STATEMENT OF FISCAL RISKS

FY 2023-24

Finance Department
Government of Khyber Pakhtunkhwa

FOREWORD

The first step in solving any problem is recognizing it. The Statement of Fiscal Risks for FY 2023-24 helps the Government identify the sources of fiscal risks that may slow down development goals. The recommendations in this statement reflect our commitment to improving the system and maintaining fiscal discipline.

Khyber Pakhtunkhwa faces a range of fiscal challenges, from managing revenues and expenditures, recovering from natural disasters, and making the best use of Public-Private Partnerships, to improving development spending and reforming public sector companies and autonomous bodies. I believe that if we implement and maintain the reforms and recommendations laid out here, we can put the province on the path to better revenue generation, cost management, efficient spending for our people, and safeguarding the vulnerable in our society.

This document is designed to highlight the fiscal risks that are particularly relevant to the Government of Khyber Pakhtunkhwa. It takes a close look at the potential impact these risks could have on the province's financial health and development goals.

Additionally, the document reviews the policies and mechanisms already in place to manage these risks, identifying where effectiveness is present and where improvements may be needed. Finally, it outlines the government's strategy for managing fiscal risks, focusing on practical steps to protect the province's finances and ensure long-term stability. This includes adopting sound financial practices, strengthening policies, and preparing for unexpected challenges.

I want to express my appreciation to Debt Management Team, especially Mr. Abdul Qayyum Khan (Team Lead, Debt & Risk Management Unit) and Mr. Muhammad Imtiaz (Financial Analyst, Risk Management Unit), as well as Mr. Waqas Paracha and his entire team from the Sub-National Governance (SNG-II) Project, for their hard work in creating the province's first fiscal risk statement.

Mr. Muzamil Aslam
Advisor to Chief Minister on Finance

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List of Abbreviations

ABs	Autonomous Bodies
ADP	Annual Development Plan
CGU	Corporate Governance Unit
DDO	Drawing and Disbursing Officer
DSR	Daily Situation Report
FD	Finance Department
FIs	Food Items
FRDMA	Fiscal Responsibility and Debt Management Act
GDP	Gross Domestic Product
GoKP	Government of Khyber Pakhtunkhwa
GSDP	Gross Sub-national Domestic Product
KP	Khyber Pakhtunkhwa
MHVRA	Multi-Hazard Vulnerability and Risk Assessment
MRG	Minimum Revenue Guarantee
NFIs	Non-Food Items
NHP	Net Hydel Profits
PDMA	Provincial Disaster Management Authority
PEOC	Provincial Emergency Operations Centre
PPP	Public-Private Partnership
PSCs	Public Sector Companies
RMU	Risk Management Unit
SNE	Schedule of New Expenditure
VGF	Viability Gap Fund
WSSCs	Water & Sanitation Services Companies

Introduction

Fiscal risks can cause unexpected changes in the government's financial plans, affecting both financial stability and the ability to deliver public services effectively. For the Government of Khyber Pakhtunkhwa (GoKP), these risks have serious consequences, potentially leading to unsustainable finances that drain resources and reduce the quality and availability of public services. These challenges can arise from different factors, such as macro fluctuations, changes in the federal transfer, or shifts in the province's revenue and spending patterns.

As part of the medium-term macroeconomic and fiscal planning, Finance Department is responsible for building a solid institutional framework to handle fiscal risks. This involves setting up systems that help identify, measure, analyze, and manage these risks. By doing this, Finance Department can better predict and respond to potential threats to the province's financial stability. The framework will provide the tools needed to quantify risks, develop strategies to minimize their impact, and ensure that fiscal management practices are more consistent and sustainable in the long term. This approach will help the government make well-informed decisions, protect public resources, and maintain financial discipline.

This annual Statement of Fiscal Risks is published in fulfillment of the requirements of Section 7 of the KP Fiscal Responsibility and Debt Management Act, 2022. The Act mandates the government to release a yearly Statement of Fiscal Risks, outlining potential risks to the province's fiscal stability which is stipulated as follows.

Statement of fiscal risks - Government shall approve a fiscal risk statement on an annual basis and present it to the Provincial Assembly of Khyber Pakhtunkhwa along-with the annual budget.

The statement shall:

(a) review the actual fiscal outcomes of the last completed financial year with the budget estimates of that year and the projections made in medium term fiscal framework in respect of that year and identify the reasons of deviation;

(b) identify the major sources of risk that can result in significant deviations between actual and expected fiscal outcomes;

(c) review the measures already taken by the Government to address the fiscal risks:

(d) identify the measures needed to strengthen the management of fiscal risks; and

(e) contain discussion on fiscal risks posed by explicit as well as implicit contingent liabilities.

In general, the Statement of Fiscal Risks framework captures three primary categories:

1. general economic risks,
2. specific fiscal risks, and
3. structural or institutional risks

Fiscal risks, under these three broad pillars, are categorized into six major areas, each presenting distinct challenges and implications for KP's fiscal management and sustainability.

These areas are outlined as follows:

1. Risks from Macro-Economic Factors and Federal Transfers
2. Fiscal Sustainability Risks
3. Public Debt Management Risks
4. Climate and Natural Disasters
5. Risks in Public-Private Partnerships Agreements
6. Challenges in Managing Public-Sector Entities (PSEs)

Statement of Fiscal Risks organizes potential risks through a fiscal risk matrix, which helps visualize and prioritize risks based on their likelihood and financial impact. This tool ensures resources are focused where most needed. High-impact risks, such as external debt liabilities and pension payments, require immediate action. Medium-level risks, like climate-related disasters, need careful monitoring and preparation. Less likely risks, such as delays in PPPs projects, are kept under observation to prevent escalation. The matrix is based on a combination of budget records, historical data, and internal analysis.

