

**Peru: Report on the Observance of Standards and Codes—
Fiscal Transparency Module**

This Report on the Observance of Standards and Codes on Fiscal Transparency for **Peru** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **April 6, 2004**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Peru** or the Executive Board of the IMF.

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PERU

**Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module**

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April 6, 2004

EXECUTIVE SUMMARY

This report assesses the fiscal transparency practices in Peru in light of the *Code of Good Practices on Fiscal Transparency* on the basis of relevant documentation and supplemented by meetings with government representatives.

In recent years, Peru has launched a number of initiatives for increasing transparency in public finances, in line with the *Code*. Major initiatives include: improvements in budget formulation; partial phase-in of an integrated financial management information system; introduction of an open procurement process; estimation of tax expenditures; adoption of a medium-term macroeconomic framework; and increased autonomy of the external audit function. Most public entities are required by law to make available to the public—including through electronic means—an unprecedented volume of information on fiscal developments and prospects.

In spite of marked progress in fiscal transparency, there remains significant scope for improvement. A number of specific weaknesses were identified: lack of stability and clarity in fiscal legislation); ambiguities in the demarcation of functions between government and the rest of the public sector; inadequate information on contingent liabilities and quasi-fiscal operations; lack of a coherent civil service system; insufficient resources to conduct external and internal audits; and unwieldy proliferation of tax preferences. Also, Congress has yet to assign clearly spending responsibilities and revenue sources at different levels of government, and to design a transparent mechanism of intergovernmental transfers and limits on internal borrowing.

With a view to correcting these deficiencies, the Fund team suggested corrective steps in a number of areas: clarification of functions within the public sector; explicit assignment of spending responsibilities, revenue sources and borrowing limits for subnational governments, and clear criteria for determining intergovernmental transfers; transparent management and regulation of the civil service; stable and unified legal framework encompassing the budget process, treasury operations, and debt management; efficient use and wider coverage of the integrated financial management information system; transparency in the tax system through a more disciplined legislative process; strengthening of the capacity for external audit; reconciliation in the institutional coverage of government statistics; and regular publication of estimates of quasi-fiscal operations, contingent liabilities, and fiscal sustainability.

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ACRONYMS AND ABBREVIATIONS

BA	Agricultural Bank (Banco Agropecuario)
BCRP	Central Reserve Bank of Peru (Banco Central de Reserva del Perú)
BN	National Bank (Banco de la Nación)
BTF	Fiscal Transparency Bulletin (Boletín de Transparencia Fiscal)
CGR	Office of the Comptroller General (Contraloría General de la República)
CND	National Decentralization Council (Consejo Nacional de Descentralización)
COFIDE	Development Finance Corporation (Corporación Financiera de Desarrollo)
CONASEV	National Securities and Exchange Commission (Comisión Nacional Supervisora de Empresas y Valores)
CONFIEP	National Confederation of Private Business Institutions (Confederación Nacional de Instituciones Empresariales Privadas)
CONSUCODE	Supreme Council on Government Contracting and Procurement (Consejo Superior de Contrataciones y Adquisiciones del Estado)
COPRI	Private Investment Promotion Commission
CPN	National Accounting Office (Contaduría Pública de la Nación)
CTARES	Transitional Regional Administration Councils (Consejos Transitorios de Administración Regional)
DGCP	General Directorate of Public Credit (Dirección General de Crédito Público)
DNPP	National Directorate of the Public Budget (Dirección Nacional del Presupuesto Público)
ELECTROPERU	National Electricity Company (Empresa de Electricidad del Perú)
ESSALUD	Social Health Insurance Fund (Seguro Social de Salud)
ESVICSAC	Security and Control Company (Empresa de Seguridad, Vigilancia y Control, S.A.)
FCR	Consolidated Reserve Fund (Fondo Consolidado de Reservas)
FEF	Fiscal Stabilization Fund (Fondo de Estabilización Fiscal)
FONAFE	National Fund for Financing State Enterprises (Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado)
FONAHPU	National Savings Fund (Fondo Nacional de Ahorro Público)
FONCODES	National Compensation and Social Development Fund (Fondo Nacional de Compensación y Desarrollo Social)
FONCOMUN	Municipal Compensation Fund (Fondo de Compensación Municipal)
IFAC	International Federation of Accountants (Normas Internacionales de Contabilidad para el Sector Privado)
IGV	General Sales Tax (Impuesto General a las Ventas)
INDECOPI	National Institute for the Protection of Competition and Intellectual Property (Instituto Nacional de Defensa de la Competencia y Protección a la Propiedad Intelectual)
INEI	National Statistics and Data Processing Institute (Instituto Nacional de Estadística e Informática)

INTOSAI	International Organization of Supreme Audit Institutions
LPSP	Public Sector Budget Law (Ley de Presupuesto del Sector Público)
LPTF	Law on Fiscal Prudence and Transparency (Ley de Prudencia y Transparencia Fiscal)
LTAIP	Law on Transparency and Access to Public Information (Ley de Transparencia y Acceso a la Información Pública)
MEF	Ministry of Economy and Finance (Ministerio de Economía y Finanzas)
MIVIVIENDA	Mortgage Fund for Housing Development (Fondo Hipotecario de Promoción de la Vivienda)
MMM	Multiyear Macroeconomic Framework (Marco Macroeconómico Multianual)
NFPS	Nonfinancial Public Sector (Sector Público No Financiero)
OAI	Internal Audit Office (Unidades u órganos de Auditoría Interna)
ONP	Public Pension Standardization Office (Oficina de Normalización Previsional)
OSINERG	Supervisory Agency for Private Investment in Energy (Organismo Supervisor de la Inversión Privada en Energía)
OSIPTEL	Supervisory Agency for Private Investment in Telecommunications (Organismo Supervisor de la Inversión Privada en Telecomunicaciones)
OSITRAN	Supervisory Agency for Investment in Public Transportation Infrastructure (Organismos Supervisores de la Inversión en Infraestructura de Transporte de Uso Público)
PAAC	Annual Procurement and Contracting Plan (Plan Anual de Adquisiciones y Contrataciones)
PCM	Presidency of the Council of Ministers (Presidencia del Consejo de Ministros)
PESM	Multiyear Strategic Sectoral Plans (Planes Estratégicos Sectoriales Multianuales)
PETROPERU	National Oil Company (Petróleos del Perú)
PROINVERSION	Investment Promotion Agency (Agencia de Promoción de la Inversión)
PPSP	Draft Public Sector Budget (Proyecto de Presupuesto del Sector Público)
SBS	Superintendency of Banking and Insurance (Superintendencia de Banca y Seguros)
SDDS	Special Data Dissemination Standards
SEAC	Electronic Government Procurement and Contracting System (Sistema Electrónico de Adquisiciones y Contrataciones del Estado)
SEDAPAL	Water and Sewage Service of Lima (Servicio de Agua Potable y Alcantarillado de Lima)
SIAF-SP	Integrated Public Sector Financial Management Information System (Sistema Integrado de Administración Financiera del Sector Público)
SILSA	Integrated Cleaning Services (Servicios Integrales de Limpieza, S.A.)
SNA	System of National Accounts (Sistema Nacional de Contabilidad)
SUNASS	National Superintendency of Water and Sewage Services (Superintendencia Nacional de Servicios de Saneamiento)
SUNAT	National Superintendency of Taxation and Customs Administration (Superintendencia Nacional de Administración Tributaria y Aduanas)

I. INTRODUCTION

1. This report¹ assesses fiscal transparency practices in Peru against the provisions of the International Monetary Fund's *Code of Good Practices on Fiscal Transparency*.² The assessment consists of two parts. The first describes current practices on the basis of responses to the IMF fiscal transparency questionnaire, and additional information obtained from the authorities. The second part contains an IMF staff commentary on fiscal transparency in Peru.

II. DESCRIPTION OF PRACTICES

A. Clarity of Roles and Responsibilities

Scope of government

2. **The public sector is clearly distinguished from the rest of the economy, but the existence of various legal and statistical definitions of the government makes it difficult to demarcate it clearly from the rest of the public sector.** Constitutionally,³ Peru is a democratic, unitary and decentralized republic, organized in accordance with the principle of separation of powers. Besides the legislative (Congress, which consists of a single chamber) and the judiciary branches (Supreme Court of Justice), the executive branch is headed by the President of the Republic, who is elected by direct suffrage, serves as head of state and directs government policy. The President of the Republic is assisted by the President of the Council of Ministers, who coordinates the functions of government and oversees the implementation of decisions of the executive branch.⁴ The remaining central authorities consist of constitutionally autonomous entities and a number of public entities that depend from ministries, and of decentralized government agencies. The latter includes entities engaged in noncommercial activities, as well as nonfinancial public enterprises and financial public institutions. By Constitution, the Republic is divided into regions, departments, provinces and districts, within which regional and local governments are constituted and

¹ Prepared by a team from the Fiscal Affairs Department, headed by G. Kopits and including M. Albino, M. Villafuerte, and J. Viñuela, during a visit to Lima, October 9-22, 2002. The team met with the chairmen of the Committee on Budget and General Accounts of the Republic and the Committee for Decentralization and Regionalization of the Congress, with officials of the Office of the President of the Council of Ministers, Ministry of Economy and Finance, Ministry of Transport, BCRP, BN, CGR, CND, CPN, COFIDE, CONSUCODE, SUNAT, INEI, SBS, ESSALUD, ONP, PETROPERU, MIVIVIENDA, SEDAPAL, OSINERG, FONCODES, and FONAFE, and with representatives of the private sector (including the Peruvian Press Council, CONFIEP, and Macroconsult).

² For purposes of this report, the term "fiscal" embraces government finances in their entirety.

³ Constitution of 1993.

