

Peru

Public Financial Management Performance Report

Based on the Performance Measurement Framework (PEFA)

European Union

European Commission
European Commission Delegation
in Peru

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Document of the European Union, the World Bank and the Inter-American Development Bank

European Union	World Bank	Inter-American Development Bank
Head of Lima's European Commission Office: Ambassador Antonio Cardoso Mota Minister: Jean Charles Fiehrer Cooperation Attaché: Karl-Heinz Vogel	Vice President: Pamela Cox Regional Director : C. Felipe Jaramillo Sector Director : Elizabeth O. Adu Sector Manager: Roberto Tarallo Task Manager: Xiomara A. Morel	Vice President: Roberto Vellutini Manager: Alicia S. Ritchie Country Representative: Ana María Rodríguez Division Manager: Katharina Falkner-Olmedo Task Manager: Germán Zappani

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List of abbreviations and acronyms

AECID	<i>Agencia Española de Cooperación Internacional y Desarrollo</i> (Spanish International Cooperation Agency)
AOP	Annual Operating Plan
APCI	<i>Agencia Peruana de Cooperación Internacional</i> (Peruvian International Cooperation Agency)
APN	<i>Autoridad Portuaria Nacional</i> (National Port Authority of Peru)
BCRP	<i>Banco Central de Reserva del Perú</i> (Central Reserve Bank of Peru)
BN	<i>Banco de la Nación</i> (National Bank of Peru)
CAS	<i>Contrato Administrativo de Servicios</i> (Administrative Services Contract)
COFOG	Clasificación de las Funciones del Gobierno (Classification of Functions of the Government)
CG	<i>Cuenta General</i> (National Financial Statements)
CGR	<i>Contraloría General de la República</i> (National Auditor General's Office)
CIDA	Canadian International Development Agency
COFIDE	<i>Corporación Financiera de Desarrollo</i> (Development Finance Corporation)
CONSUCODE	<i>Consejo Superior de Contrataciones y Adquisiciones del Estado</i> (State Procurement Senior Council)
CPCG	Comisión de Presupuesto y Cuenta General de la República (National Budget and Financial Statements Congressional Committee)
CPP	<i>Constitución Política del Perú</i> (Political Constitution of Peru)
CSC	<i>Centro de Servicios al Contribuyente</i> (Taxpayer Services Centre)
CUT	<i>Cuenta Única del Tesoro</i> (Single Treasury Account)
DFID	Department for International Development of the United Kingdom
DGAES	<i>Dirección General de Asuntos Económicos y Sociales</i> (General Directorate of Economic and Social Affairs)
DGPM	<i>Dirección General de Programación Multianual</i> (Multiyear Programming General Directorate)
DIRESA	<i>Dirección Regional de Salud</i> (Regional Health Directorate)
DISA	<i>Dirección de Salud</i> (Health Directorate)
DNCP	<i>Dirección Nacional de Contabilidad Pública</i> (National Directorate of Public Accounting)
DNEP	<i>Dirección Nacional de Endeudamiento Público</i> (National Public Borrowing Directorate)
DNI	<i>Documento Nacional de Identidad</i> (National Identity Card)
DNPP	<i>Dirección Nacional de Presupuesto Público</i> (National Public Budget Directorate)

DNTP	<i>Dirección Nacional de Tesoro Público</i> (National Public Treasury Directorate)
DPL	Development Policy Loan
DRE	<i>Dirección Regional de Educación</i> (Regional Education Directorate)
DSA	Debt Sustainability Analysis
EC	European Commission
EsSalud	<i>Seguro Social de Salud del Perú</i> (Peru's Health Social Institute)
ETE	<i>Entidad de Tratamiento Empresarial</i> (Enterprise-class entity)
EU	European Union
FAG	<i>Fondo de Apoyo Gerencial</i> (Management Support Fund)
FCR	<i>Fondo Consolidado de Reservas Previsionales</i> (Consolidated Pension Reserve Fund)
FEF	<i>Fondo de Estabilización Fiscal</i> (Fiscal Stabilisation Fund)
FMV	<i>Fondo Mi Vivienda</i> (<i>Mi Vivienda</i> Fund)
FONAFE	<i>Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado</i> (Holding entity of public sector enterprises)
FONCOMUN	<i>Fondo de Compensación Municipal</i> (Municipal Compensation Fund)
FONCOR	<i>Fondo de Compensación Regional</i> (Regional Compensation Fund)
FONIPREL	<i>Fondo de Promoción a la Inversión Pública Regional y Local</i> (Regional and Local Public Investment Promotion Fund)
GAAP	Generally Accepted Accounting Principles
GC	<i>Gobierno Central</i> (Central Government)
GDP	Gross Domestic Product
GSN	<i>Gobierno Sub Nacional</i> (Sub-National Government)
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit / German Technical Cooperation
IAASB	International Auditing and Assurance Standards Board
IADB	Inter-American Development Bank
IATA	<i>Instituto de Administración Tributaria y Aduanera</i> (Customs and Tax Management Institute)
IAS	International Auditing Standards
ICE	Institutional Control Entity
IFIS	International Financial Information Standards
IFMS	Integrated Financial Management System
IGV	<i>Impuesto General a las Ventas</i> (General Sales Tax)
IMF	International Monetary Fund
INEI	<i>Instituto Nacional de Estadísticas e Informática</i> (National Statistics and Information Technology Institute)
INPE	<i>Instituto Nacional Penitenciario</i> (National Penitentiary Institute)
IPM	Impuesto de Promoción Municipal (Municipal Promotion Tax)
IPSAS	International Public Sector Accounting Standards
ISP	Institutional Strategic Plan

JICA	Japan International Cooperation Agency
KfW	Kreditanstalt für Wiederaufbau / German Finance Cooperation
MDA	Ministries, Departments & Agencies
MEF	<i>Ministerio de Economía y Finanzas</i> (Ministry of Economy & Finance)
MEFP	<i>Manual de Estadísticas de Finanzas Públicas</i> (IMF's Government Finance Statistics Manual)
MINEDU	<i>Ministerio de Educación</i> (Ministry of Education)
MINSA	<i>Ministerio de Salud</i> (Ministry of Health)
MMM	<i>Marco Macroeconómico Multianual</i> (Multiannual Macroeconomic Framework)
OASA	<i>Oficina de Abastecimientos y Servicios Auxiliares</i> (Procurement and Auxiliary Services Office)
OECD	Organization for Economic Cooperation and Development
OGA	<i>Oficina General de Administración</i> (General Management Office)
OGPP	<i>Oficina General de Planificación y Presupuesto</i> (General Planning and Budgeting Office)
PAC	<i>Plan Anual de Control</i> (Annual Control Plan)
PACE	<i>Portal de Adquisiciones y Compras del Estado</i> (State Procurement Portal)
PAED	<i>Programa Anual de Endeudamiento y Administración de Deuda</i> (Annual Borrowing and Debt Management Program)
PCM	<i>Presidencia del Consejo de Ministros</i> (Presidency of the Council of Ministers)
PEFA	Public Expenditure and Financial Accountability
PI	Performance indicator
PFM	Public Financial Management
PTD	Program of Telematic Declaration
PESEM	<i>Plan Estratégico Sectorial Multianual</i> (Multiyear Sector Strategic Plan)
PIA	<i>Presupuesto Institucional de Apertura</i> (Initial Institutional Budget)
PIM	<i>Presupuesto Institucional Modificado</i> (Modified Institutional Budget)
PMIP	<i>Planes Multianuales de Inversión Pública</i> (Multiyear Public Investment Plans)
RD	<i>Recursos determinados</i> (Earmarked Resources)
RDR	<i>Recursos directamente recaudados</i> (Directly collected resources)
REACT	Results and Accountability Program
RENIEC	<i>Registro Nacional de Identificación y Estado Civil</i> (National Registry of Identification and Civil Status)
RO	<i>Recursos ordinarios</i> (Ordinary resources)
RUC	<i>Registro Único del Contribuyente</i> (Single Taxpayer Registry)
SAGU	<i>Sistema de Auditoría Gubernamental</i> (Government Auditing System)
SBS	<i>Superintendencia de Banca, Seguros y AFP</i> (Superintendence of Bank, Insurance and AFP)
SDR	Special Drawing Rights