Likelihood of Realization	Probable	Federal tax transfers	PSEs inefficiencies Net hydel profits	External debt liabilities Pension payments
	Possible	Macro-economic challenges	Climate-induced disasters PPP projects material price hikes, interest rate hike	Public investment management
	Remote	PPP project delays		Large climate or natural disaster
		Low	Medium	High
		Potential Fiscal Impact		

Table 1: Risk grading of KP's fiscal risks

1. Risks from Macro-Economic Factors and Federal Transfers

The global economy in 2022-23 faced increased uncertainty, amplified by the geopolitical tensions between Russia and Ukraine, as well as conflicts in the Middle East. Combined with political uncertainty at home, these issues introduced new challenges just as the world was starting to recover from the pandemic-induced downturn. According to the International Monetary Fund’s (IMF) World Economic Outlook, global economic growth is expected to slow, with projections dropping from 6.1 percent in 2021 to 3.6 percent in both 2022 and 2023.

This slowdown is also reflected in Pakistan's economy, where GDP growth fell from 6.1 percent in 2022 to -0.2 percent in 2023[1]. The ADB predicts a modest recovery for Pakistan, with a growth rate of 2.4 percent expected in 2024. The following figure show the actual and projected GDP growth rate of Pakistan.

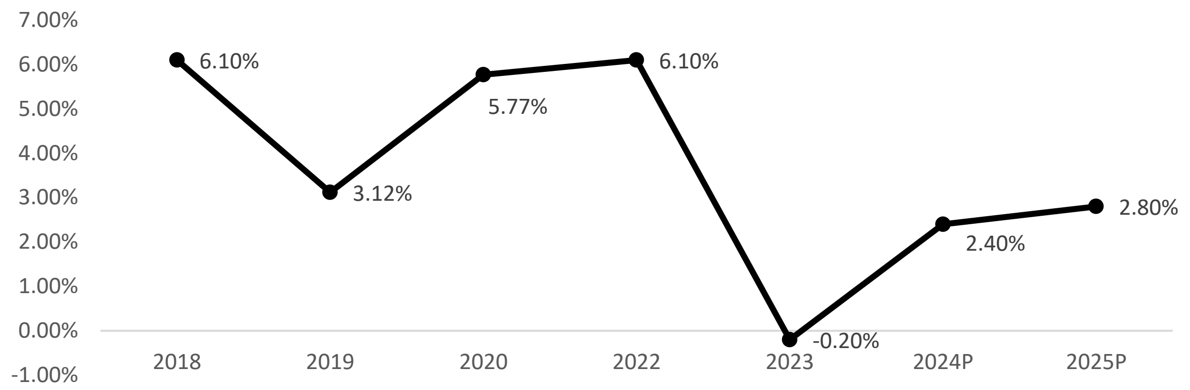

Figure 1: Pakistan GDP growth rate

1.1 Revenue Profile[2]

The fiscal framework of KP outlines its revenue profile into three primary categories: General Revenue Receipts, Capital Receipts, and Development Receipts. The revenue profile of what was budgeted in the last four years versus what actual transpired is shown in Table-2 below:

Analyzing the provided data from FY2020-21 to FY2023-24, the discrepancy between the budgeted and actual revenues for KP over the past 4 - year's points to a fiscal risk in revenue estimation. The underperformance in specific areas such as NHP and Federal Tax Assignment reflects the need for accurate forecasting in the province's fiscal structure.

	FY2020-21			FY2021-22			FY2022-23			FY2023-24		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
General Revenue Receipts	**585.0**	**551.2**	**-6%**	**709.0**	**673.6**	**-5%**	**817.5**	**770.4**	**-6%**	**1156.9**	**943.5**	**-18%**
Total Federal Transfers	535.8	491.8	-8%	634.0	611.5	-4%	732.5	703.6	-4%	1071.9	867.3	-19%
Federal Transfers – Tax Assignment	404.8	373.2	-8%	475.6	498.6	5%	570.9	586.4	3%	764.6	721.6	-6%
Federal Transfers – 1% War on Terror	48.6	44.82	-8%	57.2	59.9	5%	68.6	70.5	3%	91.9	86.7	-6%
Federal Transfers – Net Hydel Profit	58.3	47	-19%	74.7	21.0	-72%	62.0	4.9	-92%	85.1	8.5	-90%
Federal Transfers – Straight Transfers	24.1	26.7	11%	26.5	32.0	21%	31.0	41.8	35%	38.7	50.4	30%
Windfall Levy	0.0	0.0	-	0.0	0.0	-	0.0	0.0	-	91.7	0.0	-100%
Provincial Own Receipts	49.2	59.4	21%	75.0	62.2	-17%	85.0	66.8	-21%	85.0	76.2	-10%
Provincial Tax Collection	28.1	33.5	19%	43.2	41.8	-3%	52.7	41.7	-21%	56.5	53.6	-5%
Provincial Non-Tax Collection	21.1	25.9	23%	31.8	20.3	-36%	32.3	25.1	-23%	28.5	22.6	-21%
General Capital Receipts	**91.0**	**74.5**	**-18%**	**112.7**	**174.5**	**55%**	**204.6**	**246.1**	**20%**	**0.3**	**0.2**	**-40%**
Development Receipts	**247.0**	**186.2**	**-25%**	**296.7**	**179.3**	**-40%**	**310.1**	**168.3**	**-46%**	**299.6**	**184.9**	**-38%**
Total Receipts	**923.0**	**811.9**	**-12%**	**1118.3**	**1027.5**	**-8%**	**1332.1**	**1184.8**	**-11%**	**1456.7**	**1128.6**	**-23%**

[1] https://www.adb.org/where-we-work/pakistan/economy
[2] KP budget documents (Whitepaper)

2. Fiscal Sustainability Risks

Khyber Pakhtunkhwa has 569,725 active employees and 199,881 pensioners. Salaries and pensions together make up 48% of the province's total spending. This increase is putting pressure on the budget, leaving less room for important areas like development projects, the Sehat Card program, infrastructure expansion, school and health facility maintenance, and social welfare initiatives.