⁴ Such as Legislative Decrees, Emergency Decrees and Supreme Decrees on issues that fall within the purview of the Presidency of the Council of Ministers.

organized.⁵ Currently, there are three different definitions of the government for fiscal purposes. The first definition is contained in the Public Sector Budget Law (LPSP), the second is found in the recently enacted amendment to the Fiscal Prudence and Transparency Law (LPTF)⁶ and the third is used by the Central Reserve Bank of Peru (BCRP) for preparing government finance statistics. Only the last two definitions are consistent with the definition in the IMF's *Manual on Government Finance Statistics*. The first legal definition contains an incomplete coverage of the government sector.⁷

3. **The recent constitutional reform has strengthened the decentralization process, but key fiscal aspects have yet to be defined.** The reform sets the stage for introducing a regional level of government⁸—interposed between the central government and the local governments—assigning spending responsibilities and revenue sources to regional and local governments. In essence, these sources consist of taxes to be determined by law, transfers from the central budget, and revenues of certain regional and municipal compensation funds. The Basic Decentralization Law⁹ further clarifies the distribution of expenditure responsibilities among the three levels of government. That law lists the exclusive and shared responsibilities of each level of government, which are specified in the legislation governing the central and regional governments.¹⁰ The recently enacted Regional Government Law contains a detailed description of the exclusive and shared powers of regional governments, establishes regulations for regional organization and interregional coordination and includes provisions for fiscal discipline at a regional level. Other provisions for subnational fiscal discipline are also included in the recent amendment to the LPTF. Transitional, supplementary and final provisions of the Regional Government Law, instruct the executive to submit to Congress a fiscal decentralization law addressing major outstanding issues, such as tax measures concerning of the regions, and budget transfers in the course of 2004. Prior to enactment of this basic legislation, together with regulations governing regional finances,

⁵ According to the Constitutional Reform Law of March 6, 2002, regional government applies to regions and departments, and local government to the provinces, districts and population centers. Regions are created on the basis of existing departments. Nevertheless, their geographic scope can be redefined, provided they meet the terms and conditions established by the Territorial Demarcation and Organizations Law (Law 27795 of July 23, 2002).

⁶ The amendment to the LPTF was approved by Congress on April 8, 2003.

⁷ The LPSP for 2002 excludes the National Health Service (ESSALUD), the National Superintendencies of Tax Administration (SUNAT), Customs, and the Water and Sanitation Service (SUNASS), Supervisory Agencies for Investment in Telecommunications, Energy and Public Transportation Infrastructure, and legally incorporated funds such as the Consolidated Reserve Fund (FCR), the Fiscal Stabilization Fund (FEF) and other entities of minor importance.

⁸ In effect from January 2003.

⁹ Law 27783 of July 17, 2002.

¹⁰ The Executive Branch Organic Law has yet to be approved by Congress. The Regional Government Organic Law was promulgated as Law 27867 of November 8, 2002 and amended by Law 27902 of December 20, 2002..

it is premature to assess the macro-fiscal aspects of the decentralization process, or the transparency of fiscal relations between the central and regional governments.

4. The current distribution of fiscal responsibilities between the central government and local governments is legally defined, but the allocation of expenditure responsibilities and intergovernmental transfers need further clarification. The Constitution grants political, economic, and administrative autonomy to the provincial municipalities and district municipalities in matters within their competence and regulates their assets and revenue in general. The law provides certain minimum and specific responsibilities to the district municipalities, and additional responsibilities to the provincial municipalities, and a broad set of responsibilities for both types of municipalities, but without distinguishing between them.¹¹ Legal provisions also encompass the more specific functions of local government in terms of spending and revenue, their ability to borrow, and their budgetary regime.¹² Municipalities are financed primarily through central government transfers and, to a lesser extent, through taxes and other revenue. Within the legal framework of general distribution criteria for transfers—mainly based on income level and population—the Ministry of Economy and Finance (MEF) annually determines the actual indicators and weights used for this purpose. Municipalities have limited taxation capacity. Municipal taxes on property, non-sporting public events, real estate transfer (*alcabala*), vehicle ownership, gaming and casinos, are created by law. The municipalities have the authority to create, amend, abolish or provide exemptions for fees, contributions, charges for municipal services (*arbitrios*), royalties and license fees, but the law determines the rates and bases.¹³ Constitutionally, the municipalities can borrow to finance non-recurrent expenditure against their own revenue and assets, without legal authorization, except for external borrowing guaranteed by central government.¹⁴

5. The allocation of fiscal responsibilities between the executive and legislative branches needs to be clarified. The draft Public Sector Budget Law (PPSP) has to be submitted to Congress before August 30 each year, together with legislation governing indebtedness and financial balance. The LPSP must be approved by November 30; otherwise, the PPSP submitted by the executive comes into force. Congress can reduce spending and

¹¹ Articles 10-13 and 62-71 of the Municipalities Organic Law (Law 23853 of May 11, 1984).

¹² In addition to the Municipalities Organic Law, the Legislative Decree regulating municipal taxation (DL 776 of December 30, 1993). A new Municipalities Law is currently under consideration in Congress and is expected to be approved by 2003

¹³ Municipal budgets are governed by the State Budgetary Management Law (LGPE) and by directives of the National Public Budget Directorate (DNPP), although the LPSP frequently imposes limits on the growth of certain kinds of expenditure. Municipal control and use of funds is governed by the rules of the National Controls System (see below) and accounts must be kept in accordance with the general rules of public accounting.

¹⁴ This government authorization for external borrowing, required under of the new Basic Decentralization Law, conflicts with the constitutional provision on municipal borrowing, which contains no limitation.

can reallocate resources from some items to others, within the overall expenditure ceiling, but has no authority either to create or to increase public spending directly. This constitutional provision is frequently circumvented by indirect expenditure increases achieved through tax exemption legislation of various kinds. Constitutionally, such legislation must be reviewed in a report by the MEF which is not binding on Congress.¹⁵ The President of the Republic can veto the LPSP and any other law, wholly or in part, but Congress can override the veto by a simple majority of the legal quorum.

6. Extrabudgetary activities are few in number but quantitatively significant.¹⁶

Extrabudgetary activities, understood as fiscal activities that take place outside the LPSP, encompass for the most part regulatory and supervisory agencies (National Superintendency of Taxation and Customs Administration (SUNAT), National Superintendency of Water and Sewage Services (SUNASS)) and social development funds (Mortgage Fund for Housing Development (MIVIVIENDA), Social Health Insurance Fund (ESSALUD)). These entities are subject to the budget procedures established by the National Fund for Financing State Enterprises (FONAFE) for public enterprises.

7. The Central Reserve Bank of Peru (BCRP) enjoys statutory autonomy in the management of monetary policy, and its relations with the government are clearly defined by law.

The BCRP has its own legal status and own charter, and its sole responsibility is to preserve monetary stability.¹⁷ The BCRP's Board of Directors is appointed on an equal basis by the executive and legislative branches.¹⁸ Currently, some BCRP directors hold high positions in the government (e.g., a director holds the positions of Vice Minister of Finance) or maintain interest in the private sector. However, there is no evidence of conflict of interest. The BCRP is not allowed to provide financing to the Treasury or to official development financial institutions, and to extend collateral or guarantees.¹⁹ The BCRP could serve as agent for the government in its relations with multilateral credit institutions and financial agencies of foreign governments. It holds and

¹⁵ Although the legislation governing special tax treatment for certain areas of the country has to be approved by a two-thirds vote in Congress, this restriction does not appear to have been a binding constraint.

¹⁶ These do not include extrabudgetary activities in the form of quasi-fiscal activities and tax expenditure, which are referred to in other parts of this report.

¹⁷ Its activities are governed by Article 84 of the Constitution and its own charter of December 1992. It is subject to *ex post* control by the Comptroller General of the Republic and to supervision by the Superintendency of Banking and Insurance (SBS). It demonstrates fulfillment of its functions through publication of an annual report (including audited financial statements) and reports on the performance of the monetary program.

¹⁸ The Board is composed of seven directors (the President of the Board is appointed by the executive and ratified by Congress, three directors are appointed by Congress and the other three are appointed by the executive branch with a term in office that coincides with that of the President of the Republic).

¹⁹ The BCRP may operate on the secondary market to purchase securities issued by the treasury for monetary policy purposes, subject to limits on the annual increase in its holdings of such securities.

administers government deposits in foreign currency. It also manages the Consolidated Reserve Fund (FCR) and the Fiscal Stabilization Fund (FEF). While there are no specific rules for operational coordination between monetary and fiscal policy, there is a consensus on the Multiyear Macroeconomic Framework (MMM) (see paragraph 27) and the BCRP is represented in the Treasury Operations Committee that meets monthly to establish ceilings on expenditure financed from current revenue. At present, the BCRP does not engage in quasi-fiscal operations.²⁰

8. Few public financial institutions remain, but they still carry considerable weight; quasi-fiscal operations are confined mainly to the BN.²¹ The public financial institutions (COFIDE, BN and Agricultural Bank (BA)) fall under the tutelage of FONAFE and account for about 12 percent of assets in the financial system. They are governed by their own statutes, and only in an ancillary way by the Financial System Law. COFIDE is a second-tier development bank.²² BN is the fiscal agent for the government,²³ and it charges above-market fees for services.²⁴ It holds public sector deposits, most of which are not remunerated, and charges a relatively high interest rate on central government overdrafts. In addition, BN provides loans to the government, public entities, public sector employees and pensioners, at preferential interest rates.²⁵ BA was created recently to provide direct loans to small farmers at preferential rates, funded by the Treasury, as well as indirect loans through private financial institutions.

9. Public sector involvement in productive activities has been substantially reduced through privatizations and, to a lesser extent, through operating concessions; however, privatizations were not always conducted in accordance with clear procedures and

²⁰ The only quasi-fiscal transaction on its balance sheet derives from the 1994 recapitalization of the BCRP, through unremunerated treasury bonds which offset losses accumulated to that date (its current holdings of those bonds amount to less than US\$30 million). These bonds are being retired through the transfer of 25 percent of the BCRP's earnings to the Treasury, as required by law. In some measures of the overall balance of the public sector, the operating profits of the BCRP are consolidated with the rest of the public sector.

²¹ In addition, there is a public fund, MIVIVIENDA, that channels mortgage lending through financial institutions supervised by the SBS; it offers discounts of up to 20 percent for borrowers with a good payment record.

²² It raises funds through the issuance of domestic securities and external lines of credit to the government, and channels these funds to institutions supervised by the SBS for medium- and long-term financing to the export sector and to small businesses, at interest rates that exceed the cost of its funds. It also manages funds for public entities in the form of trusts and asset management contracts [*comisiones de confianza*].

²³ Its five-member Board of Directors is chaired by the Vice Minister of Finance and includes the Director General for Public Budget and three other representatives of the executive branch.

²⁴ The commission for collecting taxes is 0.55 percent, which would yield approximately US\$30 million in 2002. It charges a fixed annualized rate of 14 percent on overdrafts.

²⁵ The balance of such loans amounted to approximately US\$1.1 billion in September 2002.

under proper public supervision.²⁶ Legislative Decree 674 created the Private Investment Promotion Commission (COPRI) as the body responsible for designing and conducting the privatization process, on the basis of proposals prepared by the Special Privatization Committees. Members of COPRI were appointed by supreme resolution, for approval by the President of the Council of Ministers, and were to report directly to the President of the Republic. In terms of transparency, the privatization process suffered from several weaknesses. First, all power over the design and approval of the process was in the hands of the executive branch.²⁷ Second, neither the Congress nor the supervisory agencies exercised any oversight. Third, the agencies responsible for regulating privatized utilities were sometimes created only after privatization, and without the sufficient autonomy vis-à-vis the government. Although the authorities still consider privatization a priority, they are now focusing on the use of concessions to encourage private investment.