SEASE	<i>Sistema Electrónico de Adquisiciones y Contrataciones del Estado</i> (State Procurement Electronic System)
SECO	Swiss Secretariat for Economic Affairs
SEDAPAL	<i>Servicio de Agua Potable y Alcantarillado de Lima</i> (Lima Water and Sanitation Service)
SERVIR	<i>Autoridad Nacional del Servicio Civil</i> (National Civil Service Authority)
SIAD	<i>Sistema Integrado de Administración de Deuda</i> (Integrated Debt Management System)
SIAF-GL	<i>Sistema Integral de Administración Financiera – Gobierno Local</i> (Integrated Financial Management System – Local Government)
SIAF-SP	<i>Sistema Integral de Administración Financiera del Sector Público</i> (Public Sector Integrated Financial Management System)
SICON	<i>Sistema de Integración Contable de la Nación</i> (National Accounting Integration System)
SIDA	Swedish International Development Agency
SIS	<i>Sistema Integral de Salud</i> (Integral Health System)
SNC	<i>Sistema Nacional de Control</i> (National Oversight System)
SNIP	<i>Sistema Nacional de Inversión Pública</i> (National Public Investment System)
SNP	<i>Servicios no personales</i> (Non personal services)
SUNARP	<i>Superintendencia Nacional de los Registros Públicos</i> (National Superintendence of Public Registry Offices)
SUNAT	<i>Superintendencia Nacional de Administración Tributaria</i> (National Administration Tax Agency)
UGEL	<i>Unidad de Gestión Educativa Local</i> (Local Education Management Unit)
UIT	<i>Unidad Impositiva Tributaria</i> (Tax Unit)
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
VUSE	<i>Ventanilla Única de Comercio Exterior</i> (Foreign Trade One-stop Window)
WB	World Bank

PERUVIAN CURRENCY (UNIT OF ACCOUNT)

Peruvian Nuevo Sol (PEN)

CURRENCY EQUIVALENTS

Exchange Rates

(averages of April 15, 2009)

1 US dollar = 3.094 PEN

1 Euro = 4.089 PEN

FISCAL YEAR

January 1 – December 31

Introduction

With the evolution of European cooperation to Peru, and the possibility of budgetary support intended to encourage public policies, it was necessary to gain insight about the performance of the country's public financial management systems and practices. The European Commission retained a consulting team to prepare a report on the "Performance of Public Financial Management (PEFA - Public Expenditure and Financial Accountability) for the Republic of Peru."

This report was intended to be as comprehensive as possible, and included numerous visits and meetings with officials of the Ministry of Economy and Finance to gather relevant information. A series of meetings and communications were conducted with officials from various ministries and other institutions, including representatives of international cooperation agencies, authorities and officials of the World Bank and the Inter-American Development Bank; and, finally, the PEFA Secretariat who provided valuable guidance about the application of their framework.

This report is the result of a coordinated effort of the World Bank, the Inter-American Development Bank and the European Commission. We would like to note that the public financial management system in Peru, analyzed under the six dimensions of the PEFA performance measurement framework, operates properly in general, and it complies with international best practices. However, measures to address identified issues are in the process of being designed and implemented, so that the system will be further strengthened. This will be a decisive element to support development and poverty reduction in Peru.

We would like to thank all the stakeholders involved for their dedication to this study, especially the Ministry of Economy and Finance, which facilitated the work with its highly professional judgement.

We are therefore deeply pleased to present this report which, we hope, will contribute to enhancing and increasing the effectiveness of the cooperation offered by the people of Europe to Peru.

Antonio CARDOSO MOTA

Ambassador, Head of the
European Commission Mission in Peru

Preface

This report on the assessment of public financial management (PFM) in the Republic of Peru is the result of the joint work undertaken by the European Commission (EC), the World Bank (WB) and the Inter-American Development Bank (IADB) between September 15, 2008 and April 15, 2009. The core group in charge of the assessment was led by Karl Heinz Vogel, from the EC delegation in Peru, Xiomara A. Morel on behalf of the WB, and Germán Zappani on behalf of the IADB.

The study preparation team would like to thank the authorities of the MEF and of all other government institutions, which were involved in the PEFA assessment for their willingness and availability, as well as for their support and assistance in furnishing timely and relevant information and comments. In particular, we would like to highlight the leading role assumed by the Vice Minister of Finance, José Arista, in the performance of this task, and the ongoing support from Mr. Julio Mejía (MEF), who not only collaborated very closely on the arrangements for the field work and the facilitation of work meetings, but also shared his expertise regarding Peruvian public finance, thereby enabling the detailed treatment of the issues under analyses.

The assessment presented in this Report is the outcome of the field work undertaken by a team composed of Giovanni Caprio (head of the consulting team), Juan Carlos Aguilar, Bruno Giussani and Víctor Hugo Díaz,¹ commissioned by the European Commission (EC), and the reviews carried out by the teams from the institutions comprising the core group. The quality control of the report was provided by members of the WB and IADB teams lead by Xiomara A. Morel and Germán Zappani, and composed of José Valderrama, Enrique Fanta, Antonio Velandia-Rubiano, Joao N. Veiga and Francisco Rodríguez (WB), Héctor Rabade, Guillermo López, Carlos Pimenta, and Gonzalo Deustua (IADB).

The team would like to recognize the valuable support from the PEFA Secretariat and thank them for their active involvement, particularly, the role played by Franck Bessette, whose involvement in the opening workshop and in the review stage and his substantial contributions to the preliminary Report contributed to fulfilling the purposes of this assessment.

¹ Consultants from the company INTEGRATION GmbH, Frankfurt am Main, Germany.

The preparation of this study also benefited from the inputs and the support of Roberto Tarallo, Patricia Mc Kenzie, Enzo De Laurentiis, Livia Benavides, Jamil Sopher, Luis Barrantes, Gilma Unda and Elke Pinedo (WB).

The methodology developed by the Public Expenditure and Financial Accountability (PEFA) Project, was applied in this assessment, which was divided into several phases.

The first phase of the study –the field visit– took place in Lima between September 22 and October 10, 2008, and focused on the preparation of Section 3 of the report (except for indicators PI-23 and D-1 to D-3 of the methodology employed). During this phase, most of the information necessary for the assessment was received and reviewed in the meetings held with the main authorities of the Ministry of Economy and Finance (MEF), in particular the national directorates of Public Budget (DNPP), Public Treasury (DNTP), Public Accounting (DNCP) and Public Borrowing (DNEP), as well as the General Directorate of Social and Economic Affairs (DGAES), the General Management Office (OGA), the Multi-year Programming General Directorate (DGPM), the Integrated Financial Management System (SIAF) and the Institutional Control Office (OCI). In addition, other information was gathered from representatives of various spending ministries of the government, and from the Peruvian Congress, the National Auditor General's Office (CGR), the Central Bank of Peru (BCRP), the National Bank of Peru (BN), the Peruvian International Cooperation Agency (APCI), the National Tax Administration Agency (SUNAT), the State Procurement Council (CONSUCODE), the holding entity of public sector enterprises (FONAFE) and the Lima Chamber of Commerce. The team also received important information from a representative group of international cooperation agencies with technical and financial assistance programs in Peru. The field visit concluded with the presentation and delivery of a preliminary report on the work conducted.

The second phase of the work covered the period from October 13 to November 16, 2008 and was used to complete Sections 1, 2 and 4 of the document, in addition to the preparation of indicators PI-23 and D-1 to D-3. During this phase, the team received further information from Peruvian authorities that was relevant for the evaluation of Section 3; this enabled feedback received from Peruvian authorities, as well as from WB and IADB team members to be reflected in the draft report.

The third phase, which took place during November 24, 2008 to April 15, 2009, included consideration of the input from the PEFA Secretariat, together with the additional feedback and comments provided by MEF officials and other Peruvian authorities, all of which have been reflected in the final version, to the extent they were consistent with the methodology for this kind of assessment.

April 15, 2009

Assessment Summary

(i) Integrated Assessment of Public Financial Management

Budget credibility

Despite the significant differences found in the composition of actual primary expenditures as compared with the initial institutional budget (PIA), the central government's budget is a reliable financial tool. Budget credibility is primarily the result of a lack of payment arrears and conservative (cautious) revenue forecasting. In addition, a comparison between aggregate actual budget expenditures and the PIA shows that variations are within acceptable ranges.

Budget comprehensiveness and transparency

In general, the budget process in Peru is transparent. Documentation annexed to the Budget Bill submitted to Congress for scrutiny is comprehensive, and the general public has timely and ready access to key budgetary information. The budgetary process follows clear rules, and few instances of extra-budgetary expenditure have been observed. The aggregate fiscal risk that might arise from autonomous government agencies, public enterprises and sub-national governments is adequately regulated by law and properly supervised. The use of an acceptable budget classification system (into administrative, economic, and functional-programmatic allocations) contributes to transparency.