Salaries and pensions for the Government of Khyber Pakhtunkhwa (KP) have increased, rising by 10% from FY2022 to FY2023. Over the past decade, pension spending alone has grown nearly seven times. This increase is driven by factors such as ad hoc and retroactive pay increases, early retirements, a high replacement rate, and benefits like commutation, restoration, and survivorship for pensioners.

Additionally, rising inflation and other economic pressures are contributing to the need for further increases in pensions and salaries. The provincial government's workforce has also doubled since the 18th Amendment, leading to a rise in the number of approved positions and continuous salary hikes over time.

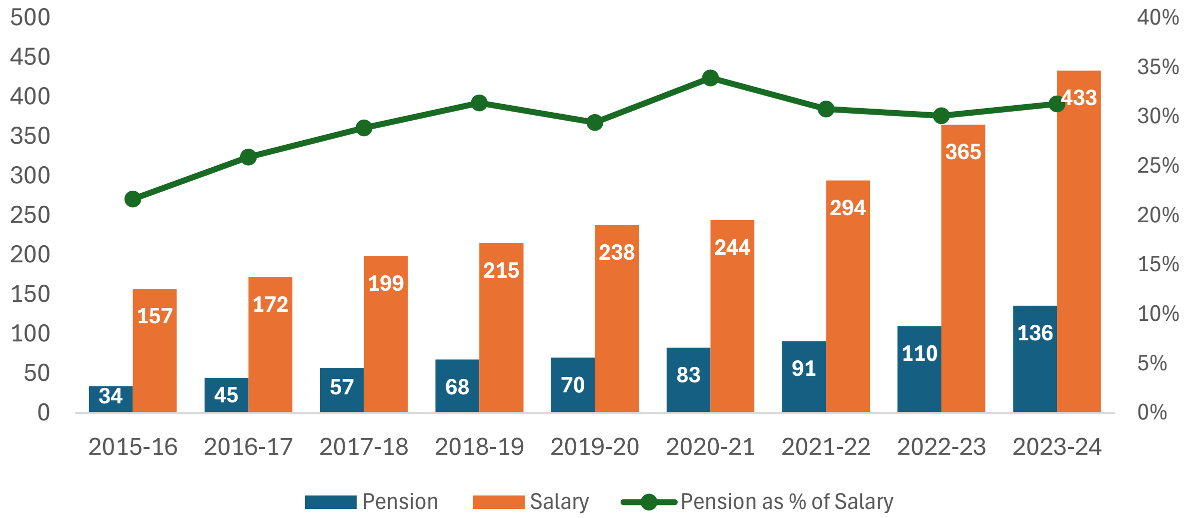

Figure 2: Pension and salary expenditure (PKR billion, %)

3. Public Debt Management Risks

As of June 30th, 2024, Khyber Pakhtunkhwa's (KP) loan liability stood at PKR 679,547 million, reflecting a 28 percent rise from PKR 530,723 million in 2023 and as of June 30th, 2023 liability stood at 48 percent rise from PKR 363,802 million in 2022. This increase is mainly due to three significant factors that have impacted the province's debt profile. The currency depreciation, fresh disbursements, and specific loan arrangements have collectively driven up KP's financial obligations on its external debt.

One of the primary factors contributing to this increase is the 33 percent depreciation of the Pakistani Rupee against foreign currencies. As KP's debts are foreign-denominated, this depreciation means a higher debt burden when converted to PKR. Consequently, the province's liabilities appear larger in its financial statements, raising concerns about the sustainability of KP's debt position.

Another contributing factor is the new disbursements totaling PKR 70,201 million received from ongoing loan agreements with international lenders. These funds, largely allocated for development projects under the Annual Development Program (ADP), have boosted KP's loan liabilities. While these projects aim to stimulate regional growth, although these loans increase the overall debt load that the province must manage effectively.

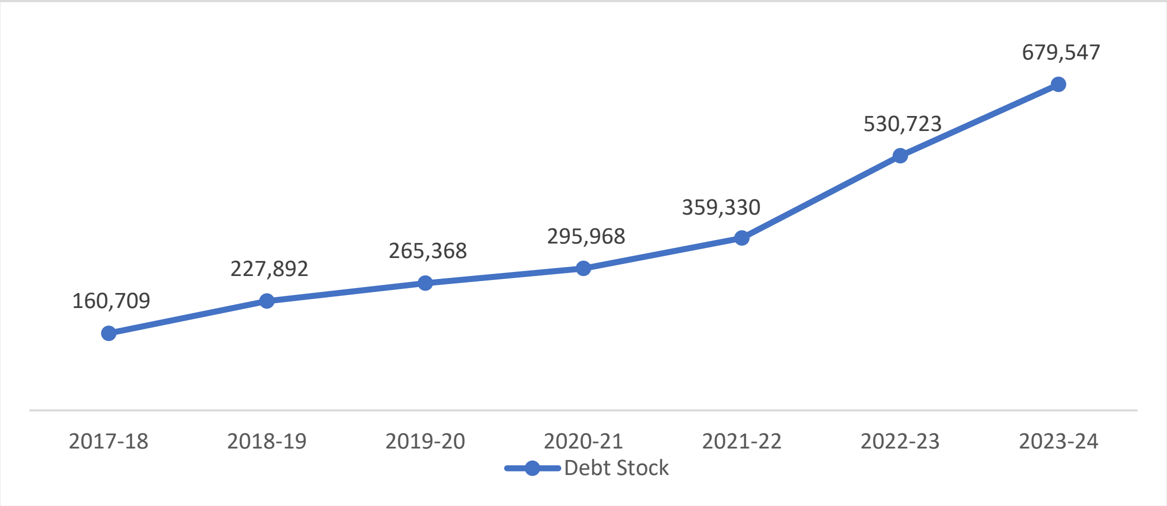

Figure 3: Khyber Pakhtunkhwa - Debt Stock (PKR million)[3]