10. The relationship between the government and nonfinancial public enterprises, which continue to play an important role in the country, is clearly regulated, and the enterprises are legally obliged to provide full disclosure of their activities, though without identifying their quasi-fiscal activities. Nonfinancial public enterprises are grouped in a holding company known as FONAFE,²⁸ responsible for managing the state's entrepreneurial activity, administering resources from state ownerships, and record and hold government's equity shares.²⁹ FONAFE earns profits, which revert to the Treasury, and provides cross-subsidies between enterprises. Nevertheless, the most important quasi-fiscal activities take place within the enterprises themselves, as a result of their internal pension plan (*cédula viva*) and cross-subsidies between different categories of users in the case of public utilities (Water and Sewage Service of Lima (SEDAPAL) and the National Electricity

²⁶ The legal framework for privatizations and concessions is contained in a number of statutes: Legislative Decree 757 of November 13, 1991, the Framework Law for Increasing Private Investment; Legislative Decree 674 of December 27, 1991, on Promotion of Private Investment in State Enterprises; Legislative Decrees 25575, 25681 and 25685, all of 1992, authorizing the state to provide safeguards and guarantees to protect acquisitions and investments, without limit, offering foreign investors special facilities for paying taxes and suspending payment of the debts of state enterprises included in the privatization process until the process was concluded; and Legislative Decree 839 of August 20, 1996, on the Promotion of Private Investment in Public Infrastructure Projects and Public Services. By means of Supreme Decree 027 of April 25, 2002, several entities, including COPRI, were merged into PROINVERSION.

²⁷ Using a practice that became widespread in the last decade, Congress delegated to the executive branch the authority to issue legislative decrees in certain areas, including over public commercial entities. In many cases, these practices were used to the point where the separation of powers and responsibilities between the two branches of government was obscured.

²⁸ Law 27170 of August 31, 1999 on FONAFE, amended by Laws 27317 and 27247. Municipal enterprises and municipally owned firms and production centers and services are not covered by FONAFE.

²⁹ Excluding BN, BA, and COFIDE, which are public financial institutions, FONAFE covers 32 enterprises in which the state has a majority interest, 30 enterprises where the state has a minority interest, and 27 enterprises in liquidation. FONAFE also manages the following entities: ELECTROPERU, which belongs to FONAHPU and FCR, and ESSALUD, with its two affiliates, SILSA and ESVICSAC.

Company (ELECTROPERU)). The financial activities of majority state-owned enterprises are regulated by FONAFE, whose Board of Directors approves their consolidated budget. In terms of transparency, FONAFE-controlled enterprises, like all public entities, are subject to the provisions of the Transparency and Access to Public Information Law. Under that law, FONAFE must also publish standard financial statements, on a detailed and consolidated basis, for the government. The majority state-owned enterprises are also subject to the directives relating to transparency in the management of enterprises under FONAFE.³⁰

11. Significant progress has been made in regulating the nonfinancial private sector—especially as regards utility companies—and in making their activities more transparent. There are no general procedures for preparing regulations affecting the nonfinancial private sector or publishing draft regulations, holding public hearings, conducting periodic assessments, or determining whether they should be maintained, modified or abolished. Regulations for the disclosure of administrative decisions by senior officials are partial and insufficient. Supervision and regulation of public utility companies by regulatory agencies (OSIPTEL, OSINERG, OSITRAN, SUNASS) are far more transparent.³¹ Regulatory decisions must be substantiated and the criteria used for their adoption must be understandable and predictable for those administered; as well, general regulations must be published in the official gazette (*El Peruano*), and public hearings must be held if necessary. Additional rules govern the timing and content of publications, as well as the procedures for the holding of public hearings.³²

12. In general, the legal and regulatory framework for supervising the financial system and financial markets is adequate and in line with international standards.³³ The Superintendency of Banking and Insurance (SBS), BCRP and the National Securities and Exchange Commission (CONASEV) are responsible for supervision of the financial sector. The SBS³⁴ is an autonomous institution that regulates and supervises banks, public financial entities, insurance and reinsurance companies, and private pension funds; as such, it issues prudential regulations and can intervene and liquidate institutions. Its regulatory framework does not distinguish between private and public institutions, or between domestic and foreign ones. Peru has a well-defined system of financial assistance, corrective action, and resolution

³⁰ Directive 003-2002/FONAFE, approved by the Board of Directors.

³¹ Framework Law 27332 of July 27, 2000, on Regulatory Agencies for Private Investment in Public Utilities.

³² Supreme Decree 124 of November 29, 2001, establishing rules to ensure transparency in setting of regulated prices, whereby the information used by the regulatory agencies must be available to enterprises and users. Law 27838 of September 12, 2002, on Transparency and Simplification of Rate Setting Procedures.

³³ IMF, *Financial System Stability Assessment*, SM/01/75, February 2001

³⁴ Its legal basis is contained in the Constitution (Article 87) and the General Law on the Financial System and the Insurance System and the Statutes of the Superintendency of Banking and Insurance (Law 26702 of June 1996).

strategy for distressed banks.³⁵ However, recent years have seen the proliferation of ad hoc and uncoordinated programs for assisting banks, and the actual and potential fiscal costs of those programs are not easy to identify. The BCRP supervises the interbank and exchange rate markets and the payments system, but does not have the authority to issue compulsory-purchase instruments, to impose limits on the composition of banks' loan portfolios, or to establish multiple exchange rates. In exceptional circumstances, it may set maximum and minimum interest rates to stabilize the market. The CONASEV regulates the securities market in accordance with the manual on best practices in monetary and financial policies.

Fiscal management framework

13. The legal and administrative framework for fiscal management is fairly comprehensive and public, but it is excessively fragmented among various legal provisions with different hierarchy and time span (most of them valid for only one year) that introduce uncertainty and instability.³⁶ There is no comprehensive legislation governing financial administration and budgeting that provide a basic and stable set of norms on major aspects of fiscal administration (budget process, cash management, public credit,

³⁵ The BCRP's lender-of-last-resort function is clearly defined and limited in its statutes. There is also a Deposit Insurance Fund that is financed by premiums on deposits and that has access to lines of credit from the Treasury, approved by Emergency Decree.

³⁶ The legal framework governing fiscal management includes: the Constitution (Articles 74-82 on the tax and budget regime); Law 27209 of December 2, 1999, on Government Budget Management; annual laws on the public sector budget, financial equilibrium and public sector borrowing; Law 27245 of December 23, 1999, on Fiscal Prudence and Transparency; Law 24680 of June 3, 1987, creating the System of National Accounts; Law 27312 of June 28, 2002, on Management of the Republic's General Account; Decree Law 19350 of April 4, 1972, establishing the procedure for making payments through bank sub-accounts of the Treasury account, amended by Decree Law 19463 of July 11, 1972, Decree Law 20517 of January 21, 1974, giving indefinite duration to procedures established in the two previous decree-laws; Decree Law 25907 of November 27, 1992, authorizing public entities to deposit funds in any entity of the national financial system, with the exception of funds from the Treasury; Decree Law 26162, regulating the National Controls System; Law 27066, expanding the powers of the Comptroller General; Legislative Decree 850 creating the Single National Registry of Audit Firms. In addition, the directives of the DGPP for the Programming and Formulation of Institutional Budgets for the Public Sector, for the Programming and Formulation and Approval of Institutional Budgets for Local Governments, for the Approval, Execution and Control of the Public Sector Budgetary Process, for the Execution and Control of the Institutional Budgets of Local Governments, Closing and Reconciliation of the Public Sector Budget, Programming of the Budgets of the Regulatory and Supervisory Agencies, Resource Administrators, Funds, Municipal Enterprises and Other Service Enterprises, for the Budgetary Process of Regulatory and Supervisory Entities, Resource Administrators, Funds, Municipal Enterprises and Other Service Enterprises, Classifiers for the Fiscal Year and Master Classifiers of Revenue and Financing and Glossary of Terms for the Budgetary Management System. Rules governing the cash management system: Supreme Decrees 310-1989, amending Decree-Laws 19350 and 19463 (referred to above), 347-1990 and 195-2001 and Directives of the General Directorate of the Public Treasury 077-1998 (close of operations for the preceding fiscal year), 051-2001 (procedures for the administration of directly collected revenue), 063-2001 (procedures for opening bank accounts for direct-and delegated-execution operations), 066-2001 (cash flow directives for 2002) and 079-2002 (amending the preceding directives). All these statutes can be found at <http://www.mef.gob.pe>.

accounting and supervision). Instead, there is a set of fairly complete regulations of fiscal administration focused primarily on financial and legal compliance rather than on outcomes. This framework is excessively complex and difficult to analyze³⁷ due to fragmentation into rules of varying ranking that, at times, cover a given regime only partially, or partially amend existing rules without necessarily respecting the legally established hierarchy of regulations, or that incorporate permanent provisions within rules applicable to a single fiscal year. On the other hand, the legal framework regulates a financial administration process in which programming and coordination of aggregate spending is highly centralized under the MEF, while execution and authority over spending amendments is widely decentralized among the budgetary entities. This situation, combined with the absence of an integrated financial information system, as discussed below, poses serious difficulties in terms of information and coordination. Finally, the lack of a more permanent legal framework governing the budget process and the treasury and credit operations means that important and constant aspects of financial management must be regulated through annual directives.

14. **The Constitution establishes the principle of legality for taxation.**³⁸ The Tax Code³⁹ sets forth the general principles, institutions, procedures and rules governing the tax law system. Taxes must be supported by specific legislation, except in the case of customs tariffs and rates, which are approved by the executive branch, since the annual budget law precludes tax measures. As well, specific legislation is required for exemptions, jurisdictional and administrative procedures, sanctions, penalties, and adjustments and guarantees for tax liabilities.

15. **Tax legislation is public and readily accessible, but is made very complex by the large number of exceptions and procedures for granting them.** Tax regulations are published in the official gazette, and SUNAT posts them on its website.⁴⁰ In addition to providing details on tax regulations, the web allows for online consultations (responses to which establish precedents), and for submission of complaints and suggestions. SUNAT has 20 direct service centers and ample informational material to assist taxpayers.⁴¹ The simplicity of the tax system and of the rules governing it has been severely compromised,

³⁷ The DNPP has found it necessary to prepare and publish a glossary of terms in order to standardize the meaning of important concepts not defined, or defined inadequately in the legislation.