Policy-based budgeting process

Budget formulation is an orderly and institutionalized process, subject to budget ceilings approved by the Council of Ministers. A Budget Bill is submitted to and approved by the appropriate authorities within the time frames set forth in the Constitution. However, there are some delays in the issue of budget circulars and directives with regard to those embedded in the governing laws, thus effectively limiting the time available for public agencies to prepare their own institutional budgets.

The central government regularly conducts debt sustainability analyses (DSA), while the Multiannual Macroeconomic Framework (MMM) contains three-year fiscal forecasts. Although sector strategies are prepared considering current budgetary constraints and costs,

there is a strong multi-year inertial bias that limits the usefulness of such sectoral forecasts. Finally, ongoing investments do not always include estimates of future budgetary implications, particularly those related to recurrent expenditure.

Predictability and control in budget execution

Taxpayer obligations and liabilities are transparently recorded and reported. Taxpayers are registered in a comprehensive database system, with links to other relevant recording systems. Tax registration is mandatory, with penalties for non-compliance. Tax audits are based on clear risk criteria. However, tax arrears are still very high.

There are sound cash flow forecasts for the current fiscal year. These forecasts are regularly updated, allowing public institutions to program their expenditures at least one month in advance. While in-year budget adjustments are frequent, they are undertaken with relative transparency.

Public debt is accurately recorded and supported by good-quality data. The central government's functions of contracting for loans and issuing guarantees are conducted according to transparent criteria and specific fiscal targets that are defined by law. Most cash balances are regularly calculated and consolidated.

Payroll controls, controls in government procurement, and internal controls for non-salary expenditure are effective. Internal audit systems are efficient, although they suffer from limitations in financial and human resources, which inhibit these functions from being developed fully.

Accounting, recording and reporting

Budget execution is well documented and it is possible to monitor progress closely by means of the quarterly reports prepared by the MEF, which are sent to Congress and to the Office of the National Auditor General, as well as through the information published in the economic transparency website. The National Financial Statements (*Cuenta General de la República*) are prepared annually and submitted in a comprehensive document that contains information regarding revenues, expenditures, and financial assets and liabilities. Those Statements are audited within the legally-established time period. The budget allocation to each basic service delivery unit (primary schools and health clinics) is not specifically identified.

External scrutiny and audit

The annual audit of public institutions covers approximately 75% of the total expenditures set forth in the budget, and is conducted pursuant to the respective regulations and within the time frames established by law.

Legislative scrutiny of the annual budget bill is conducted in accordance with well established procedures, in compliance therewith and within a reasonable time period; however, the legislature's capacity to conduct these reviews is limited. The scrutiny of the National Financial Statements is performed in a similar way, and in a timely manner. However, in-depth hearings are held only occasionally with respect to the main conclusions, and the recommendations proposed to Congress are not always implemented due to lack of follow-up.

(ii) Assessment of the impact of public financial management weaknesses²

Aggregate fiscal discipline is well safeguarded in Peru; various elements of the public financial management system (hereinafter PFM) contribute to this, and they are analyzed according to the PEFA methodology in this assessment. The most significant items are the lack of payment arrears, the lack of extra-budgetary expenditures and the sound levels of fiscal revenue achieved, which are generally higher than those initially programmed under the PIA. The systematic robustness of the public debt sustainability analyses conducted by the government, and the quality of the data resulting there from, also influence aggregate fiscal discipline positively. Other functions contributing to aggregate fiscal discipline include: the establishment of good quality management transparency criteria, fiscal targets in support of borrowing by the central government, adequate oversight of the aggregate fiscal risk generated by other public sector agencies and aggregate expenditures that do not vary greatly from the PIA. Among the less favorable factors relating to aggregate fiscal discipline are that sector strategies and their associated costs are often not linked to the government's fiscal forecasts.

Peru's orderly budget preparation process, the comprehensiveness of the information included in budget documentation, the adequate coverage of the projects and programs funded by the international community in the government's reports, and a sufficient collection of consolidated fiscal data related to the central government, all taken together provide the necessary constituents for ensuring the *strategic allocation of resources*. A sound budgetary classification system combined with timely legislative scrutiny of the annual budget bill also enable the government to ensure that resources are allocated according to strategic priorities, albeit less significantly. However, this positive assessment is somewhat muted because of substantial variances between actual expenditures against PIA allocations for specific sectors, and by the fact that sector strategies are established without a clear linkage to multi-year fiscal forecasts. Finally, it should be noted that financial information furnished by the donors to the government for reporting on their support for programs and projects is incomplete and thus not helpful for establishing that resources have been allocated according to strategic priorities.

² For further details, see the tables in Annex 4.

The factors contributing to efficient and effective *service delivery* by Peruvian public sector agencies are: timeliness and reliability of information provided to sub-national governments on the allocations and transfers to them during the year covered by the budget; adequate forecasting and monitoring of cash flows; and efficient controls over payroll, government procurement and non-salary expenditures. The good oversight provided by the Office of the National Auditor General by way of its external audit function, also contributes to the effectiveness of public sector service delivery. However, there are some elements which constrain the efficiency and effectiveness of service delivery. These include: frequent budget adjustments (despite the relative transparency of the adjustment process) and the irregularity of legislative follow-up of audit reports submitted to Congress. In addition, because less than half of the external aid funds to the central government are managed in accordance with the national procedures, it is difficult to exercise oversight of projects funded with external aid. Finally, there is insufficient information being provided to enable tracking the resources actually allocated to each service delivery unit in the education and health sectors.³

The assessment of the extent to which the existing PFM system in Peru supports the achievement of aggregate fiscal discipline, a strategic allocation of resources and efficient and effective service delivery, is strongly influenced by the comprehensiveness of available fiscal information. In this context, the National Financial Statements are based on comprehensive information, submitted to Congress in a timely manner, and is based on reliable accounting standards (International Public Sector Accounting Standards, or IPSAS). Also budget execution reports are highly useful, the reconciliation of government bank accounts are performed in a timely manner, and the scope of the government's audit process is adequately broad.

In **conclusion**, the PFM system and practices in place in Peru –analyzed according to the six dimensions of the PEFA framework– function in an adequate manner, and in line with international best practices. There are relatively few weaknesses; those have been identified and the appropriate corrective actions are either being designed or implemented. These remedial efforts should lead to a subsequent strengthening of the country's PFM system, which in turn should contribute to support economic development and poverty reduction in Peru. The leading role assumed by the national government is essential to the success of the reform program. Table 1 summarizes the scores related to the performance indicators obtained by following the PEFA framework. The scores are further explained in Section 3 of this report.

³ Performance indicator 23 (PI-23).

**Table I. PFM Performance Indicators (PI) for Peru
(Standard indicators under PEFA methodology)**

A. PUBLIC FINANCIAL MANAGEMENT OUTCOMES: Budget Credibility		Scoring
PI-1	Aggregate expenditure out-turn compared to original approved budget	B
PI-2	Composition of budget expenditure out-turn compared to original approved budget	C
PI-3	Aggregate revenue out-turn compared to original budget	A
PI-4	Stock and monitoring of expenditure payment arrears	C+
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency		
PI-5	Classification of the budget	B
PI-6	Comprehensiveness of information included in budget documentation	A
PI-7	Extent of unreported government operations	A
PI-8	Transparency of inter-governmental fiscal relations	A
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	B+
PI-10	Public access to key fiscal information	A
C. BUDGET CYCLE		
C (i) Policy-Based Budgeting		
PI-11	Orderliness and participation in the annual budget process	A
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	B
C (ii) Predictability and Control in Budget Execution		
PI-13	Transparency of taxpayer obligations and liabilities	B+
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	A
PI-15	Effectiveness in collection of tax payments	D+
PI-16	Predictability in the availability of funds for commitment of expenditures	B+
PI-17	Recording and management of cash balances, debt and guarantees	B+
PI-18	Effectiveness of payroll controls	B+
PI-19	Competition, value for money and controls in procurement	B+
PI-20	Effectiveness of internal controls for non-salary expenditure	B+
PI-21	Effectiveness of internal audit	C+
C (iii) Accounting, Recording and Reporting		
PI-22	Timeliness and regularity of accounts reconciliation	B+
PI-23	Availability of information on resources received by service delivery units	D
PI-24	Quality and timeliness of in-year budget reports	C+
PI-25	Quality and timeliness of annual financial statements	A
C (iv) External Scrutiny and Audit		
PI-26	Scope, nature and follow-up of external audit	B+
PI-27	Legislative scrutiny of the annual budget law	B+
PI-28	Legislative scrutiny of external audit reports	C+
D. DONOR PRACTICES		
D-1	Predictability of direct budget support	A
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	C
D-3	Proportion of aid that is managed by use of national procedures	D

(iii) Prospects for reform planning and implementation

The government's process to reform and modernize PFM enjoys broad political support from the government and opposition parties, as well as from civil society organizations. The National Accord sets an example of the broad political will to improve the efficiency and effectiveness of the public sector; and, the increasing participation of regional and municipal authorities in decisions related to decentralization implies that they too are committed to enhancing the efficiency and effectiveness of their service functions.