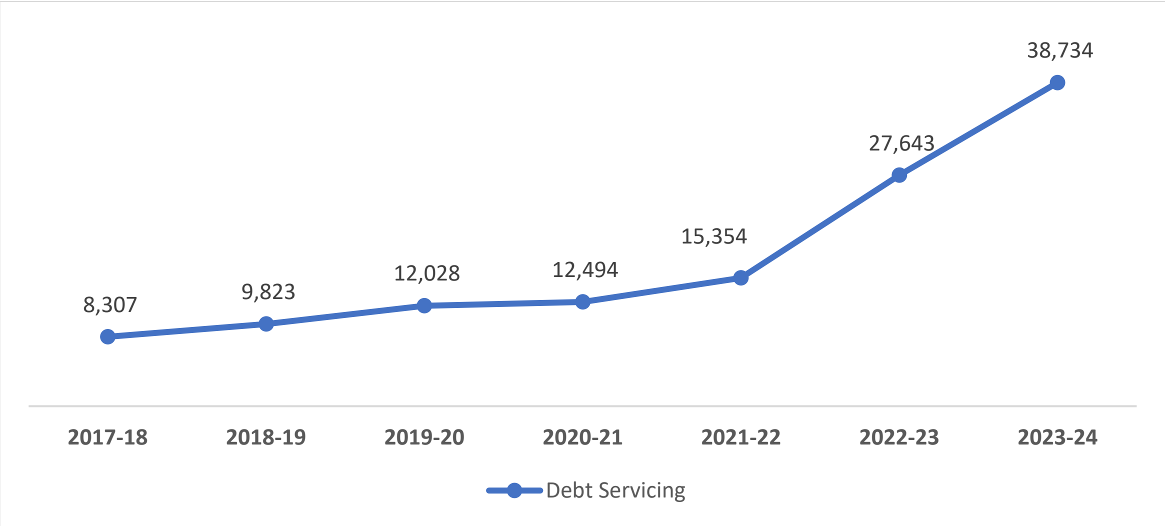

Figure 4: Khyber Pakhtunkhwa - Debt Servicing (PKR million)[4]

Under the FRDMA, the Government of KP is mandated to formulate and approve a Medium-term Debt Management Strategy (MTDS) that aligns with the overarching medium-term fiscal framework. This strategy, which spans a minimum of three years, is an essential instrument for fiscal and debt management, ensuring that the province's borrowing and debt servicing activities are sustainable. The MTDS, updated annually, is presented alongside the annual budget to the Provincial Assembly for transparency and legislative oversight. The medium-term debt management strategy addresses several aspects and outlines the following debt limitations as stipulated by the FRDMA:

[3] https://www.finance.gkp.pk/article/debt-statistical-bulletin-01-july-2022-to-30-june-2023 & https://www.finance.gkp.pk/article/debt-statistical-bulletin-01-jul-2023-till-30-jun-2024

[4] https://www.finance.gkp.pk/article/debt-statistical-bulletin-01-july-2022-to-30-june-2023 & https://www.finance.gkp.pk/article/debt-statistical-bulletin-01-jul-2023-till-30-jun-2024

- **Debt Servicing Limit:** Debt servicing costs in a financial year should not exceed 10 percent of the KP's average revenue,
- **Public Debt and Guarantees Limit:** The combined stock of total public debt and guarantees must not exceed 150 percent of the province's average revenue, preventing excessive borrowing that could jeopardize fiscal stability.

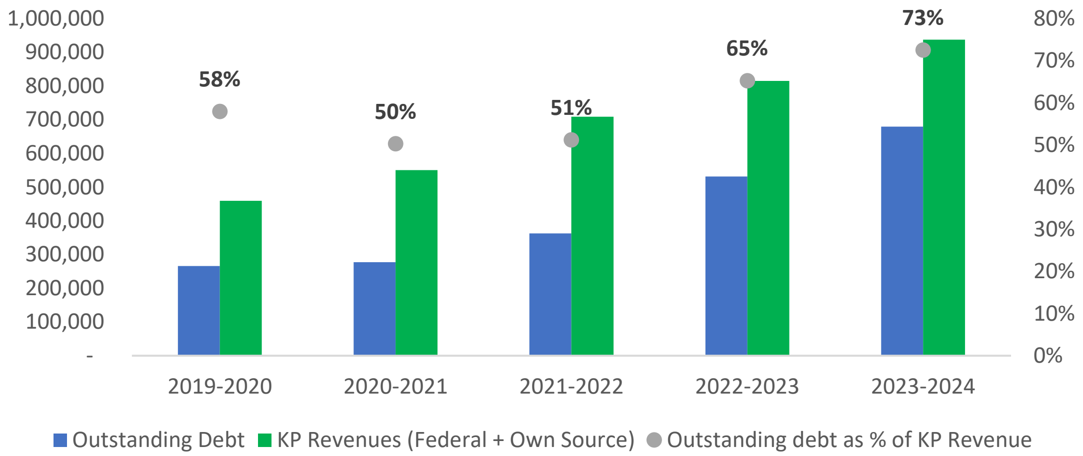

Figure 5:Outstanding debt as percentage of Khyber Pakhtunkhwa Revenue [5]

Risk Indicator		30th June, 2022	30th June, 2023	30th June, 2024	FRDMA Limits
Outstanding Loan Stock to KP's Total Revenue		**51.2%**	**65.2%**	**72.5%**	**150%**
Debt Service to KP Revenues		**2.21%**	**3.6%**	**4.1%**	**10%**
Cost of Debt	Weight Average Interest Rate (Range)	0.67%	1.26%	2.63%	
Refinancing Risk	ATM (years)	10.55	10.3	9.9	
	Loan Maturing in 1 year (as % of total debt)	8.4%	9.03%	8.94%	
Interest Rate Risk	ATR (years)	5.85	5.55	5.32	
	Loan Refixing in 1 year (as % of total loan)	5.43%	5.33%		
	Fixed rate loan (as % of total loan)	58.2%	56%	55%	
FX – Risks	Foreign exchange loan (as % of total loan)	98.8%	99.2%	99.4%	

Table 2: Risk Indicators[6]

3.1 Risk Mitigation Strategies

To manage risks, Government of KP has started focusing on two main policy approaches: first, clearly setting debt limits and sticking to those, and second, making sure development spending is more efficient.