³⁸ The government tax system is relatively simple and consists of the personal income tax, corporate income tax, general sales tax, excises tax, payroll taxes, and customs tariffs.

³⁹ Consolidated Text of the Tax Code, Supreme Decree 135-99-EF.

⁴⁰ See <http://www.sunat.gob.pe>.

⁴¹ SUNAT has published Standards for Providing Service to Taxpayers or the Public (Notice 016-2001).

however, by the large number of exemptions and highly differentiated treatment across sectors and regions, the frequent amnesties and the installment payment of tax liabilities.⁴²

16. **Taxpayer rights and resolution of tax disputes are clearly defined by law.** The Tax Code establishes the rights and duties of taxpayers and the system of sanctions. Tax decisions may be challenged by appeal to a higher authority within the tax administration. If the dispute is not resolved, the taxpayer may turn to the Tax Court, and ultimately to the ordinary courts of justice.

17. **The Ethics Code for the Civil Service has been recently enacted in law.**⁴³ The code is binding on all employees of the public administration, whether appointed to a regular career position, to a “trust” position, or to perform activities on behalf of the government. The code is based on principles of neutrality, transparency and accountability, and prohibits conflicts of interest, acceptance of improper advantages, or political advocacy.

B. Public Availability of Information

Publication of information

18. **Publication of detailed fiscal information within specific time limits is a legal requirement.**⁴⁴ The most important statutes in this area are the LPTF and the Law on Transparency and Access to Public Information (LTAIP). The LPTF requires the government to disclose its medium-term economic and fiscal policy objectives in the MMM, published at the beginning of June of each year, together with the technical opinion from the BCRP. The law also requires publication, within 60 calendar days after the end of each semester, of a report on compliance with the targets established in the MMM. The LTAIP includes extensive requirements for the publication of fiscal information.⁴⁵ In addition, the MMM

⁴² There are 98 special regimes for the income tax and 175 for the general sales tax. Four amnesty laws have been approved in the last two years.

⁴³ Law 27815 of August 2002

⁴⁴ The legal basis includes the LPTF and its regulations (Supreme Decree 039-2000-EF), Emergency Decree 035-2001-PCM, and the LTAIP (Law 27806 of July 2002). There are also specific provisions such as those referred to in footnote 31 governing public entities that fall under FONAFE.

⁴⁵ The law requires all entities of the public administration to publish their budgets on a quarterly basis, with details on investment projects underway, information on staffing levels and on contracting and procurement procedures, and to send this information to the MEF for posting on its website. The law also requires the MEF to publish the fiscal balance for the consolidated public sector within 90 calendar days after the end of the fiscal year, together with the balances for the two preceding fiscal years; quarterly information on revenue and expenditure of the Central Government and Decentralized Agencies covered by the budget law; drafts of the Borrowing, Financial Equilibrium and Budget Law and their rationale, within the first two working days of September; quarterly detailed information on the balance and profile of the external and domestic public debt owed or guaranteed by the public sector, and by creditor, amount, terms, and interest paid and payable; a timetable of quarterly disbursements and amortizations, by source of financing; quarterly information on public investment projects; the balance of the FEF within 30 calendar days after the end of the fiscal year; results of

(continued)

must contain an analysis of fiscal risks from substantial deviations in macroeconomic assumptions (with an indication of the contingency measures to be taken in case the deviations materialize), and estimates of tax expenditures. The LTAIP also requires consistency between the budget documentation and the MMM projections with regard to the fiscal balance and changes in the public debt.

19. **The calendar for publishing information is generally consistent with those in the Special Data Dissemination Standards (SDDS).** As a subscriber to the SDDS since 1998, Peru publishes information on operations of the consolidated public sector and on central government debt, within the time limits established, although there is a longer lag (five weeks) in publishing data on monthly operations of the central government. The MEF has recently begun to publish fiscal statistics in the Fiscal Transparency Bulletin (BTF) with a lag of three weeks. There is, however, no formal calendar for issuing the BTF.

Information on fiscal activity

20. **There is a great volume of information published on the central government, though there are differences in coverage among data sources.** The BTF of the MEF includes detailed monthly data on budget execution (revenue and expenditure) for the central government (LPSP coverage) and on nonfinancial public enterprises. In addition, quarterly data are published on financing of the consolidated public sector (LPTF coverage) and on the stock of public debt. With the recent amendment to the LPTF, the coverage of the BTF is expected to be consistent with the *Manual on Government Finance Statistics*. The BCRP publishes monthly data on the central government, the coverage of which is consistent with international standards, including the supervisory and regulatory agencies, MIVIVIENDA (an extrabudgetary mortgage fund) and ESSALUD (under FONAFE).

21. **The LPSP does not provide comparable information for the immediately preceding fiscal years, or forecasts for future years.** This is offered only in the MMM, within the LPTF coverage, different from that of the budget.⁴⁶ No information is included for reconciling the principal budget aggregates as originally approved with subsequent revisions and final execution. Annual changes in the presentation of budget documents make it impossible to conduct comparisons over time. The BTF provides historical data with budgetary coverage, which can be used for reference purposes.

the budgetary evaluation at the end of the fiscal year. The LTAIP also requires FONAFE to publish the consolidated budget for entities under its control; quarterly balance sheets and the savings, investment and financing account; and audited financial statements within 120 calendar days after the end of the fiscal year. CONSUCODE must publish quarterly statements of procurement and contracting by public entities, in detail and by budgetary item.

⁴⁶ It covers institutions and agencies of the central government, regional governments (under control of the central administration) and other decentralized agencies, as well as constitutionally autonomous bodies. It excludes local governments and their enterprises, the BCRP and the SBS.

22. **The PPSP for 2003 includes an estimate of tax expenditures, but provides no information on the contingent liabilities and quasi-fiscal activities of financial and nonfinancial public entities.** The draft budget for 2003 is the first to include tax expenditure estimates, which in the case of regional governments were imputed on the basis of an index of physical infrastructure shortages. There is no systematic quantification of public contingent liabilities, but the amendment to the LPTF contains a transitional provision requiring the MEF to determine and identify the types and legal bases of contingent liabilities.⁴⁷ There are quasi-fiscal operations in the public sector that the budget documents do not mention or attempt to quantify.

23. **There are various public sources of information with considerable detail on public financial assets and liabilities, but they are based on different methodologies and coverage.** The General Account of the Republic includes financial, treasury and public debt statements for the central government and for the public sector as a whole. With respect to medium and long-term public liabilities, the General Directorate of Public Credit (DGCP) maintains a database accessible on its website with historic annual data (from 1970 for external debt) and current quarterly data broken down between external and domestic debt, by creditor, currency and interest rate.⁴⁸ The information includes flow data on new loans, disbursements and debt service for the period, updated debt balance, and monthly debt service projections for the remainder of the year, and for future years until the outstanding obligations are repaid. Aggregate data on this basis are published monthly in the BTF. However, domestic public debt information from the DGCP and the BTF differs significantly from that published by the BCRP.⁴⁹ In terms of information on the net financial assets of the central government, the BCRP and the BTF publish only partial data, with differing coverage, but to some extent complementary.

24. **The fiscal balance is published for the general government and the public sector as a whole, though with differences in coverage.** The MEF and BCRP provide quarterly

⁴⁷ In June 2001, the MEF published a report on public liabilities, including contingencies, that serves as reference for updates. The most important obligations relate to the public pension system: the website of the ONP carries an updated actuarial calculation for the general pension scheme under Decree Law 19990, but no recent or consolidated calculations are available on obligations under the special regimes of Decree Law 20530 or the military and police pension funds. To cover this gap, Supreme Decree No. 106-2002-EF requires public entities to calculate the present value of pension liabilities. That decree, however, does not require entities to publish the method used for the calculation.

⁴⁸ <http://www.mef.gob.pe/DGCP/index.htm>.

⁴⁹ The MEF information is not consolidated for the public sector, as required by the Public Sector Borrowing Law, nor does it include short-term domestic debt. Moreover, it excludes the obligations of local and regional governments to BN, as well as certain public securities issued in the course of operations to support the financial system, and the outstanding obligations to contributors who have transferred to the private pension system. The BCRP makes such adjustments and publishes an estimate (using a methodology on which no details are provided) of outstanding obligations as well as the central government's short-term debts (overdrafts) to BN. It does not, however, include local government liabilities to private financial institutions.

fiscal information with a broad coverage, with a lag of approximately five weeks. The BTF information is based on the consolidated public sector as defined by the LPTF, which excludes local governments. Moreover, the coverage of general government in the BTF excludes local governments, ESSALUD and the regulatory agencies.⁵⁰ The classification presented by the BCRP (nonfinancial public sector and general government) is in line with international standards. With the amendment to the LPTF, the coverage under the LPTF also conforms with international standards.

C. Open Budget Preparation, Execution and Reporting

Budget documentation

25. **Budget documents specify medium-term economic and fiscal policy objectives, but do not include any analysis of fiscal sustainability nor do they indicate how the PPSP is linked to the objectives established in the MMM or in sectoral strategic plans.**⁵¹ The MMM, which is approved by the executive branch as a guide to preparation of the PPSP, presents three-year economic and fiscal policy objectives and, in particular, sets quantitative targets for the principal fiscal aggregates for the general government and for the consolidated public sector. The MMM also indicates the trend of the debt-to-GDP ratio for the following three years, consistent with the targets for the fiscal balance, but it does not include an analysis of fiscal sustainability. The recent amendment of the LPTF requires the MMM to include indicators of fiscal sustainability over the medium and long term.⁵² By law, the PPSP must also be consistent with the sectoral objectives established in the Institutional Operating Plans derived from the Multiyear Sectoral Strategic Plans (PESMs) that are approved each year by the MEF and the Presidency of the Council of Ministers (PCM).⁵³ Although the PESMs are not presented to Congress, they are summarized in the Statement of Objectives. The plans include no discussion of the relationship between budgetary programs and the fulfillment of institutional objectives, which makes it difficult in practice to monitor their consistency with the PPSP.

⁵⁰ In terms of budget documentation, the 2003 budget includes aggregated reference information on the budgets of local governments and other entities (regulatory and supervisory agencies, MIVIVIENDA, and municipal enterprises and entities).

⁵¹ In accordance with the Constitution (Article 78) and the LPTF (Article 11), budget documentation includes a statement of objectives, the draft public budget law, draft laws on borrowing and financial balance, the MMM and detailed revenue and expenditure annexes.

⁵² An initial fiscal sustainability exercise was conducted this year in the MEF and submitted to Congress in support of the PPSP.