The process of implementing the government's broad reform program is led by the Presidency of the Council of Ministers (PCM), jointly with the MEF in matters related to PFM. This high-level leadership implies strong support for implementation of the reform process. However, some isolated initiatives and duplication of efforts still exist. Some more effective coordination arrangements need to be created, involving all the stakeholders in the process.

Interventions in support of the state reform process require stronger harmonization efforts among the international donor community, especially with regard to the funding of programs and projects that aim to enhance the effectiveness of the Peruvian government in the short term. Lastly, it is important to highlight that external resources are still not transferred to the central government to be managed using national procedures.

Section 1. Introduction

The purpose of this section is to explain the context for this assessment, describe the process and methodology followed in conducting the analysis, and discuss the scope of the assessment performed.

Purpose of the report

This report is based on the PEFA methodology, and should be used by Peruvian authorities and officials as a baseline for monitoring PFM system and practices in the country. This report should also inform the dialogue between the government and various multilateral and bilateral development cooperation agencies on the status of PFM, and the strengths and weaknesses of reforms currently in progress or that may be proposed in the future. The report should also assist those development agencies in determining the country's eligibility for new budget support programs or verifying compliance with PFM-linked general or specific disbursement conditions of previously approved programs or projects. In addition, the report could lead to the development of an integrated public finances project or a broader public finances institutional support program, coordinated among various cooperation agencies.

PEFA Report preparation process

The European Commission (EC) financed the evaluation exercise, while the World Bank (WB) and the IADB were actively involved in all actions undertaken to prepare for the mission. Representatives from both agencies attended both the introductory meeting with the government at the EC local office (September 22, 2008) and the first meeting held in Peru between the consulting team members and the EC representatives. During the days following that meeting, the World Bank arranged several technical meetings held at its Lima Office with consulting team members, Bank specialists and IADB representatives.

On September 22, an introductory meeting was held at the MEF between the Peruvian government representatives, consulting team members⁴ and agency (EC, WB and IADB)

⁴ This group will also be referred to as the PEFA team or PEFA team members.

representatives. In addition, the Vice Minister of Finance, José Arista, the heads and key staff of various MEF directorates (Budget, Treasury, Accounting, Borrowing, Economic Affairs and Multi-year Programming) attended the meeting.

On September 23, Luis Valdivieso, then Minister of Economy and Finance, and the Ambassador to the EU, Antonio Cardoso, conducted the formal introduction of the PEFA mission. That meeting was joined by the Head of EC Cooperation, Jean-Charles Fiehrer, and the EC Cooperation Attaché, Kart-Heinz Vogel. Other attendants were the World Bank's Regional Director for Bolivia, Ecuador, Peru and Venezuela, Carlos Felipe Jaramillo; the Head of Cooperation of the Canadian International Development Agency (CIDA, Canada), Rebecca Mellett; Franck Bessette, of the PEFA Secretariat in Washington, D. C., and representatives of the EC, the WB, the IADB, and the cooperation agencies of Belgium, Switzerland (SECO), Germany (GTZ), Japan (Japan International Cooperation Agency, JICA) and the United Kingdom (DFID).

On September 25, Franck Bessette and the members of the PEFA team conducted an introductory workshop with representatives from the various MEF directorates, the National Budget and Financial Statements Congressional Committee (CPCG), the National Auditor General's Office (CGR), the Central Reserve Bank of Peru (BCRP), the holding entity of public sector (FONAFE) and representatives of the various international cooperation agencies (EC, WB, IADB and IMF). During that one-day workshop, the basic elements of the methodology used for the PEFA framework and its application to the Peruvian context were elaborated, and several sample information-seeking exercises were conducted.

Prior to the completion of the field work, on October 7, the PEFA team members presented the preliminary results of the exercise to MEF, at a meeting held with the Vice Minister of Finance and the general directors of MEF. WB and IADB representatives also participated in the meeting. On October 9, the PEFA team made a similar presentation to the EC delegation in Lima, with representatives of several EC Member States (France, the Netherlands, Spain, Sweden, Romania and Belgium) as well as APCI also in attendance.

On October 15, the head of the PEFA team, Giovanni Capri, presented the preliminary results of the exercise at the EC's office in Brussels (AIDCO). Several representatives of AIDCO (which executes the EC's development aid), including Paolino Corda and Marco Formentini, attended to this meeting, as did other AIDCO and RELEX (Foreign Affairs) officials.

Methodology for the development of the report

The data survey methodology included several components (some mentioned above):

- Initially, and prior to the field mission, existing PFM data and documents were collected from the various Peruvian government websites, and from those of the WB, the IADB, and the EC as well as other agencies (IMF, UNDP, OECD).

- This initial effort was supplemented by an introductory workshop held with the main PFM stakeholders in the country. About fifty public officials and several representatives of international cooperation agencies took part in the workshop.
- The process continued with the collection of statistical data as programmed and executed from the budget years 2005, 2006 and 2007; consistency checks were applied using Excel worksheets by cross-referencing data from different sources.
- The interviews and work sessions at the MEF and line ministries, conducted with officials from the national and general directorate level, deputy directors and, subsequently, technical staff, were the major tasks of the field mission. In addition to technical staff from the ministries, the team met with representatives from SUNAT (National Tax Administration Agency), the CGR, the National Bank of Peru, CONSUCODE (State Procurement Council), APCI, the National Congress and the Lima Chamber of Commerce.
- At the end of the field mission, several control interviews were held to determine the soundness of the information gathered.

Scope of the assessment as provided by the report

The exercise based on the PEFA methodology covered approximately 63% of the Peruvian Public Sector Budget, with a major focus on the financial activities carried out by central government agencies (National Government). These entities include: the various ministries (16), autonomous constitutional agencies (8)⁵ and decentralized public agencies (33).

Decentralized public agencies are entities attached either to ministries or other entities with the same rank as ministries, but not to autonomous constitutional agencies. For example, APCI is attached to the Ministry of Foreign Affairs; the National Statistics and Information Technology Institute (INEI), the Voluntary Fire-fighters General Corps of Peru and the National Radio and Television Institute of Peru are attached to the Presidency of the Council of Ministers; the National Port Authority (APN) is attached to the Ministry of Transport and Communications; the National Penitentiary Institute (INPE) and the National General Archive are attached to the Ministry of Justice, and the National Library of Peru is attached to the Ministry of Education.

⁵ Autonomous constitutional agencies are: (i) the National Auditor General's Office; (ii) the Public Prosecution; (iii) the Office of the Ombudsman; (iv) the National Judicial Council; (v) the Constitutional Tribunal; (vi) the National Elections Court; (vii) the National Office of Election Processes; (viii) the National Identification and Civil Registry (RENIEC). Altogether, these agencies account for 1.25% of the public expenditure programmed for 2007.

In Peru, the aggregate of a ministry and one or more public decentralized agencies comprise a sector. It should be noted that a ministry's budget does not include the budget of its attached entities. The sector budget, however, includes the entire budget for the ministry and its attached entities, with all of them being designated as "budget implementation agencies" (*pliegos presupuestales*).

The central government's autonomous agencies excluded from this assessment –namely, the 33 public universities and the 17 enterprise-like entities (ETEs)– account for approximately 6% of 2007 programmed public expenditure. The team members have worked regularly with, and thus are knowledgeable about, two major ETEs: CONSUCODE and SUNAT.⁶

Sub-national governments (also not included in the scope of this assessment) may be divided into two groups: (i) the 26 regional governments, representing approximately 17% of the 2007 programmed public expenditure; and (ii) the 1834 local governments, comprising 14% of said expenditure.