[5] https://www.finance.gkp.pk/article/debt-statistical-bulletin-01-jul-2023-till-30-jun-2024
[6] https://www.finance.gkp.pk/article/debt-statistical-bulletin-01-july-2022-to-30-june-2023

As part of the Fiscal Responsibility and Debt Management Act (FRDMA), Government of KP is committed to keeping debt levels under control. The key strategies include:

- Debt Limits: Government of KP has set specific debt limits under the FRDMA to ensure it doesn't face situations where access to market financing could be cut off.
- Debt Thresholds: These are set levels where debt starts to hurt the economy, making it harder for GoKP to manage economic stability and threatening long-term debt sustainability.
- Debt Targets: GoKP has set cautious debt targets to make sure debt stays within safe limits, even during times of economic challenges.

4. Climate and Natural Disasters

Khyber Pakhtunkhwa is one of Pakistan's regions most affected by climate change, with its diverse weather patterns presenting various challenges. The province is home to over 40.85 million people (2023 census), and around 80 percent[7] of its population relies on agriculture as their main source of income. This makes local communities especially vulnerable when climate-related disasters strike.

The floods of 2022 served as a harsh reminder of KP's exposure to climate risks. The province saw losses estimated at PKR 121 billion in public infrastructure, as reported in the KP monsoon contingency planning. To address the immediate damage, PKR 19 billion had to be diverted from the Annual Development Plan (ADP) for recovery efforts. This event made it clear that KP is not fully prepared to handle such disasters.

From these experiences, it's clear that KP needs to improve how it handles disasters. Strengthening early-warning systems, improving coordination between institutions, and building more climate-resilient infrastructure are key steps. Additionally, better planning for recovery after disasters will help communities bounce back faster and reduce the lasting impacts on people's lives and livelihoods.

4.1 Quantifying Fiscal Impacts for Relief and Rehabilitation

The Provincial Disaster Management Authority (PDMA) of the Government of KP has implemented measures for preparedness and mitigation during monsoon seasons. A detailed exercise has been undertaken to assess fiscal measures for immediate relief and rehabilitation costs under three different scenarios: worst, medium and low cases.

To calculate immediate fiscal costs, PDMA has classified historical monsoon flood patterns into three broad classifications:

1. Category A (frequent flooding). The rivers are Kabul, Khiali, Panjkora, Kunhar etc.
2. Category B (Less frequently flooding): Which receive less frequent floods
3. Category C (Occasional flood): Occasional floods because of heavy concentrated rainfall in their catchment areas

Based on the intensity and frequency of past disasters, a methodology has been formulated to estimate future relief and rehabilitation costs to Government of KP. This has been based keeping in consideration the timeline of past events summarized in Figure 7 below.

[7] https://epakp.gov.pk/wp-content/uploads/2022/09/Khyber-Pakhtunkhwa-Climate-Change-Policy-2022.pdf

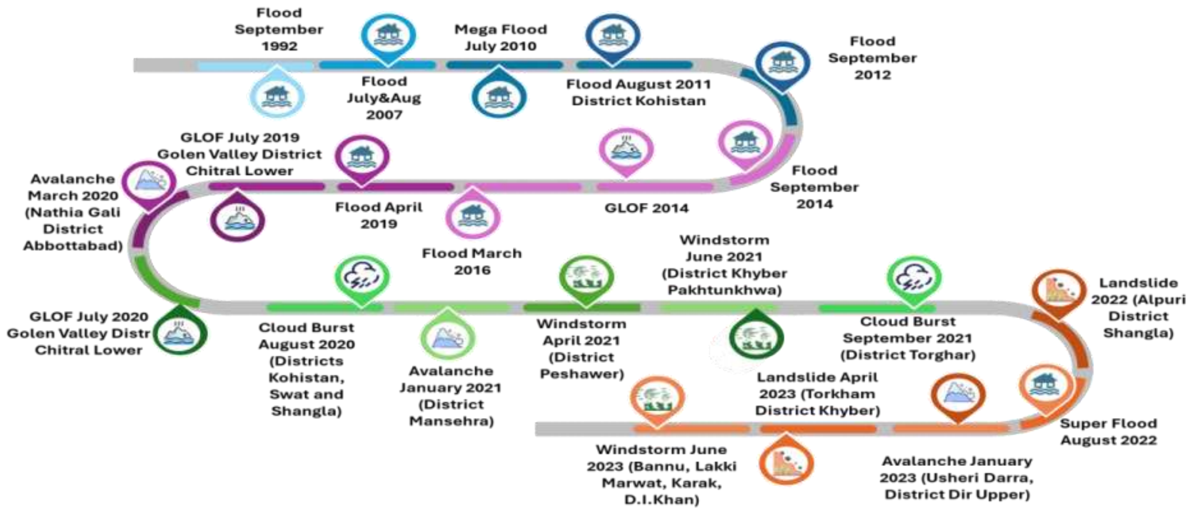

Figure 6: Historical timeline of climate and disaster events in Khyber Pakhtunkhwa

To address the financial challenges caused by climate-related events, the Provincial Disaster Management Authority (PDMA) has created a detailed monsoon contingency plan for 2023. Based on lessons from the 2022 floods and updated field data, the plan outlines the expected funding needed to respond to different possible situations, whether high or low impact. The plan also lists the resources required for both food and non-food items, ensuring readiness to handle emergencies during the monsoon season with a well-planned financial response.