⁵³ Article 55 of the Budget Management Law. The first medium-term National Strategic Plan was prepared for 2002-06. The National Plan merely compiles the PESMs, but does not set sectoral priorities.

26. **Macro-fiscal rules are defined by law and the executive branch is required by law to report to Congress on compliance with these rules.**⁵⁴ Constitutionally, permanent expenditure cannot be financed with borrowing.⁵⁵ The LPTF establishes quantitative limits on the consolidated fiscal balance and on non-financing spending by the general government, and it defines the circumstances and procedures for waivers. The LPTF also establishes rules on the balance and non-interest expenditure during election years, as well as rules on the accumulation and use of FEF funds for conducting anticyclical fiscal policy. In the last two years, the budget balance rule has been suspended by Congress, at the request of the executive branch, and the degree of compliance with the expenditure rules and the FEF has not been ascertained in either the MMM or the PPSP. The recent amendment to the LPTF introduces rules limiting the deficit and borrowing of subnational governments⁵⁶

27. **Although the PPSP is not based on a multiyear budget framework, it is formulated within a comprehensive and coherent macroeconomic framework.** Medium-term projections of fiscal aggregates are not based on comprehensive estimates broken down for different spending entities, nor can they provide proper linkage between the current and capital budgets. The macroeconomic framework is prepared by the MEF, prior to preparation of the draft budget, using a quantitative macroeconomic model.⁵⁷ The underlying assumptions are discussed in the MMM document. By law, the MEF must submit the draft MMM to the BCRP for a technical opinion on the macroeconomic framework and on the compatibility of fiscal policy with forecasts for the balance of payments and net international reserves, and with monetary policy.⁵⁸ Although the PPSP is consistent with fiscal targets in the MMM, the budget documentation does not explicitly indicate how that consistency is achieved. The MMM is approved by the Council of Ministers and published, along with the BCRP report, in full in the official gazette and at the MEF website. Amendments to the MMM must follow the same procedures as those for its approval.

28. **There is no analysis of fiscal risks in the budget documentation; while new revenue policies are identified, their impact is not quantified; and expenditure policy changes are not clearly distinguished.** The Statement of Objectives does not include sensitivity test of fiscal aggregates in the face of changes in economic parameters or other uncertainties, nor does it contain an analysis of the principal contingent liabilities. The

⁵⁴ Articles 12 and 13 of the LPTF.

⁵⁵ Article 78 of the Constitution.

⁵⁶ An evaluation of compliance with the LPTF during 2000 and 2001 is provided in “Peru’s Fiscal Challenges and Vulnerabilities” *Peru: Restoring Fiscal Discipline for Poverty Reduction* (Washington: World Bank and Inter-American Development Bank, October 2002)

⁵⁷ The model includes five blocs (supply, demand, external, fiscal and prices) and provides estimates for a three-year horizon, using 67 equations and quarterly information for the period 1993-2001.

⁵⁸ Article 11 of the LPTF.

document specifies, but does not quantify, new tax policy and administration measures that are to be adopted. The document does not distinguish clearly between existing and new expenditure policies in the PPSP.

Budget presentation

29. **The expenditure classification is not compatible with the analytical presentation in the *Government Finance Statistics Manual* and budget data are not always shown in gross terms.** The PPSP uses a functional programming classification. The PPSP is submitted and approved by budget institution, by source of financing, by function, by program, by subprogram, by activity, by project, and by generic expenditure group. The presentation facilitates administrative control but does not allow analysis of the economic impact, by program, of budgetary transactions. The PPSP proceeds directly from functions to activities and does not permit identification of budget allocations by program. Moreover, it includes a residual item for "other capital expenditure," which undermines the transparency of investment spending. Expenditure on wages is included as non-personal services under the goods and services heading. Tax revenue does not include commissions received by SUNAT, nor the municipal promotion tax (earmarked for the Municipal Compensation Fund (FONCOMUN)) levied at a 2 percent rate of the General Sales Tax (IGV) tax base.

30. **The PPSP does not present the budget balance nor does it provide a reconciliation between the PPSP and the fiscal target for the nonfinancial public sector (NFPS) set by the MMM.** The MMM shows the balance and aggregates for revenue and expenditure, both for the general government and the NFPS. However, the difference in coverage between the MMM and the PPSP, together with the lack of a clear methodological explanation of their linkage, makes it difficult to establish consistency between the fiscal target in the MMM and the draft budget. In neither the MMM nor the PPSP is there any statement on the accounting methodology for deriving the financial position of the NFPS.

Budget execution procedures

31. **The principles and standards of the public sector accounting are general in scope and consistent with international accounting standards, but are not applied in practice.**⁵⁹ The National Accounting Office defines, enforces and evaluates the accounting systems for institutions under the PPSP. The current chart of accounts was adopted in 1998, and since 1999 the Integrated Public Sector Financial Management Information System (SIAF-SP) has been in use for keeping official budgetary, financial and accounting records

⁵⁹ The norms for public sector accounting are part of the System of National Accounts (SNA) established by Article 145 of the Constitution, and regulated by Law 24680 of 2000. The SNA is under the responsibility of the National Accounting Office, and the Accounting Standards Council, which is the advisory agency for the SNA. That Council includes the Peruvian Federation of Accountants, the College of Public Accountants of Lima, and the faculties of accounting sciences of major universities.

on revenue and expenditure for public sector spending units.⁶⁰ In principle, the SIAF-SP provides full institutional coverage for the central administration and allows for recording at each phase of expenditure (commitment, accrual, payment). Although it includes three modules (budget execution, cash flow operations and accounting), it functions in practice as a financial management tool for that portion of public funds managed by the Treasury, covered also by a budget administration system in the National Directorate of the Public Budget (DNPP). The SIAF-SP does not currently have the capacity to record information on budget amendments, nor does it allow the formulation of monthly and quarterly budget allocations. Moreover, commitments are not properly recorded, because they are registered on the basis of monthly advances and not on the actual amount of contracts and orders placed. These limitations, together with the need for duplicate records, the methodological differences between the SIAF-SP and the DNPP system,⁶¹ problems with expenditure classification, its link to the chart of accounts, and incomplete recording of payments,⁶² impede the monitoring of payment arrears in a reliable way, or to reconcile the budget automatically with accounting and banking records.⁶³

32. The internal control system is partially operational and is being modified in order to reinforce its effectiveness.⁶⁴ Over the past decade, important regulations were issued with respect to internal control and resource management,⁶⁵ but in practice only one in three public entities observes those rules. Ex ante and simultaneous internal control rests exclusively with the officials of each entity, based on its internal procedures. Ex post internal control is exercised both by the head of each public entity and by the Internal Audit Office (OAI) which each entity is required to have by law. The OAI is responsible for conducting financial and management audits and special reviews that may include either financial or operational objectives, or both. The Office of the Comptroller General (CGR) is responsible for overseeing the installation and equipping of the OAI and, in this context, it approves and supervises annual audit plans for all public entities. The audit reports prepared by the OAI are not published but are submitted to the CGR, together with semi-annual evaluations of the

⁶⁰ Resolution 10 of 1997 from the Accounting Standards Council and Vice Ministerial Resolution 029 of 1998 from the MEF. Public enterprises are governed by international accounting standards for the private sector (IFAC).

⁶¹ A cancellation does not represent the same type of operation in the two systems.

⁶² The SIAF-SP does not record the payment phase when expenditure is financed by an external credit.

⁶³ A review of the expenditure classification and its relationship to the chart of accounts is currently underway. Efforts are also being made to improve the budget module so that budget formulation and amendments can be recorded in real time within the SIAF-SP. The improved version of the SIAF-SP will be implemented in 1,826 municipalities, before it is adopted at the national level.

⁶⁴ The National Control System was established in Article 82 of the Constitution, and amended by Law 27785 of 2002.

⁶⁵ CGR Resolution 072 of 1998 and Resolutions 123 and 126 of 2000.

annual audit plan. The recently approved National Control System Law has made the heads of the OAI administratively subordinate to the CGR.⁶⁶ In addition to the internal controls called for under the national control system, the DNPP exercises budgetary supervision by monitoring the execution of revenue and expenditure in accordance with the authorized budget and amendments thereunder.

33. **The Government Contracting and Procurement Law has a national scope and is based on principles of impartiality and transparency.**⁶⁷ The law establishes basic standards that public entities must observe in the selection processes, and indicates situations in which the law does not apply.⁶⁸ The amounts for determining the selection process are established each year by the LPSP. By law, every entity must approve and publish an Annual Procurement and Contracting Plan (PAAC) and must appoint a Special Committee of at least three members, on a permanent basis or for each selection process. Records on the selection process in each entity are public and any contract exempted from the general law must be approved by institutional resolution and published in the official gazette. Regulation and supervision of the contracting system is the responsibility of the Senior Council on Government Contracting and Procurement. That body is also responsible for administering the National Register of Contractors and the Register of Persons Ineligible for Government Contracts, which are public. Entities must provide quarterly reports to the Supreme Council on Government Contracting and Procurement (CONSUCODE) and CGR on their contracting procedures.⁶⁹ The Government Contracting and Procurement Tribunal acts as the highest authority for settling disputes during selection processes. Subcontracting is permitted, with prior approval of the public entity involved in the process, and any increase to a contract exceeding 15 percent in value requires approval by the CGR—once the new law on the national control system is approved.

34. **The Government Contracting and Procurement Law is frequently violated and there remain some important exceptions.** Fewer than half of the public entities have prepared a PAAC or adapted their internal organization to the requirements of the law. Waivers are invoked for emergency reasons without real justification in order to circumvent normal public contracting procedures, and the approval of additions to contracts is abused. Special contracting rules still exist for specific institutions, without justification, and the

⁶⁶ Previously, this subordination was only functional.

⁶⁷ Supreme Decree 012-PCM of 2001 and its regulations.

⁶⁸ Selection processes include bidding, public competition, direct award, and minor award. Exemptions from bidding and competitive procedures may be allowed for contracts for public services subject to single pricing, for emergency contracts, and for contracts in which goods or services allow no substitutes.

⁶⁹ Supreme Decree 031-PCM of 2002 contains the general policy guidelines for the Electronic Government Procurement and Contracting System (SEAC). Although public entities are being incorporated into the SEAC only gradually, as their infrastructure and technological conditions allow, it is expected that entities will begin to publish information on the selection processes in the SEAC, to be administered by CONSUCODE.

contracting process is frequently entrusted to private entities that are not subject to the same general regulations.