Table 1.1 below summarizes the composition of the public sector budget by jurisdictional classification. The scope of the assessment is restricted to the central governments, excluding other autonomous agencies and subnational governments.

Table 1.1. Composition of the Public Sector Initial Budget, 2007

Institution	Number of entities	Percentage of aggregate public expenditure
Central government*	59	63.3%
Other autonomous agencies	50	5.9%
a) Public universities	33	3.2%
b) Enterprise-like entities	17	2.7%
Sub-national governments:	1,860	30.8%
a) Regional governments	26	16.8%
b) Local governments / Municipalities	1,834	14.0%

* Including 8 autonomous constitutional agencies and 33 decentralized public agencies.

Source: Team estimates from 2007 PIA budgetary data.

⁶ Although they are categorized as ETEs, such entities actually perform government roles and are part of the central government. For practical reasons, they were excluded because they did not report through the SIAF (Integrated Financial Management System) but through other means.

Section 2. Information on the country general situation

The purpose of this section is to provide general information about the Republic of Peru, the core characteristics of the PFM system in place in the country, and the reforms currently under way.

2.1. Description of the economic situation

Context

With a population of 27.9 million inhabitants (2007) and an area of approximately 1.28 million square kilometers, the Peruvian economy has been one of the best performers in Latin America in recent years. This performance is largely the result of good macroeconomic policies, the discipline shown by the authorities in enforcing those policies, and a relatively favorable international economic climate. The real gross domestic product (GDP) grew consistently at an average of over 6.5% per year between 2002 and 2008. Over the last three years (2006 to 2008), GDP increased on average by more than 8.5% per annum. Until 2006, the average annual inflation rate was very low (2.0% per year between 2002 and 2006); however, inflation increased to 3.9% and 6.7% by the end of 2007 and 2008, respectively, due to increases in international oil and food prices. Per capita income increased steadily (both in real and nominal terms) between 2000 and 2008, reaching US\$3,450 in 2007.⁷

In recent years the Peruvian economy has benefited from increases in prices for its raw materials in global markets. However, this growth has been sustained by dynamic domestic demand, supported by public and private investment. Consumption and investment have each contributed about 5 percentage points to annual growth (World Bank, 2008: 3). Growth has also been attained in nontraditional sectors, characterized by increasing exports and improvements in productivity. Between 2002 and 2008, exports grew on average by approximately 25% per year. Imports also increased, albeit not so rapidly, resulting in an annual average trade surplus of 7% of GDP during 2005 to 2008.

⁷ This equals the gross national income calculated according to the Atlas method, and expressed in current US Dollars (source: World Bank, www.worldbank.org).

The poverty data for Peru shows that the level of growth during this period had a positive impact on the quality of life in general: between 2004 and 2007, the poverty headcount decreased by 9.3%, from 48.6% to 39.3%. While such a decrease is sharper in the Lima metropolitan area and in coastal areas (both rural and urban), poverty in general also fell in all mountain regions.⁸ Likewise, extreme poverty levels tended to decline during the same period. At the national level, extreme poverty decreased by 3.4% (from 17.1% to 13.7%) and it declined in all coastal and mountain regions; it fell sharply in the Lima Region (from 1.3% to 0.5%).⁹

Additional data indicates the positive impact of recent economic growth. For instance, the 2007 national census shows an improvement in the population's living conditions. In particular, there has been an increase in access to basic services: the population with access to drinking water now exceeds 70.0%, and those with access to electricity verge on 80.0%. The number of households without sanitation services decreased by 3 percentage points, and educational levels show considerable improvements, with the illiteracy rate dropping to 10.0%. Infant mortality rates have dropped from 24 to 18 per 1,000 live births between 2005 and 2007 (INEI 2007 and MEF 2008). The employment rate has improved in recent years, coupled with an increase of 16% in average real income. In addition, unskilled-workers salaries have increased more than skilled-workers salaries (World Bank, 2008: 6).

Despite all the positive factors mentioned above, the Peruvian economy is currently faced with very difficult international economic conditions. The subprime crisis in the United States gave rise to a severe global recession lately, following a rise in inflation.¹⁰ The rate of economic growth, which was 10.3% in the first three quarters of 2008, slowed to 6.7% in the fourth quarter of that year. By the end of 2008, inflation had climbed to 6.7%, although there are some recent signs of reduction. The terms of trade fell by 13.3% in 2008. The international crisis is expected to continue affecting the Peruvian economy adversely during 2009, with persistent signs of volatility and uncertainty.

In this context, an Economic Stimulus Plan is being implemented by the Peruvian Government. This plan contains expansive monetary and fiscal measures intended to mitigate the impact of the international situation on the domestic economy, while attempting to prevent an inflationary rebound and allowing for a relatively fast return to robust, sustainable growth.

⁸ Source: National Statistics and Information Technology Institute (INEI).

⁹ *Ibid.*

¹⁰ In fact, the rise in inflation has causes, such as the rise in the prices of oil and food (corn, vegetable oils, soybeans, among others), that are usually associated with the high global economic growth. The global recession is now likely to be causing a reduction in inflation.

Global public sector reform program

The global public sector reform program focuses on three priority areas: economic growth, improved social development and modernization of public sector institutions. These government priorities are reflected in the 2009 budget, which initially included a 20% increase in public investment (MEF, 2008: 10). In view of the deteriorating international situation, the government now plans to increase public investment by 50%, with much of the increment being channeled to infrastructure. In 2009, the government reiterated that the fight against poverty and the improvement of various social indicators such as malnutrition, access to and quality of education, health and sanitation services will be the main target of macroeconomic policy (MEF, 2009: 9; FMI, 2008: 35¹¹). Government priorities are taken into account with sound, prudent macroeconomic policies aimed at generating a fiscal surplus in the good times (together with a reduction in the public debt to GDP ratio); these policies enhance the government's response capacity in a period of deteriorating external conditions. In January 2007, the IMF approved a stand-by agreement for Peru for 172.37 million special drawing rights (SDRs) over 25 months. In addition, Peru has signed or is negotiating several free trade agreements, which create new opportunities and enable better access to new markets.

Rationale for PFM reforms

To support economic growth, an important policy priority for the government is to enhance the efficiency and effectiveness of public expenditure. Currently, the government is implementing fiscal policies that have the objectives of improving the quality of expenditures, improving tax management systems and processes, and closely managing public debt. More recently, the government has focused on applying result-based budgetary techniques, improving the Public Expenditure Monitoring and Evaluation System, and implementing the National Public Investment System at a decentralized level. In addition, the government attempts to be as transparent and efficient as possible in applying budgetary and other public sector processes. Regulatory quality and improved administrative management are two additional priority elements of the government's PFM reform program.¹²

¹¹ Letter of Intent sent by the Peruvian Minister of Economy and Finance to the Managing Director of the IMF, in which he specifies that strengthening the Poverty Reduction Strategy is a high priority for the government.

¹² The government's PFM reform programs are and will continue to be supported by the WB and the IADB (through three DPLs, the fiscal management and competitiveness loan in the case of the WB; and the III Public expenditure and management quality improvement program in the case of the IADB).

2.2. Description of budgetary outcomes

Fiscal performance

Fiscal policy has been well managed in recent years. The central government had a slight deficit in 2005, which became surpluses of 1.3% and 1.6% of GDP in 2006 and 2007 respectively. The same trend can be observed in the non-financial sector of government (Table 2.1):

**Table 2.1. Central government budget
(As a percentage of GDP)**

	2005	2006	2007 (preliminary)
Total revenues	15.8	17.4	18.0
Total expenditure	16.6	16.1	16.4
- Non-interest expenditure	14.7	14.2	14.6
- Interest expenditure	1.9	1.9	1.8
Central Government Aggregate deficit (-) / surplus	-0.8	1.3	1.6
Central Government Primary surplus	1.1	3.2	3.4
Aggregate deficit (-) / surplus of the non-financial public sector	-0.3	2.0	3.0
Net financing of the non-financial public sector	0.3	-2.0	-3.0
- External	-1.3	-0.4	-0.9
- Domestic	1.6	-1.7	-2.3

Sources: Team calculations based on MEF, 2008 and IMF, 2008: 24.

The good fiscal policy outcomes are reflected in an improvement in the overall collection of tax payments. Central government revenues have grown significantly between 2005 and 2007, from 15.8% to 18.0% of GDP; the rate of increase exceeds the GDP growth rate, while expenditures have been largely contained (they decreased slightly in relation to GDP).

