for the zila council to examine the budget in the context of estimates and/or appropriations, examining government departments on their actual results and budget projections.</p> <p>Human capacity development of councilors at all levels to enhance their ability for informed engagement in the budget approval process.</p> <p><i>Responsibility: Provincial Assembly Public Accounts Committee, Nazims, Finance Department</i></p>
	<p>Rules for in-year amendments to the budget without ex-ante approval by the legislature</p> <p><i>Rating for provincial level: 'B'</i> <i>Rating for subprovincial level: 'B'</i></p>		

PFM Indicators	Dimensions Assessed	Causes for Rating Less than B	Areas for Focused Improvement Interventions
<p>PI-28 Legislative Scrutiny of External Audit Reports</p> <p>Overall Rating: 'D+' for Provincial and 'D' for Subprovincial</p>	<p>(i) Timeliness of examination of audit reports by the legislature (for reports received within the last 3 years)</p> <p><i>Rating for provincial level: 'D'</i> <i>Rating for subprovincial level: 'D'</i></p>	<p>The public accounts committees (PACs) in Sindh, including the zila accounts committee (the subprovincial equivalent of the provincial PAC), have a long history of backlogs and nonfunctionality.</p> <p>At the subprovincial level, the zila accounts committees have not, systematically, considered the accounts and audit reports of the district governments since 2002.</p>	<p>Learn from and adopt in-country good practices to clear backlogs, for instance actions taken by Punjab assembly.</p> <p>Adequate donor support for institutional strengthening of PAC.</p> <p>Apply the PAC timetable rules and improve timeliness of examination of audit issues.</p> <p>Implement review of district audit reports by zila accounts committees.</p> <p>Prioritize and sequence the pending reports review with a reverse order methodology to review most recent reports first.</p> <p>Ensure that zila accounts committees have assistance from district audit or a senior representative at their meetings.</p> <p>Improve committee guidelines; assess scope to provide committee procedural and policy guidelines based on experience in other jurisdictions.</p> <p><i>Responsibility: Nazims, Auditor General, Finance Department , Devolution Support Program</i></p>

Pakistan, Sindh Province: Public Financial Management Accountability Assessment

	<p>(ii) Extent of hearings on key findings undertaken by the legislature</p> <p><i>Rating for provincial level: 'B'</i> <i>Rating for subprovincial level: 'D'</i></p>	<p>At subprovincial level virtually no hearings are held. The zila accounts committees (ZACs), according to audit reports, have been established but have generally not commenced functioning.</p>	<p>Fast-track action for operationalizing the zila accounts committees (ZACs).</p> <p>Institutional strengthening of zila accounts committees.</p> <p><i>Responsibility: Nazims, Auditor General, Finance Department, Devolution Support Program</i></p>
	<p>Issuance of recommended actions by the legislature and implementation by the executive</p> <p><i>Rating for provincial level: 'B'</i> <i>Rating for subprovincial level: 'D'</i></p>	<p>No hearings are held for any recommendations to be issued.</p>	<p>As above</p>

Annex 2: Sources of Information

A. Persons involved in discussions

- Special finance secretary (budget), Finance Department, government of Sindh
- Secretary, Information Technology Department, government of Sindh
- Additional finance secretary (resources), Finance Department, government of Sindh
- Deputy finance secretary Provincial Finance Commission (PFC), Finance Department, government of Sindh
- Accountant general, government of Sindh
- Additional accountants general, government of Sindh
- Director general and directors, District Audit, Department of the Auditor General of Pakistan
- Director general, Commercial Audit
- Chief of foreign aid, Department of Planning and Development, government of Sindh
- Secretary, PAC and provincial assembly
- Project director, deputy and assistant directors, Decentralization Support Program, Finance Department, government of Sindh
- Director, Provincial Audit, Department of the Auditor General of Pakistan
- Director, Revenue Receipt Audit, government of Sindh
- Executive district officer (P&F), drawing and disbursement officer, district accounts and treasury officer, Mirpurkhas
- Deputy district officer (P&F), Hyderabad
- Director operations, Project to Improve Financial Reporting and Auditing (PIFRA)
- Deputy director, PIFRA, Sindh

B. Documents referenced

- Sindh PFAA 2004
- Budget documents for FY2004, FY2005, and FY2006
- Budget Analysis FY2008
- Provincial audit reports
- RRA reports
- ADB Devolution Report 2004
- CFAA 2003

Pakistan Sindh Province

Public Financial Management and Accountability Assessment

This report presents the public financial management and accountability assessment for Pakistan's Sindh province. The assessment uses 31 performance indicators to evaluate six core public financial management dimensions. The report presents a snapshot of the relative strengths and weaknesses of the province in managing budgetary outcomes, aggregate fiscal discipline, the strategic allocation of resources, and efficient service delivery. It also flags the need for reforms in Sindh in specific areas of budget development, budget execution, internal control, accounting, external audit, and legislative and public oversight.

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