35. Procedures for hiring and remunerating government personnel are opaque and open to discretion. Fewer than half the workers in the executive branch are career civil servants,⁷⁰ and there is a variety of personnel regimes and remuneration schemes, subject to different principles, criteria and standards.⁷¹ The private activity regime, under which public enterprise employees are supposed to be grouped, has been widely extended to institutions of a clearly government nature.⁷² The hiring of personnel under contract without adequate regulation of rights and benefits (non-personal service contracts) is also widely used.⁷³ In the SIAF-SP, their pay is recorded as expenditure on goods and services, thereby underestimating personnel expenditure. The great variety of interpretations as to what does or does not constitute wage and salaries (interpretations that in fact can coexist within the same regime) has resulted in significant salary discrepancies for the same categories under different regimes, and even within the same regime. Contracts and pay arrangements of this type show up in projects associated with international agencies (UNDP, IDB, World Bank). Currently there is no entity issuing policy in this area, nor any reliable record of personnel working in the public sector.⁷⁴

Obligation to provide fiscal information

36. During the fiscal year, the executive branch is legally required to submit quarterly reports on budgetary execution to Congress and to the CGR.⁷⁵ Budget execution reports generally present the most recently amended revenue and expenditure budget, and compare this against execution. The reports usually take as reference for comparison the budget execution record for the preceding year, instead of the budget initially approved. The consolidated reports on financial execution of the PPSP are submitted quarterly by the MEF to Congress and the CGR, within 30 days after the end of the quarter.

⁷⁰ Legislative Decree 276 and regulations thereunder.

⁷¹ Not counting special careers for the diplomatic service, the defense sector and internal security, teachers, health professionals and university staff. In July 2001 an analysis of the personnel system was conducted by the Multisectoral Commission to Study the Situation of Personnel in the Central Public Administration.

⁷² Such as the judiciary, the Legislature, the CGR, superintendencies like SUNAT, and entities such as CONSUCODE.

⁷³ The system of non-personal service contracts is also used by the private sector.

⁷⁴ With a view to correcting these distortions, a draft law on the civil service is being prepared by the PCM: it calls for reorganizing public employees into an integrated civil service regime.

⁷⁵ Article 41 of the LGP and the annual budget laws. Actually, reports are submitted to the Committee on Budget and General Accounts of the Congress.

Similarly, quarterly reports on physical and financial execution of the budget are submitted separately by each entity of the PPSP to Congress and to the CGR.⁷⁶

37. **Constitutionally,⁷⁷ the executive branch is responsible for submitting to Congress the General Account of the Republic, together with the CGR audit report.** By law,⁷⁸ the General Account of the Republic contains financial statements, information on tax performance, budget execution, cash flow operations, public debt, public investment, social spending, special funds, and a general balance sheet for the public sector. The General Account must be submitted to Congress by November 15 following the fiscal year in question, and published about 15 months after the end of the year in question.⁷⁹ In the last four years, about 90 percent of entities have submitted information on time. The General Account is available at the MEF website, and the underlying documentation must be retained on file for at least 10 years, and must be open at all times to audit and inspection.

38. **A national system of performance evaluation of public entities is being developed and implemented.** The strategic planning process began in early 2000⁸⁰ with the preparation of Multiyear Strategic Sectoral Plans (PESMs) for 2001-05, and with the definition of qualitative and quantitative indicators for measuring and evaluating the performance of public entities. The MEF has coordination responsibility for the PESM measurement and evaluation system, as well as, for the publication of a semi-annual monitoring report on progress, at its website. The PESM evaluation is divided among: the spending units, which monitor input and output indicators; the budgetary entities responsible for monitoring strategic objectives and outcome indicators; and the institutional sectors, which evaluate the final impact of government activity. The first comprehensive semi-annual performance evaluation of PESMs for 2002-06 has yet to be conducted or published.

⁷⁶ Local governments and their decentralized public agencies must also submit reports on financial and physical execution of their budgets to the MEF, the Congress and the CGR, but on a semi-annual basis.

⁷⁷ Article 81 of the Constitution.

⁷⁸ Law 27312 of 2000.

⁷⁹ By law, entities must submit information for the General Account to the National Accounting Office by March 31 of the following year. The National Accounting Office prepares the General Account and submits it by July 31 of each year to the CGR, which then conducts and reports on its audit to the MEF. After the account is presented (together with the auditor's report) to the Congressional Committee on the General Account of the Republic on November 15, that committee has 90 days to examine it and issue an opinion, before the Congress makes a determination. If Congress does not issue a determination during this time, the opinion of the review committee is sent to the executive branch, which must promulgate the General Account by Legislative Decree within the next 15 days.

⁸⁰ Departmental Resolution 01-2000 of the DNPP and Ministerial Resolution 084-2001 of the MEF.

D. Assurances of Integrity

Data quality standards

39. **The balance for the general government and for the public sector is published, albeit with differing coverage.** The MEF and the BCRP present quarterly fiscal information with broader coverage, with a lag of about five weeks. Information in the BTF is based on coverage of the consolidated public sector as defined by the LPTF, which excludes local governments. The coverage of general government in the BTF excludes local governments, ESSALUD and the regulatory agencies. The consolidated classification presented by the BCRP (for the nonfinancial public sector, and the general government) is in line with international standards. As mentioned before, with the recent amendment to the LPTF, the coverage of the BTF is expected to be in line with international standards.

40. **Unlike the General Account of the Republic, the budget documentation prepared by the MEF does not explicitly indicate the accounting basis or the standards used in its compilation.** As noted earlier, the accounting regulations issued by the National Accounting Office as well as government's chart of accounts are of public knowledge and are published at the National Accounting Office (CPN) website.

41. **While the information presented in various fiscal reports is internally consistent, there are some problems of reconciliation between budget, accounting and banking data.** Reconciliation between the budget and the accounting information is not automatic and is done manually every quarter. The banking reconciliation reveals lags for certain operations involving extraordinary resources or delegated execution (through operating units), since the SIAF-SP deals only with spending units. Fiscal information meets the integrity standards of the SDDS.

Independent scrutiny

42. **The Office of the Comptroller General of the Republic (CGR) is an autonomous entity that exercises external control over the public sector.**⁸¹ The CGR is the technical agency responsible for the National Control System, endowed with administrative, functional, economic and financial autonomy in supervising, overseeing and verifying the activities and results of public management, and assessing administrative, management and internal control systems.⁸² The CGR is required to formulate a National Control Plan and, as

⁸¹ The legal basis for the CGR is found in Article 82 of the Constitution and the recently approved Organic Law on the National Control System and the Office of the Comptroller General (Law 27785 of July 2002). While the latter requires the CGR to prepare its budget and submit it to Congress for approval, in practice it is part of the public sector budget that the MEF prepares and submits to Congress. The CGR is responsible for public sector entities, private enterprises or those with government shareholding interest, and private entities, exclusively with respect to any state funds or assets that they may receive or manage.

⁸² The CGR exercises ex ante control over borrowings, additions to project contracts and military procurement. The recently approved legislation established a linkage (gradual, as permitted by budgetary resources) making

(continued)

noted earlier, to approve the annual internal control plans of individual entities. There is no legal obligation to evaluate the National Control Plan, which is prepared for purposes of complementing the approved internal audits. The plan is not published, and no evaluation of it has yet been made. The entities, for their part, must provide the CGR with a semi-annual monitoring report on their internal control plans. The CGR may require specific steps for internal control, to exercise ex post external control directly, or to contract an external audit firm, through competitive bids, to conduct external audits of entities under its authority, if they are in a position to cover the associated costs.⁸³ As well, an evaluation report on the General Account, prepared by the CPN, must be submitted each year to Congress. The CGR has recently launched a program to upgrade its in-house technical expertise and computer resources, which have lagged severely behind in the last decade.

43. **The CGR publishes decisions based on its audits and monitors compliance with its recommendations.** These decisions include general recommendations, imposition of penalties, or an order to initiate administrative and/or legal action. Detailed reports are withheld from publication, in order to protect individual rights and pre-trial evidence, but any legislator may request them. The CGR has the authority to supervise compliance with its recommendations, and to impose sanctions for noncompliance. The activities of the CGR are subject to congressional oversight, on the basis of an annual management report from the Comptroller General, who is appointed by Congress for a term of seven years. The CGR's audit practices are consistent with the international standards of the International Organization of Supreme Audit Institutions (INTOSAI).

44. **There is no formal mechanism for the evaluation of fiscal forecasts and of the underlying macroeconomic assumptions by independent experts.**⁸⁴ To date, there has been no ex post comparison of observed outcomes with previous projections, nor have the details of the macroeconomic and fiscal models used for these forecasts been published.⁸⁵ Nevertheless, as noted earlier, the LPTF requires the BCRP to issue an independent technical opinion. In addition, the MMM, which constitutes the basis for preparing the annual budget and which is published in advance of the budget's submission to Congress, serves as a mechanism for stimulating public discussion over medium-term macroeconomic projections and goals.

the heads of internal audit (including those of the armed forces and the national police) functionally and administratively dependent on the CGR, a move that will have the effect of diluting internal and external control responsibilities.

⁸³ Some 350 external audits have been recorded to date in 2002 (out of a total of 2,600 public sector entities), of which about 100 were conducted directly by the CGR.

⁸⁴ Nevertheless, the MEF held a seminar this year with private sector experts to discuss its forecasting models.

⁸⁵ The MEF is in the process of conducting ex post review of assumptions in the MMM, given the model-based macroeconomic forecasts.

45. **The National Statistics and Data Processing Institute (INEI), the country’s official statistical agency, is autonomous in technical matters and is a user of fiscal information for preparing the national accounts.**⁸⁶ INEI obtains annual data from the General Account of the Republic and the SIAF-SP, and coordinates with the BCRP to ensure reconciliation of the fiscal accounts with the national accounts methodology. The Constitution and the charter of the BCRP⁸⁷ require publication of the principal macroeconomic statistics. In this connection, the BCRP performs a more thorough reconciliation of the fiscal accounts with the rest of the macroeconomic accounts.

III. IMF STAFF COMMENTARY

46. Following a period of opacity and excessive discretionality in public finances, **in recent years the Peruvian authorities have taken significant initiatives to establish a financial management system that is generally transparent and, in some aspects, is close to internationally accepted good practices.** In addition to legislation on fiscal prudence and transparency, progress has been made in the budget process, the tax system, and the dissemination of fiscal statistics. Evidence of such progress includes: implementation of the SIAF-SP, strengthening of CONSUCODE, the increasing autonomy of the CGR, measurement of the tax expenditure budget, and the obligation of public sector entities to publish information (mainly through the websites on Economic Transparency and the BTF), in accordance with the LTAIP (Box 1). Consequently, Peru today compares favorably with other countries in emerging markets. Nevertheless, the authorities are aware that many of these improvements still require further effort. To this end, additional measures are planned to strengthen good practices within a coherent and stable institutional framework.