Good fiscal performance enabled transfers to the Fiscal Stabilization Fund (FEF), which was established to retain reserves for use during unfavorable economic cycles. Every year, the FEF receives fiscal savings generated by budgetary surpluses, as well as the revenue from privatizations and other sources. The FEF may only be used for expenditures related to poverty reduction programs, with an upper limit of 40% of the FEF balance per year. If the amounts retained by the FEF were to exceed 2.0% of GDP, the budgeted allocations would be used to make prepayments of public debt.¹³

¹³ Fiscal Transparency and Accountability Law (Law No. 27958) of May, 2003, Article 7.2.

During the period under analysis, external debt as a percentage of GDP has been significantly reduced, from 28% in 2005 to 19.6% in 2007. Domestic debt grew from 9.7% of GDP in 2005 to 10.8% in 2007. As indicated in Table 2.1, debt interest expenditures remained stable in 2005 and 2006 and decreased slightly in 2007.

Allocation of resources

Budget allocations for the three-year period under analysis (2005-2007) reflect the government's priority with respect to social improvements. There was a sustained contribution of resources to the education sector, together with a significant increase in the health sector (a 23% increase in 2006 and 2007 as compared to 2005). Moreover, the resources allocated to transport have also increased considerably (nearly 70%) in 2006 and 2007 over 2005 (Table 2.2).

**Table 2.2. Budget allocations executed for the most important functions
(As a percentage of total expenditure)**

	2005	2006	2007 (preliminary)
Education and culture	17.7%	17.4%	17.4%
Health and sanitation	8.9%	11.0%	11.0%
Social security and welfare	23.9%	21.8%	21.2%
Agriculture and fishing	2.0%	2.8%	3.0%
Transport	3.5%	3.6%	6.1%
Justice	2.6%	2.7%	2.5%
Defense	11.8%	11.6%	10.5%
—	—	—	—
Total	100%	100%	100%

Source: Team calculations based on executed budget data from the MEF's Economic Transparency website:
<http://transparencia-economica.mef.gob.pe>

The budget allocations executed per economic categories also reflect the government's priorities regarding development. A relative increase of capital expenditures (investments) can be observed between 2005 and 2007 (from 11.23% of total expenditure to 13.13%). In addition, the relative increase of transfers during the same period evidences the enhanced developmental role of regional governments and municipalities.¹⁴ This classification also shows the relative decline of payroll and interest expenditures.

¹⁴ Between 2006 and 2007, inter-governmental transfers grew by 78% in current Peruvian new soles (team calculations based on real budget data from the MEF Economic Transparency website: <http://transparencia-economica.mef.gob.pe>).

**Table 2.3. Actual budgetary allocation by economic classification
(As a percentage of total expenditure)**

	2005	2006	2007 (preliminary)
Current expenditures	88.77%	87.73%	86.87%
- Payroll	26.61%	25.64%	23.25%
- Goods and services	20.57%	20.82%	19.63%
- Interest payments	11.70%	11.63%	10.77%
- Transfers	29.90%	29.63%	33.22%
Capital expenditures	11.23%	12.27%	13.13%
Total	100%	100%	100%

Sources: Team calculations based on MMM 2007-2009, 2008-2010, 2009-2011 and IMF, 2008: 24.

2.3. Description of the legal and institutional framework of public financial management

Peru has a sound legal framework for PFM. The 1993 Political Constitution of Peru covers the basic aspects related to tax issues, public debt, government procurement, budget preparation and execution and external oversight (by the CGR and Congress).¹⁵ Various laws, decrees and regulations provide specific details on the implementation of these functions. Table 2.4 enumerates the constituents of Peru's legislative framework for PFM.

Table 2.4. PFM Legal Framework

<p>MEF (DNPP, DNTP, DNCP, DNEP)</p> <ul style="list-style-type: none"> - General Law on the National Budget System (Law No. 28411 of January 1, 2005) - Law on the Framework for Public Sector Financial Management (Law No. 28112 of November 27, 2003) - General Law on Public Borrowing (Law No. 28563 of June 25, 2005) - Directive No. 013-2001-CG/B340 on the Rules for Financial Information Audit and Special Examination of Budget Information prepared for the National Financial Statement by public sector entities, 2001 - General Law on the National Accounting System (Law No. 28708 of April 12, 2006) replacing the Law on CGR Management (Law No. 27312 of July 19, 2000) - General Law on the National Treasury System (Law No. 28693 of March 21, 2006) - Law establishing the National Public Investment System (Law No. 27293 of June 28, 2000) - Executive Decree sanctioning the Directive for Public Investment Multi-year Programming (No. 176-2006-EF of November 18, 2006) <p>National Auditor General's Office</p> <ul style="list-style-type: none"> - Charter of the National Audit System and Office of the National Auditor General (Law No. 27785 of July 22, 2002) <p>Procurement</p> <ul style="list-style-type: none"> - Legislative Decree sanctioning the State Procurement Law (No. 1017 of June 3, 2008)* <p>Social Security System Laws</p> <ul style="list-style-type: none"> - Law establishing the Health Social Insurance (Law No. 27056 of January 30, 1999) - Law on the intangible nature of Social Security Reserves and Funds (Law No. 28006 of June 18, 2003) - General Law on the Financial and the Insurance Systems and Charter of the Superintendence of Banking and Insurance Institutions (Law No. 26702 of December 9, 1996)

¹⁵ Political Constitution of Peru (CPP), Chapter IV: On the tax regime and the budget.

SUNAT

- *Uniform Revised Text of the Tax Code (Executive Decree No. 135-99-EF of August 19, 1999)*
- *Law on the General Administrative Procedure (No. 27444 of April 11, 2001)*
- *Law regulating the Contentious Administrative Procedure (No. 27584 of December 7, 2001)*
- *Law on Custom Crimes (No. 28008 of June 19, 2003)*
- *General Customs Law (Executive Decree No. 129-2004-F of September 12, 2004)*
- *Customs duties (Executive Decree No 017-2007-EF of February 18, 2007)*
- *Superintendence Resolution sanctioning the regulatory provisions of Legislative Decree No. 943, which sanctioned the Law on a Single Taxpayer Registry (No. 210-2004/SUNAT of September 19, 2004)*
- *Superintendence Resolution amending Superintendence Resolution No. 210-2004/SUNAT, regulating provisions of Legislative Decree No. 943 (No. 298-2004/SUNAT, published on December 7, 2004)*
- *Superintendence Resolution whereby the Regulations on the Progressive System Applicable to Violations of the Tax Code was approved (No. 063-2007/SUNAT of April 1, 2007)*

Access to information

- *Law on Transparency and Access to Public Information (Law No. 27806 of August 3, 2002)*
- *Fiscal Prudence and Transparency Law (No. 27245 of December, 1999) as amended by the Fiscal Responsibility and Transparency Law (Law No. 27958 of May, 2003)*

FONAFE

- *Law regulating and providing for the management of State Enterprise activity (Law No. 27170 of September 9, 1999)*

Decentralization

- *Decentralization Base Law (Law No. 27783 of July 21, 2002)*
- *Regional Governments Charter (Law No. 27867 of November 17, 2002)*
- *Municipalities Charter (Law No. 27972 of May 26, 2003)*
- *Fiscal Decentralization Law (Legislative Decree No. 955 of February 5, 2004)*
- *Law on Canon, natural resources tax income sharing system between level of governments (Law No. 27506 of July 10, 2001)*

* This Decree abolished and superseded the Law on State Procurement (Law No. 26850 of June 21, 1997), the Uniform Revised Text on State Procurement (Law No. 28267 of November 26, 2004), the Regulation of the Law on State Procurement sanctioned by Executive Decree (No. 084-2004-PCM of November 26, 2004), and the Executive Decree Amending the Regulation of the Law on State Procurement (No. 028-2007 of March 2, 2007).

PFM institutional framework

PFM in Peru is carried out at three levels. The central government level is the most important, covering about 70% of public expenditures (2007 PIA); the two remaining levels are the regional and local jurisdictions, which account for approximately 30% of public sector expenditure.¹⁶

■ Government institutions and PFM

The President of the Republic is the Head of State and represents the nation; the direction and management of public services are entrusted to the Council of Ministers. Congress is the representative body of the nation, and its main roles consist of preparing and approving laws, including fiscal economic legislation,¹⁷ as well as exercising permanent oversight and political control over the country's economic, political and social development.

¹⁶ For further details, see the segment on "Scope of the assessment as provided by the report" in Section 1.