4.2 Mitigating Measures to Reduce Climate and Natural Disaster Impacts

To reduce the impact of climate and natural disasters, the government has taken several proactive steps:

1. **Provincial Emergency Operations Centre (PEOC)**: A centralized hub has been set up to ensure smooth coordination between provincial departments and districts during emergencies. The PEOC helps manage early warnings, communication, and information sharing before, during, and after disasters.
2. **Flood Telemetry Stations**: PDMA has installed flood warning systems in vulnerable areas to collect real-time data and improve disaster response. This helps in monitoring water levels and predicting floods.
3. **Improved Coordination**: PDMA collaborates with various departments and humanitarian organizations to streamline disaster management efforts, including early warning, rescue, and relief operations. A daily situation report (DSR) is generated to keep all stakeholders informed.
4. **Humanitarian Response Facility**: A centralized facility has been established in collaboration with UNDP and the World Food Program to store emergency supplies like tents, blankets, and hygiene kits, improving the province's ability to respond quickly to disasters.
5. **Risk Assessments**: The government plans to conduct multi-hazard vulnerability risk assessments to identify and address areas most at risk from disasters, ensuring better resource allocation and preparedness.
6. **Project Screening for Resilience**: PDMA will be involved in early infrastructure project planning to ensure that new projects consider climate and disaster risks, making it more resilient from the start.

5. Risks in Public-Private Partnerships

Public-Private Partnerships (PPPs) provide a different way to develop infrastructure and improve public services. Rather than the government managing all tasks alone, PPPs involve private partners working together with the public sector. This cooperation helps projects move faster, work more smoothly, and offer better services. By sharing tasks, risks, and benefits, both the government and private sector work together to create better results for the community.

Investing in infrastructure is important for improving KP's economy, but limited resources and tight budgets make it difficult for the provincial government to fund these needs. To achieve its goal of 7 percent annual growth, KP needs to invest about 7 to 9 percent of its GDP in infrastructure[8]. With financial constraints, partnering with the private sector through public-private partnerships (PPP) is key to meeting these demands and supporting long-term growth.

5.1 KP - PPP Framework

Public-Private Partnerships (PPPs) Framework in Khyber Pakhtunkhwa operates under the KP PPP Act, 2020. At the heart of this framework is the PPP Committee, which is responsible for approving and awarding projects submitted by government departments, with guidance from the PPP Unit.

The PPP Unit serves as the secretariat and provides technical support to the Committee. It offers expert advice on the technical, financial, economic, and legal aspects of projects. The Unit also works with PPP Nodes and Risk Management Unit, providing centralized expertise to help plan and manage PPP projects.

The PPP Unit’s main responsibilities include helping the Committee create guidelines, set project standards, and prepare necessary documents. It also assists government departments at every stage of the project, from selecting proposals to final evaluations, and ensures projects align with KP's infrastructure development goals.

5.2 Size and Composition of the Sector

Since the enactment of PPP Act, KP government has completed two projects through the public-private partnerships model, one in the road sector and the other in a special economic zone. For road projects, the government sets aside Viability Gap Funding (VGF) in its annual budget to ensure smooth operations, while the private sector handles the design, construction, financing, operation, and maintenance of the projects.

One major success under this model is the Swat Motorway Phase-I, an 82-kilometer road from Karnal Sher Khan in Swabi to Chakdara. With a total investment of PKR 34.1 billion, the project was completed through a 25-year concession agreement.

The Swat Motorway Phase-II was launched in 2022, extending the motorway from Chakdara to Fatehpur. The project is valued at PKR 49.4 billion, with both the government and private partner contributing. Although financial close has not yet been reached, commercial close was achieved in December 2022.

In addition, the Rashakai Special Economic Zone (SEZ) was initiated in 2020 under the PPP model, with private sector investment of USD 128 million. Unlike the road projects, the SEZ

[8] https://www.sbp.org.pk/departments/ihfd/InfrastructureTaskForceReport.pdf

did not require government funding, and aims to attract businesses and promote economic growth in the region through private investment alone.

Project name	Description	Project cost	Status
Swat Expressway – 1	Construction of 82-km 4-lane green-field access-controlled motorway on Public Private Partnership (PPP) basis.	PKR 34.1 billion	Operational project
Swat Expressways – 2	Construction of an 80-km 4-lane green-field access-controlled motorway.	PKR 49.4 billion	Project has been awarded (Concession Agreement signed)
Rashakai Economic Zone	Spread over the area of 1000 acres, Rashakai SEZ is a project under the industrial cooperation of China Pakistan Economic Corridor (CPEC) framework. SEZ is being developed by CRBC in joint venture with KPEZDMC.	USD 128 million	Operational project

Table 3: Summary of PPP projects

KP government is planning to develop Dir and D.I Khan Motorways through public-private partnerships. These projects are expected to be economically viable, but both will need initial and ongoing Viability Gap Funding (VGF) from the government to ensure financial feasibility.

In addition to the DIR and D.I Khan motorway projects, KP government is actively pursuing public-private partnerships in other key areas, including tourism, education, energy, and power projects. By using the PPP model, the government aims to attract private investment to enhance these sectors, promoting sustainable development and enhancing public services across the province.

5.3 Fiscal Risks in KP's PPP Projects

KP government recognizes that contingent liabilities in PPP projects can pose financial risks. These liabilities can result from unexpected events such as legal disputes, cost overruns, or force majeure situations like natural disasters or pandemics. When a private partner fails to meet contractual obligations, the government might have to step in and cover the costs, which could strain its finances. This potential burden underscores the importance of carefully managing risks in PPP agreements to protect public funds.