47. **Notwithstanding the initiatives under way, there are still areas that require attention from the authorities in order to avoid future risks.** Potential risks to medium and long-term fiscal viability arise from prevailing ambiguities in the demarcation of functions and responsibilities between the central government and the rest of the public sector—above all, the public financial institutions and subnational governments—and from certain shortcomings within the central government. These shortcomings include lack of resources for internal and external controls, the lack of transparency in human resource management, and proliferation of tax preferences (including frequent tax amnesties and facilities for extended payment tax arrears). Although a lesser degree of stability in the legal system is to be expected during this period of transition, it is essential for the longer term to

⁸⁶ INEI operates under the Law on the Organization and Functions of the National Statistics Institute, Decree Law No. 604.

⁸⁷ Article 84 of the Political Constitution of Peru and Articles 73 and 74 of the BCRP Charter.

Box 1. Recent Progress Toward Fiscal Transparency

Adoption of a Multiyear Macroeconomic Framework (MMM)

- Legal establishment of an MMM to provide the context for budget preparation. The MMM is approved by the Council of Ministers and disclosed to the public.

Reform of the budget system

- Adoption of Multiyear Strategic Plans in the 26 institutional sectors of the public administration.
- Introduction of accounting rules consistent with international standards.
- Development of an Integrated Financial Management Information System, with broad coverage including the traditionally secret sectors of Defense and Interior.
- Estimates of tax expenditures.
- Establishment of a pilot program for civil society participation into the capital budget for 2003.

Timely and compulsory disclosure of fiscal information

- Establishment of the Economic Transparency website, the monthly Fiscal Transparency Bulletin, and websites for public institutions.
- Annual and semi-annual publication of medium-term economic and fiscal policy guidelines through the MMM.
- Quarterly publication of budget execution, including detailed information on ongoing investment projects.
- Quarterly publication of the stock and contracting of the external and domestic public debt, including publicly guaranteed liabilities.
- Quarterly publication of audited balance sheets and financial statements for public enterprises.

Strengthening the Office of the Comptroller General (CGR)

- Expansion of the CGR authority over private entities, with respect to public resources and assets that they may receive or manage.
- Strengthening of the enforcement and sanctions capacity of the CGR.
- Greater CGR control over additions to work contracts.

Strengthening the procurement and contracting system

- Approval and publication of an Annual Procurement and Contracting Plan by each public entity.
- Introduction of the Electronic Government Procurement and Contracting System (SEAC).
- Issuance of regulations on secret military procurement and contracting.

Progress in regulating the nonfinancial private sector

- Definition of procedures for setting regulated prices.
- Public disclosure of information used by regulatory agencies.

ensure continuity in the rules of the game as they affect the private sector.⁸⁸ Currently, the availability and dissemination of voluminous and diverse information on public finances may be confusing. In many areas there is still a lack of relevant, timely and readily understandable information that is useful to the public, the Congress and the government entities. Generally speaking, the presentation of fiscal information needs to be adapted to the needs of users.

48. In order to maximize the benefits that fiscal transparency can bring to the quality of public management and its credibility in the eyes of the public and of financial markets, **a number of measures are proposed in key areas to supplement the progress already achieved, consistent with the authorities' declared transparency goals and with international good practice.** The measures recommended in some areas are likely to take more time and effort to implement than those recommended in other areas. On one hand, measures such as reorganizing and expanding fiscal statistics, as well as identifying and quantifying quasi-fiscal activities and contingent liabilities, could be implemented immediately. On the other hand, measures for enhancing fiscal transparency in inter-governmental relations, taxation, human resource management, strengthening the CGR and expanding the SIAF-SP will require legislative changes or technological innovations that may require more time. Major recommendations are summarized below.

Management and distribution of functions

49. **Legal redefinition of the scope of government.** The institutional scope of government should be expanded for fiscal purposes, by incorporating all decentralized public entities devoted essentially to noncommercial activities, so as to remove elements that inhibit functional transparency. Consistent with good international practice, the government sector should include all extrabudgetary activities that are wholly or mostly financed with public funds or that perform public services, but are currently classified outside of government.⁸⁹ At the same time, it is important to identify quasi-fiscal activities of public financial institutions and nonfinancial public enterprises.⁹⁰ This would lead to greater clarity in the management of those entities that are engaged primarily in financial or commercial activities in the rest of the public sector and that, though subject to government oversight (through FONAFE) and to accounting and pricing regulation or banking supervision, operate outside the budget process.

⁸⁸ The great majority of businesspeople view stability in the legal system as the most important measure for fostering employment in Peru; see the results of the Apoyo's opinion poll and Market Survey, *El Comercio*, October 18, 2002.

⁸⁹ In practice, the proposed change amounts to replacing the legal definitions of the government sector now found in budget management legislation and LPTF with the definition used for statistical purposes by the BCRP, without affecting the current economic and financial independence of these entities.

⁹⁰ This principle must, of course, also apply to any enterprise or financial institution or in the private sector. Moreover, the identification of quasi-fiscal operations extends to those that have no net budgetary impact as they are internally financed through cross-subsidies (ELECTROPERU, SEDAPAL, MIVIVIENDA).

50. **Transparency at the subnational levels of government and in intergovernmental relations.** The ongoing decentralization process is justified by aspirations for regional and local autonomy, and by its potential contribution to greater efficiency and equity in public management. Nevertheless, international experience suggests that decentralization brings with it risks to the stability and transparency of public finances. To minimize these risks, it is essential to clearly define expenditure responsibilities, and to identify tax revenue and other permanent sources of financing (beyond occasional sources such as the proceeds from privatization) at each level of government. Intergovernmental transfers should be based on sufficiently transparent criteria that will ensure vertical balance between the levels of government.⁹¹ As well, rules on borrowing should be strictly enforced with strong supervision and sanction capacity by the central government and with sound budget practices at the subnational level. In addition, without questioning the autonomy of subnational governments, they should be subject to the same degree of transparency in their management and control as central government entities, including the use of uniform accounting and information disclosure practices.⁹²

51. **Clarity in the management of human resources in the public sector.** The authorities are about to launch initiatives to standardize the civil service within a single regime as quickly as possible and to establish a salary scale that will reflect workers' productivity in various fields as well as labor market conditions. This standard treatment is expected to apply to all sources or channels of financing, including international agencies. These initiatives involve creating a detailed personnel database and drafting a legal and regulatory framework that will include different levels of government and the rest of the public sector.⁹³ Steps should also be taken to eliminate the appointment of the civil servants to state entities where this could give rise to potential conflict of interest. In addition to achieving greater transparency, all these steps should serve to enhance the efficiency and credibility of the entire public sector.

Fiscal management

52. **Transparent legal framework for fiscal management.** The tradition of annual revisions to budget management rules implies a considerable degree of instability and therefore a lack of transparency in the budget process. This practice should be replaced by drafting and approving a general budget and financial administration law, or budget code, that would lay down a permanent set of basic regulations for the principal aspects of fiscal

⁹¹ These criteria might include, for example, inter-regional equity and tax capacity, weighted with relevant quantitative indicators for determining intergovernmental transfers.

⁹² In particular, there is a need to identify the extensive quasi-fiscal operations conducted by municipal water and sanitation enterprises (in some cases without any pricing regulation), which produce deficits that require discretionary transfers from the central government.

⁹³ This database would have the same scope as the SIAF-SP. The legal framework will be based on drafts of the Executive Branch Organization Law and the Administrative Career Law.

administration (while allowing for occasional amendments in light of circumstances or methodological innovations). The general budget law should include rules governing the budget, cash management, debt management, accounting and control. To give the legal framework greater certainty and stability, regulations to the general budget law could consolidate many provisions that tend to be repeated in successive years and that are currently included in annual directives.

53. **Expanding the SIAF-SP and using it more effectively.** Despite progress in the design and application of the SIAF-SP in recent years, it still has shortcomings that prevent it from being used successfully as a tool for monitoring the various stages of the expenditure process, performing periodic reconciliations of the budget balance against the financial accounts, and measuring the budget balance on an accrual basis. The following steps are recommended as a way of turning the SIAF-SP into a truly integrated system that will serve these functions. First, its expansion of coverage to all expenditure regardless of how they are financed, that is, in addition to those financed from regular revenue. Second, proper recording of commitments so that the system can become a reliable tool for measuring payment arrears. To this end, recording should be based on the total value of contracts and orders and not on monthly advances for project execution. Third, clear treatment of any additional commitment, especially where this involves adding staff to the payroll of budgetary units. Fourth, identification of all expenditure items on the basis of classifiers that are compatible with international standards, and review of their relationship with the chart of accounts. Finally, full development of the budget module so that the budget management system of the DNPP can be dismantled. In this way, the SIAF-SP would offer real-time information on budget amendments and would make it easier to program monthly and quarterly budgetary allocations.

Taxation

54. **Enhancing transparency in the tax system.** Despite past efforts, there is still considerable scope for simplifying the tax system and making it more stable and transparent. Above all, this will require greater discipline in the legislative process so that, as with budget legislation, proposed amendments to tax laws and to the tax code are subject to executive oversight, at least in the sense that the opinion of the MEF on congressional initiatives should be not merely advisory but binding: this would help reverse the dizzying proliferation of exemptions and other tax preferences. In this area, the annual tax expenditure budget prepared by the SUNAT constitutes an important contribution to public debate. In addition, there should be greater clarity and stability in the drafting and application of the tax code. The frequent granting of tax amnesties and deferred tax payment plans pose the greatest threat to the transparency, credibility and integrity of tax administration.

Control and audit

55. **Strengthening audit capacity and functions.** The significant increase in the autonomy of the CGR should be accompanied by a substantial increase in material and human resources at its disposal. The latter would strengthen capacity to conduct performance

audits, in addition to compliance and financial audits, which in turn will require the design and monitoring of reliable indicators. However, senior audit officials of each budgetary entity under the administrative authority of the CGR is not necessarily a positive step, since it could undermine progress towards adequate internal controls (which can never be substituted by the external audit function) within each entity.

Fiscal information

56. **Reorganization and expansion of fiscal statistics.** The foregoing recommendations would facilitate the presentation of more reliable information for measuring and forecasting the fiscal position at different levels of government, as well as for the general government. Government accounts should include information on quasi-fiscal operations in the rest of the public sector; as a minimum, such operations should be systematically identified and, to the extent possible, their impact on the fiscal balance should be estimated.⁹⁴ An important step in reorganizing the fiscal statistics has been the adoption of a new institutional coverage of government in the recent amendment to the LPTF, which is close to international practice. Adjusting the government accounts in this way and consolidating them with those of public enterprises would allow measuring the nonfinancial public sector borrowing requirement and comparing it with that of other countries, and also assessing the sustainability of the public debt over the medium and long term.