¹⁷ The Legislative Power lies with Congress. It consists of a single chamber of representatives with one hundred and twenty congressmen. Congress members are elected for a period of five years, by means of an election process established by law.

In addition to the line ministries, the central government includes 8 autonomous constitutional agencies and 33 decentralized public agencies. There are also 33 universities and 17 enterprise-like entities (ETEs), which are organized as autonomous agencies. The major state-owned enterprise, Petroperú, is managed by a board of directors appointed with the involvement of the Executive Branch. The remaining 35 state-owned enterprises –both financial and non-financial– jointly fall under the jurisdiction and budget of the FONAFE; their combined equity amounts to PEN 19.7 billion (as of September, 2009). The main enterprises (61% of the aggregate equity) are Servicio de Agua Potable y Alcantarillado de Lima (SEDAPAL, a water and sanitation utility), Fondo Mi Vivienda (FMV, a housing financing fund), Electroperú (an electricity company), the National Bank of Peru and Corporación Financiera de Desarrollo (COFIDE, Development Finance Corporation).¹⁸

■ MEF and PFM

MEF, through its various directorates, plays the main role with respect to PFM:

- The National Public Budget Directorate (DNPP) is the line agency of the MEF that administers the National Budget System and is responsible for the formulation, approval, execution and assessment of the budget process for all public sector entities and agencies.
- The National Directorate of Public Treasury (DNTP) is responsible for allocating the government's cash, and for programming and authorizing payments and fund movements through its bank accounts, based on the National Government's Cash Budget. The DNTP is also the custodian of Public Treasury securities.
- The National Directorate of Public Debt (DNEP) is responsible for programming, budgeting, regulating, negotiating, recording, overseeing, keeping accounts and coordinating the approval of public borrowing and other liability management operations. It also handles debt service operations for the government and transacts any operations associated with prudent debt management. It serves as the exclusive financial agent of the national government and is the preparer and publisher of public debt statistics.
- The National Directorate of Public Accounting (DNCP) is responsible for issuing the rules and establishing the procedures within its scope of authority, and is responsible for elaboration of the National Financial Statements (Cuenta General de la República).

These four directorates report directly to the Vice Minister of Finance.

- The General Directorate of Social and Economic Affairs (DGAES) is the line agency responsible for supervising and coordinating the Economic and Social Policy development, execution, monitoring and evaluation in the short, medium and long term. It also manages

¹⁸ Team estimates based on information from <http://ofi.mef.gob.pe/fonafe>.

the Economic Program and Multiannual Macro-economic Framework, pursuant to the applicable laws.

- The General Directorate of Public Sector Multi-year Programming (DGPM) is in charge of the National Public Investment System (SNIP), with the responsibility for optimizing the use of public resources allocated for investments.

Both the DGAES and the DGMP are line agencies of the Vice Ministry of Economy.

■ The Supreme Audit Institution and PFM

In Peru, the Office of the National Auditor General (CGR) is the highest-ranking agency in the National Oversight System, which was established to oversee the efficient, effective and economic use of state resources, as well as the proper management of public debt, the lawful execution of the public sector budget and the actions of the institutions subject to oversight.

Key Features of the PFM System

The Integrated Financial Management System (SIAF) plays a key role in the Peruvian PFM system; in January 1999, this integrated financial management system became the official system for recording expenditure and revenue operations. It is closely linked to the financial management of the Public Treasury. Currently, the SIAF covers the financial activities of central government, the autonomous agencies (universities and ETEs) and regional and local governments.

Section 3. Assessment of Public Financial Management Systems, Processes and Institutions

3.1. Budget Credibility

To assess whether the budget is sufficiently realistic and whether it is implemented as intended, this section focuses on four indicators: (i) aggregate expenditure divergences, (ii) deviations in expenditure composition, (iii) aggregate revenue deviations, and (iv) stock of expenditure payment arrears.

PI-1 Aggregate expenditure out-turns compared to original approved budget

To assess indicators PI-1 and PI-2, the consulting team worked with primary expenditure data¹⁹ provided by the DNPP and the DNTP. The information used to establish executed primary expenditures was the data actually paid within that year and subsequently.²⁰ According to the PEFA methodology, the cash-based criterion is to be used instead of the accrual-based principle. The data are presented in tables A1-1, A1-2 and A1-3 of Annex 1.

(i) Difference between executed primary expenditure and primary expenditure as originally budgeted

In two out of the past three years, executed (paid) primary expenditure –excluding expenditures that were externally financed– deviated from the central government’s initial budget by more than 5% but less than 10% (see Table 3.1). In general, these results indicate good programming of expenditures for the period 2005-2007. Based on this criterium, programming for 2005 was excellent, as execution very well reflected the original budget. However, the situation changed during the following two years, when executed primary expenditures deviated increasingly from the approved budget. Despite these increases, the overall deviation in primary expenditure in 2006 and 2007 was less than 10%, which implies that budget execution was conducted generally as planned.

¹⁹ In accordance with the PEFA methodology, data provided on primary expenditures include current and capital expenditures, excluding public debt service charges, but also excludes externally-financed project expenditures (loans and grants).

²⁰ The law allows accrued unpaid expenditures as of December 31 of a fiscal year to be paid during the first quarter of the following fiscal year (Law No. 28411 of December 6, 2004, article 37.2).

The discrepancy between the original budget and the executed budget can be accounted for by two important factors: on the one hand, there were increases in the budget granted after its approval; and, on the other hand, the degree of expenditure execution relative to the amended budget was less than anticipated. In recent years, significant budget increases have been granted during the budget execution period,²¹ but the relatively low levels of execution of investments largely offset these supplementary credits. Together, these factors account for the small discrepancy in PI-1.²²

Table 3.1. Deviations in Budget Execution of the Central Government's Overall Expenditure and Composition (As a percentage of originally budgeted expenditure)

Year	Overall primary expenditure out-turn, net of external financing (a)	Variance in primary expenditure composition, net of external financing (b)	Extent to which variance in composition exceeds overall expenditure out-turn (b)-(a)
2005	0.3%	12.0%	11.7%
2006	6.7%	12.2%	5.4%
2007	8.2%	14.7%	6.5%

Source: Annex 1.

Indicator	Score	Explanation
PI-1 Aggregate expenditure out-turn compared to original approved budget	B	Scoring Method M1
(i) The difference between executed primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure)	B	In no more than two of the last years has the executed expenditure deviated from budgeted expenditure by more than 5% of budgeted expenditure.

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

(i) Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years

To measure this indicator, an empirical assessment was conducted with respect of expenditure out-turns against central government's initial budget (PIA) at a sub-aggregate level under the sector classifications.²³ Variances in the composition of primary expenditures exceeded the overall deviation in primary expenditure by more than 10% only in 2005 (Table 3.1).

²¹ Nevertheless, it should be underscored that the MMM forecasts –the macro-economic basis for budget preparation– are basically conservative; besides, in a context of economic growth of the Peruvian economy, added to a favorable international scenario as the years here assessed have proven to be, it is to be expected that the differences between estimated and executed amounts would be significant.

²² Source: World Bank comments (October 31, 2008) on the Preliminary Report.

²³ For further details, see Annex 1.

Some of the most important factors giving rise to discrepancies between the sectoral allocations within the PIA and the executed budget are presented below and specified by year for the period 2005-2007.

2005: 2005 was a pre-election year and that tends to be a time when the entire public sector increases its expenditures. Various deviations took place, and below are some of the explanations for them:

- The Defense Fund for the Armed Forces was established under the Presidency of the Council of Ministers (PCM), (PEN 118 million); in addition, there were important social subsidies (Juntos Program) established under the PCM (PEN 78 million);
- In the Justice sector, judgments were paid by the Ministry of Justice (PEN 31 million);
- Collective redundancies were paid under the Labor and Employment Promotion sector, by the Ministry of Labor (PEN 75 million);
- In Energy and Mines, fuel subsidies were paid and the Fuel Price Stabilization Fund was created (PEN 180 million);
- Other extraordinary allocations were made due to the election process (these were made to the National Elections Court, National Office of Election Processes, National Identification and Civil Registry).