From the government's perspective, PPP projects come with a variety of risks. In addition to financial liabilities, there are risks related to project delays, quality of service, and public dissatisfaction if the project does not meet expectations.

Furthermore, external factors like fluctuating market prices, interest rates, and political instability can also impact the success of a PPP project. The government must carefully assess these risks at the planning stage, ensure strong legal and financial safeguards, and maintain close coordination with private partners throughout the project to minimize the likelihood of unexpected problems.

By recognizing and addressing these risks early on, the government can ensure that PPP projects deliver long-term benefits without creating additional financial burdens. This proactive approach to risk management is key to maintaining both fiscal stability and public trust in PPP initiatives.

Finally, KP government may face high costs if a PPP contract ends early, known as termination liabilities. These costs are often unpredictable and difficult to plan for, as the full impact might not be clear until after the contract is terminated. If this happens during other financial challenges, like natural disasters or debt issues, it could add more pressure on the government’s budget.

Early termination can also damage the KP government’s reputation with investors, making it harder to regain their trust and attract new investments for future projects. Proper risk management and maintaining good relationships with private partners can help avoid these issues and protect the government's finances.

6. Challenges in Managing Public-Sector Entities (PSEs)

In Khyber Pakhtunkhwa (KP), the provincial government owns 186 Public Sector Companies (PSCs) and Autonomous Bodies (ABs). These organizations play a key role in delivering important services to the public. Operating under different government departments to improve efficiency, reduce costs, and provide better public services. Some of these companies focus on commercial activities, while others work independently, all contributing to managing public resources effectively.

To keep these entities running, the KP government allocates around PKR 40 billion from its budget, which is about 4% of the province’s total spending for the year 2022-23. This direct funding helps ensure that PSCs and ABs have the financial support needed to meet public demands.

In addition to this budget, the government also provides off-budget support through development loans and grants. This extra financial help is aimed at encouraging growth and expanding services, ensuring that these organizations can continue serving the province effectively.

6.1 The PSCs/ABs Universe

Government of KP has 13 Public Sector Companies (PSCs), while the rest are Autonomous Bodies (ABs), including Medical Teaching Institutions (MTIs), schools, and universities. Although the PSCs are set up to make a profit, many do not fully recover their costs. Among these PSCs are 7 Water and Sanitation Services Companies (WSSCs) that operate throughout the province, providing essential services.

Public Sector Companies (PSCs) and Autonomous Bodies receive budgeted funds to cover their operating costs and handle any revenue shortfalls. Before requesting funds, consultation takes place with the relevant line departments for approval. Once approved, the request is sent to the Finance Department (FD), and the respective Secretary of the line department approves the expenditures.

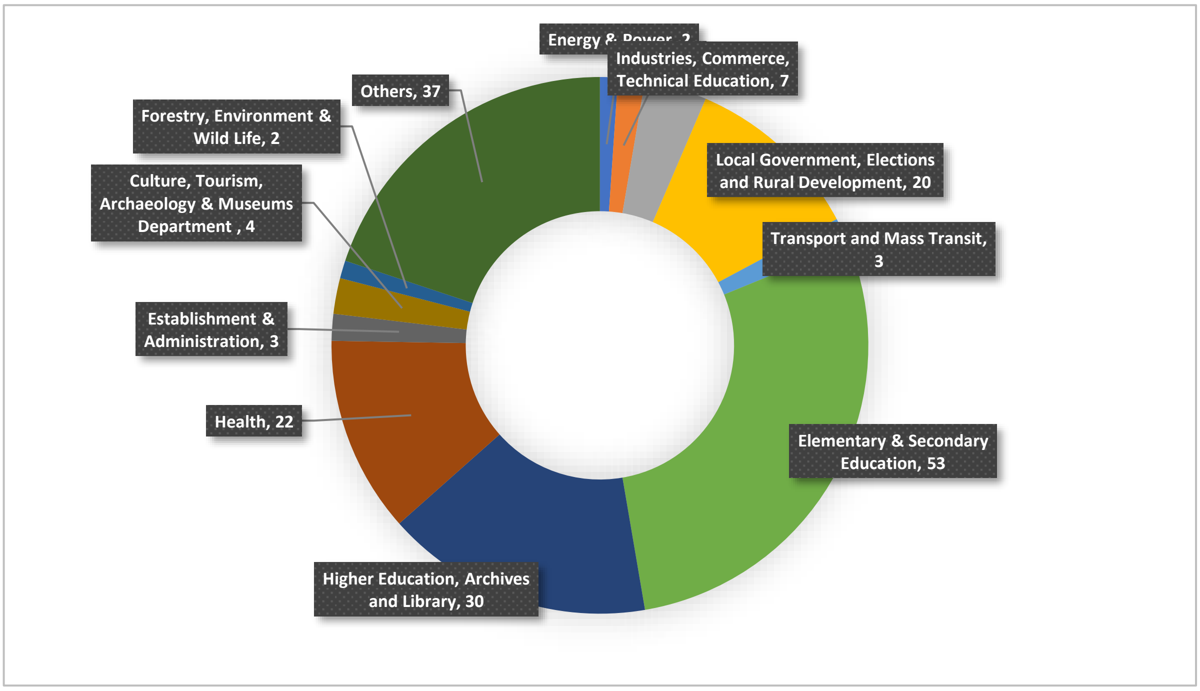

Figure 7: Number of PSEs – categorization by department

6.2 Key Fiscal Risks

Public Sector Companies (PSCs) and Autonomous Bodies (ABs) often face challenges in covering their expenses because the government sets low prices for services like municipal utilities and healthcare. These prices are not enough to meet the actual costs of providing these services. This issue, combined with weak governance and a lack of proper cost accounting for public service obligations, creates financial risks for the government. Therefore, price structure should be revised and enhanced.