57. **Consistency of budget documentation and reconciliation with other official reports.** The MEF has taken important steps to ensure the frequent dissemination of reports on annual budget forecast and execution and on the MMM for the public sector, in addition to the public sector statistics published by the BCRP. Three additional tasks remain to be addressed, however. First, the budget documentation should quantify any new policy measure whether it involves tax policy and administration or expenditure measures introduced in the annual budget, as well as the principal sources of fiscal risk. Second, budget execution and forecasts should be presented on a uniform basis of accounting and classification (economic and functional).⁹⁵ Third, the various presentations (ex ante and ex post) of public sector operations should be reconciled at a sufficient level of disaggregation. This would provide a baseline for evaluating fiscal performance and compliance with fiscal goals, consistent with the LPTF.⁹⁶ Overall, such a uniform presentation of public sector

⁹⁴ While it is relatively easy to estimate the cost of some government-type operations that are undertaken by commercial entities (for example, the financial cost of bank rehabilitation), it may be more difficult to measure the subsidy element contained in apparently commercial operations (for example, when BN makes loans to local governments). As indicated earlier, such operations at times include cross-subsidies that have no net impact on the public deficit but that are distortionary and affect the size of the public sector.

⁹⁵ As a minimum, the budget documentation should include original and revised estimates for major aggregates for the two fiscal years preceding the current one, and a forecast of the most important aggregates for the subsequent two years.

statistics would make it easier to set clear fiscal policy goals and facilitate a more informed budget debate. In the end, this would enhance the credibility of fiscal policy.

58. **Enhancement of the Multiyear Macroeconomic Framework (MMM).** In order to increase the transparency and the viability of fiscal policy, the mission recommends enhancing the MMM in two directions. On one hand, the MMM should incorporate an indicative multiyear budget program showing the major expenditure items in a manner consistent with the time frame, the methodology and the macroeconomic assumptions of the MMM. On the other hand, the MMM should be supported by medium- and long-term fiscal sustainability exercises, including information on the present value of contingent liabilities (as suggested in the following paragraph). Annual publication of such sustainability calculations,⁹⁷ together with the budget program (containing information on methodology and basic assumptions) in the MMM and in the budget documentation, would offer a true multiyear macro-fiscal framework as practiced in advanced economies and in some emerging markets.

59. **Information on contingent liabilities.**⁹⁸ Information on the stock of outstanding public debt (including the net stock of floating debt and other short-term liabilities) should be supplemented with information on the public sector's contingent liabilities. This will require statistics on the cumulative amount of guarantees, with a projection of their probable realization. As part of this exercise, it is important to prepare (subject to annual review) medium- and long-term forecasts of the financial situation of defined-benefit pension regimes of all public sector entities (including the *cédula viva* pensions under Decree 20530), since they constitute a growing future obligation of the general government.⁹⁹ Information on contingent liabilities is to be presented at present value, as a supplement to the real debt of the public sector. Forecast of contingent liabilities would facilitate the assessment of important sources of fiscal risk, in the context of medium- and long-term fiscal sustainability scenarios.

⁹⁶ Information contained in the MMM should of course be transparent in terms of methodology, parameters and other assumptions about underlying economic policy measures. Transparency in the accounting base and institutional coverage, as recommended, are essential for applying macro-fiscal rules in general.

⁹⁷ Although the LPTF require fiscal sustainability calculations, the only official presentation of such calculations to date was contained in a recent statement by the Vice Minister of Finance before the Congressional Committee on Budget and Public Accounts, (September 18, 2002).

⁹⁸ It is important to distinguish between guarantees that are certain to give rise to a government obligation, which represent actual liabilities, and those that might but will not necessarily result in a government obligation, to be considered contingent liabilities.

⁹⁹ These medium- and long-term forecasts should be published with information on the methodology used and on the underlying demographic and macroeconomic assumptions, including the discount rate used in present value calculations.

INTERNATIONAL MONETARY FUND

**Peru : Report on Observance of Standards and Codes—Fiscal Transparency:
Response by the Authorities**

Prepared by
the Ministry of Finance of Peru

April 6, 2004

The “Report on the Observance of Standards and Codes (ROSC) Fiscal Transparency Module” was prepared at the end of 2002, since then the Government of Peru has implemented many recommendations made in the report.

In particular, the difference between the coverage of the original Fiscal Prudence and Transparency Law and that used by the Central Bank of Peru has been resolved with the enactment of the Fiscal Responsibility and Transparency Law (law No. 27958, published on May 8th, 2003).

Specific Observations

Paragraph 2

There are only two definitions of coverage of the public sector. One is used in the Public Sector Budget law and the other is established by the Fiscal Responsibility and Transparency Law (LRTF). The latter is equivalent to the one used by the Central Bank of Peru and is also consistent with the IMF - Handbook of Public Finance Statistics.

Paragraph 3

It is important to highlight that the Fiscal Responsibility and Transparency Law (LRTF) establishes fiscal rules for both the regional and local governments (Article 1, numeral 2, subsections (a)-(e)).

Also, a proposed Fiscal Decentralization Law (FDL) --together with its background materials-- was published on December 31 2003 in the web page of the Ministry of Economy, in order to receive suggestions from specialists and the general public.

Subsection 16 of Article 1 of the proposed FDL envisages the enactment of legal rules that improve fiscal decentralization and increase the efficiency of tax collection, even at the local governments level.

Paragraph 4

Despite the fact that there is no formal restriction on local governments' domestic indebtedness, Banco de la Nación usually provides credit tied to the FONCOMUN [Fondo de Compensación Municipal] resources that each Municipality receives. Furthermore, the proposed FDL contains a chapter on indebtedness and fiscal rules, that complements those established in the Regional Governments Organic Law and the Fiscal Responsibility and Transparency Law.

Paragraph 13

With the regard to the lack of legislation addressing issues of budget and financial administration, the government has recently enacted the Public Sector Financial Administration Framework Law (Law No. 28112, November 28th, 2003). The main goal of this law is to "review the financial administration of the Public Sector, establishing basic rules for a comprehensive and efficient management of the processes linked to the collection and allocation of public resources (such as the registry and submission of appropriate information in order to promote the fulfillment of the responsibilities and duties of the Government, in a context of fiscal responsibility and transparency and maintenance of macroeconomic stability.

Regarding local governments, there is information available from the Integrated System of Financial Administration of the Public Sector (SIAF-SP). Also, the proposed FDL would require that regional and local governments prepare reports about economic and financial management, which is intended to improve the information available about the public finances prepared by both the Ministry of Economy and the Central Bank. This report will be available on the Internet.

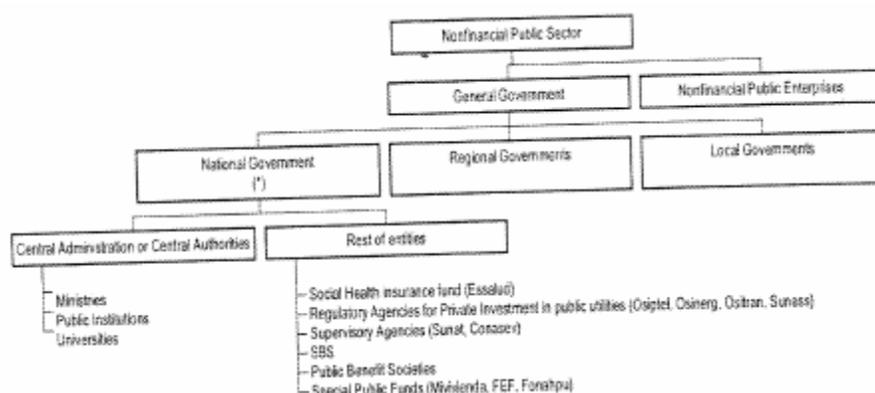
Paragraph 20

Since mid-June 2003, ESSALUD is no longer included under the coverage of FONAFE, restoring its administrative, economic, financial and budget autonomy (Law No. 28006).

Paragraph 24

The coverage under the LRTF includes local governments. Moreover, the Fiscal Transparency Bulletin (BTF) contains information based on the general government. Therefore, the statement that "the coverage of general government in the BTF excludes local governments" is no longer valid.

Coverage of Nonfinancial Public Sector in the LRTF



Paragraph 25

The Public Sector Budget (PPSP) is linked to the objectives established in the MMM. Both the MMM 2004-2006 and the Revised MMM 2004-2006 include budgetary information. It is important to highlight that this does not imply that there is a multiannual budget in Peru, because only the current budget year projection has legal backing.

According to the LRTF (Article 4), the MMM must include an analysis of fiscal sustainability. This analysis is contained in the MMM 2004-2006 (Box 7). Also, this document includes an analysis of sensibility of the fiscal outlook (Box 13).

Paragraph 29

The municipal promotion tax (IPM) is 2 percent and not, 2 percent of the value added tax (IGV) base. Currently, the VAT rate is 17 percent and the municipal promotion tax is equivalent to an additional IGV of 2 percent, giving a total IGV+IPM rate of 19 percent.

Paragraph 35

Recently, a census on the number of public workers and pensioners was concluded. It indicated that the total number of public servants at end-2003 was 1,568,282. Of this, 778,701 are permanent employees, 704,931 are pensioners, and 84,600 are hired by service contracts and others.

The study covered the national government, regional governments, military personal, non-personal services contracts and others. The sources of information are SUNAT, Banco de la Nación, and the DNPP Census 2003. The study results will be verified this year on the basis of information provided by each public entity.

Paragraph 39

This paragraph is not updated because the information in the BTF is based on the same coverage that is used by the BCR. This coverage is in line with international standards.

Paragraph 58

Suggestions to improve the MMM have been introduced. (See comment to paragraph 25).

Comments to Notes

Note 46

The LRTF coverage includes local governments. (See comment to paragraph 24.)

Note 47

The Public Pension Standardization Office (ONP) uses an updated actuarial calculation for the general pension scheme under Decree Law 19990. In the case of Decree Law 20530, ONP estimates the present value of pension liabilities with information from 1997 payrolls, estimating an aging rate of the workforce. At this moment, the present value of pension liabilities under Decree Law 19990 is US\$15,151 million and US\$24,415 million under Decree Law 20530.

Supreme Decree No. 106-2002-EF requires public entities to give information to ONP to calculate the present value of pension liabilities of each public entity.

The ONP publishes the methodology for the calculation of the present value of pension liabilities (Resolución Jefatural No. 052-96/ONP-JEFATURA).