6.2.1 Lack of transparency in grants in aid to PSCs and ABs:

A major concern is the lack of transparency in how grants are provided to PSCs and ABs. More than 70 percent of these entities, including 64 considered major, do not have clear tracking for the funds received. This happens because many lack Drawing and Disbursing Officer (DDO) codes, making it difficult to track the exact flow of funds.

Without DDO codes, budgetary releases to these entities are grouped under the “Grant in Aid” account and disbursed through relevant line departments. This lump-sum approach means the Finance Department can only verify the amounts by directly confirming with the entities, making the process less transparent and harder to manage.

This lack of tracking leads to financial leakages, as the government cannot easily monitor how much money is being disbursed to each PSC or AB. It also allows funds to be released to entities that may not have been included in the budget, bypassing the standard budget process.

Table 5: PSCs/ABs with and without DDO codes

Department Name	Total Entities	DDO Code Not Available	Entities with DDO Code
Total	**186**	**128**	**58**
Agriculture	1	1	0
Energy & Power	3	3	0
Finance	3	1	2
Industries, Commerce, Technical Education	9	7	2
Local Government, Elections and Rural Development	20	12	8
Transport and Mass Transit	3	2	1
Elementary & Secondary Education	53	47	6
Higher Education, Archives and Library	36	36	0
Health	38	4	34
Labor	4	4	0
Culture, Tourism, Archaeology & Museums Department	4	4	0
Forestry, Environment & Wild Life	2	1	1
Communication & Works	1	0	1
Science & Technology and Information Technology	1	0	1
Law, Parliamentary Affairs & Human Affairs	1	1	0
Housing	1	1	0
Establishment & Administration	3	2	1
Relief & Rehabilitation Department	2	1	1
Livestock, Fisheries and cooperative department	1	1	0

Table 4: PSCs/ABs with and without DDO codes

6.2.2 Governance issues and Weak monitoring

The Corporate Governance Unit (CGU) was established in 2019 under the Finance Department to reform the PSCs and ABs and introduce policy frameworks to improve transparency and accountability[9]. Its role includes enhancing board effectiveness, creating policy frameworks, ensuring corporate governance compliance, identifying cost-saving or revenue-generating opportunities, and developing tools to monitor performance.

However, CGU faces several challenges. It is understaffed and lacks the capacity to fully carry out its mandate. One major issue is that policy frameworks set by the CGU are not followed during the board appointment process. The CGU also lacks authority to ensure compliance with these policies, which undermines key reforms.

To promote transparency, CGU developed a financial reporting system with the Financial Management Information Unit (FMIU). An online portal was created to track financial information from all PSCs and ABs, but after the initial round of data collection, updates have not been made due to non-compliance from the entities. Although the goal was to link funding requests to CGU's reporting, this has not yet been enforced.

[9] Functions of the Corporate Governance Unit (CGU), https://www.finance.gkp.pk/articles/about/wings/corporate-governance-unit-cgu

6.2.3 Lack of Public Disclosures

As seen in Table 19, the data on financial and non-financial information of PSCs and ABs is not readily available with the Finance Department or the line departments for any decision-making matter. This lack of system to compile this information on periodic basis coupled with the entities' reliance on government budgetary releases and weak monitoring capacity of CGU, poses a serious fiscal risk that will have uncontrolled on-budget allocations to these entities.

The Finance Department and line departments are also not aware of the operational health of the PSCs and ABs, showing weak ownership function that builds more slack into the system and these entities do not have incentive to improve performance. In addition, the utilization of the funds that go toward the PSCs and ABs is often opaque, rigorous monitoring is needed to improve this function.

6.2.4 Fiscal support to Commercial PSCs and ABs

There are more than 10 commercially oriented PSCs and ABs of the government that are expected to generate profits and perform critical public service functions for a fee. These PSCs need to be scrutinized so that their funding requests are for performing critical public service function and no funds are given for operational support or bailout support.

The costing of the public service obligations may be carried out separately by the entity and discussed with the line department in advance before performing that function.

Category	Identified Risks	Mitigation measures by GoKP
Macroeconomic and federal transfers	Economic instability (inflation, variations in monetary policy and supply chain disruptions) Deviation in actual vs. budgeted receipts Fluctuation in national tax collection Delays in disbursement of funds	Close coordination with the Federal Government for resolution of NHP and straight transfers Formation of revenue committee to closely follow up on general, capital and development receipts Implementation of the Treasury Single Account (TSA)
Debt Management	High reliance on external loans Majority floating rate debt FX exchange risks Interest rate price risks Refinancing risks	Setting out clear debt limits under FRDA Adherence to debt limits set out under FRDA 2022 Optimizing development spend more prudently
Development Spending	High throw-forward amounts under C&W, water, health and education portfolio	process Develop a medium to long-term sectoral strategy Improve the project appraisal stage for
		Improve financial discipline Strengthen the monitoring function by equipping the Corporate Governance Unit Improve budget efficiency to target priority areas Aggregate PSC and AB reporting practice Preparation of online monitoring dashboards for CGU
Climate and Natural disasters	Lack of annual budgeting of monsoon contingency relief and rehabilitation funds under high, medium and low impact scenarios	Efforts to budget for low impact, high frequency events Established PEOC in KP Implemented remote call management system
Pension payments	Liabilities of active pensioners and employees Fiscal slippages on current pension expenditure Retirement Withdrawals under the contributory pension scheme	
PPPs	Fiscal illusions due to accounting treatment, asset recognition criteria and lack of management of contingent liabilities MRG acting as contingent subsidies Frequent re-negotiation of PPP contracts	Established a gatekeeper in the form of RMU to identify, control, budget and monitor fiscal risk Close evaluation projects' macro-fiscal implications at feasibility stages