2006: This was an election year and there was a change of administration (July 28):

- In July, the outgoing administration carried out financial remediation operations and regularized the payment of contributions to EsSalud in the amount of PEN 264 million;
- In August, the new administration expanded public expenditure (expansion of investments) with a supplementary credit in the amount of PEN 1,937 million, mainly in the Housing and Construction, and Agriculture sectors; of these allocations, only 50% had been spent as of December of that year;
- In December, the new administration expanded the budget with a supplementary credit in the amount of PEN 1,818 million: (a) the MEF created four special funds out of the tax revenue surplus (for a total of PEN 1,000 million), which remained unspent; (b) an exceptional contribution was made to support the Military and Police Pension Fund in the amount of PEN 200 million; (c) a contribution was made to EsSalud for PEN 269 million to regularize the contribution to actuarial reserves; in addition, it was considered necessary to include an allocation for the investment expansion program in the 2007 budget, because only 50% of the amount allocated for 2006 had been spent.

2007: A low level of execution was observed during the year, because the new administration was in a learning period. Under the PCM, additional transfers were made on account of decentralization to local governments (PEN 225 million); also, the remaining 50% of expanded investments from 2006 was included as a supplementary credit.

During the period 2005-2007 under analysis, the variance in primary expenditure composition was smaller in 2006 and 2007. However, the budget was increased after its approval in 2006. There was also slower than projected budget execution, particularly in 2007. For the entire period 2005-2007, expenditure composition has varied to a considerable extent relative to PIA estimates, thus weakening policy objectives.

Indicator	Score	Explanation
PI-2. Composition of expenditure out-turn compared to original approved budget	C	Scoring Method M1
(i) Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years	C	Variance in expenditure composition exceeded overall deviation in primary expenditure by 10% in no more than one of the last three years.

PI-3 Aggregate revenue out-turn compared to original approved budget

To assess indicator PI-3, the consulting team compared revenue estimates included in the PIAs against executed budgets, as well as differences observed in diverse MMMs reviewed. The DNPP and the DNTP cooperated with team members in debugging the data. These data are presented in Table A-5 of Annex 1. No data was collected from the related website.

(i) Actually collected fiscal revenues compared to revenue estimates in the original, approved budget

A comparison of budgeted fiscal revenues (both tax and non-tax revenues, but excluding grants and the proceeds of loans) and actually collected revenues demonstrates prudent cash forecasting.²⁴ During the period under review (2005-2007), actual revenues were much greater than budgeted revenues. This good performance can mainly be attributed to the increased collection of taxes on income (by 77% and 54% in 2006 and 2007, respectively) and, to a lesser extent, to increased revenues from the general sales tax (by approximately 16% each year, in 2006 and 2007).

In that context, the higher than expected revenues occurred in a highly favorable economic scenario: GDP growth was better than expected throughout the period; and, especially, the price of minerals produced and exported by Peru –which accounts for a considerable share of collected taxes– increased much more than expected. These factors had a positive impact on the income tax revenues, and also on royalties and similar revenues that in Peru are recorded as non-tax revenue.

²⁴ This opinion is shared by the IMF representative in Peru.

Table 3.2. Budget execution of tax and non-tax collection as a percentage of collection considered in the PIA

	2005	2006	2007
Execution of domestic revenue	106.95%	125.96%	117.41%

Sources: See details in Annex 1, Table A-5.

Indicator	Score	Explanation
PI-3. Aggregate revenue out-turn compared to original, approved budget	A	Scoring Method M1
(i) Actual domestic revenue collection compared to revenue estimates in the original, approved budget	A	Actual domestic revenue collection was above PIA revenue estimates in the three years under analysis (2005-2007).

PI-4 Stock and monitoring of expenditure payment arrears

The General Budget Law makes no reference to the concept of “*payment arrears*”²⁵; therefore, these are not regulated.²⁶ Essentially, the Peruvian budget system only allows ministries, departments and agencies (MDAs) to undertake spending operations according to the law, explicitly following the stages of commitment, accrual and payment.²⁷ In recent years, because the government realized a budgetary surplus, no issues were encountered in financing their expenditures.²⁸ In practice, however, payment arrears would be incurred with respect to the provision of services or for works performed if, having completed the expenditure commitment stage and after acceptance of the good or service, the government had not accrued the expenditure, or if, having accrued the expenditure, it failed to complete the payment²⁹ (possibly being in default with suppliers, employees or contractors if the payment was not completed by the agreed payment date).³⁰ Such circumstances might arise from a lack of liquidity, which is not currently an issue in Peru.³¹

²⁵ Payment arrears are defined as obligations arising from expenditures incurred which are overdue or, in budgetary terms, as a committed and not accrued expenditure, in spite of the good or service having been accepted, or as an accrued commitment unpaid within the term previously agreed upon. The latter cases are part of the so-called floating debt, as designated in some countries of the region.

²⁶ For instance, the *General Law on the National Budget System* (Law No. 28411 of January 1, 2005) should define such situation.

²⁷ Article 33 of the General Budget Law.

²⁸ See Section 2.2 of the Report.

²⁹ While the law exclusively provides for these three stages in expenditure execution (Law No. 28411, articles 33 to 36), there is a fourth stage in practical terms, namely: drawing, subsequent to accrual and prior to payment.

³⁰ Failure to make payroll social security payments or to comply with the payment of debt service charges within the agreed term renders the obligation automatically overdue.

³¹ Additionally, the government’s strategy regarding debt management has consisted in paying external public debt in advance; therefore, there are no interest (or principal) amounts in arrears.

Accounting for government operations in Peru is accomplished using the Integrated Financial Management System for the Public Sector (SIAF-SP). Allocations from the annual budget (approved by law) are distributed quarterly; subsequently, allocations for expenditures are made on a monthly basis, based on the resources available in each month's program. Thus, it is not possible to commit expenditures unless there are prior duly authorized budgetary allocations and unless there are available resources, because the system does not allow it; that way, operations are duly formalized and recorded under a monthly commitment schedule, which is loaded in SIAF. An expenditure is accrued when the good or service has been delivered and accepted, and an estimate is then entered into the system about the "best payment date." If the expenditure is committed and the good or service has been delivered and accepted, but the expense was not accrued, then a default situation would arise; however, SIAF does not provide for such a situation.³² Theoretically, nothing should prevent the expenditure in this case from being accrued. Moreover, under Peru's SIAF system, when expenditure is committed, it can be accrued and paid, and resources should be available (together with the relevant budgetary allocations for such expenditure). If the financial situation is different –e.g., if the Public Treasury lacks liquidity, no commitment whatsoever would be allowed in excess of the expenditure ceilings authorized by the Public Treasury Cash Committee; therefore, the system would not allow the recording of such an activity.

Every year, all commitments must be accrued as of December 31 and no accrual is allowed after that date (the system blocks the recording). This includes operations involving commitments where the goods, works or services are to be received during the following year. If proper accruals are not made by December 31, outstanding committed operations are annulled or terminated. As of December 31 there may be accrued operations not yet paid because it may well occur that the payment date agreed in the contract falls in the following year; in all events, the payment deadline is March 31 of the following year.³³ These accrued, unpaid amounts as of December 31 of each year are not deemed payment arrears.³⁴

(i) Stock of expenditure payment arrears

At the closing of the last year (2007) there were no payment arrears.³⁵ Furthermore, the presence of arrears does not represent a systematic problem, given the favorable economic situation.

³² A finding of this study is the limitation of SIAF-SP information, in the sense that it fails to identify the expenditure obligation's due date. Generally, in the case of suppliers of goods and services, billing does not entail a specific term. In practice, payment is demanded on delivery, but this term actually means payment within approximately fifteen days because financial and administrative management issues (logistics) for payment authorization.

³³ The law makes provision for the treatment of accrued unpaid expenditures at the closing of the fiscal year (Law No. 28112, article 20.3).

³⁴ The law makes provision for the treatment of commitments and accruals at the closing of the fiscal year (Law No. 28411, article 37).

³⁵ Sources: DNPP, DNTP, DNCP, DNER, IMF (work session held with the resident representative). A reprogrammed payment was detected in the amount of PEN 100 million, authorized by means of a supplementary credit during fiscal year 2007, regarding debt under Emergency Decree No. 037-94, which was paid at the beginning of the fourth quarter of 2008.

(ii) Availability of data for monitoring the stock of expenditure payment arrears

With respect to (i) and footnote 30, data were generated about the extent of payment arrears as of December 31, 2007. However, no data about arrears are produced annually or following routine procedures.³⁶

Reforms

The reform of budget classifiers and the use of the *GFSM*³⁷ issued by the International Monetary Fund (IMF, 2001) starting from the 2009 budget will strengthen accrual-based recording, and thus improve the recording and detection of potential arrears.

Indicator	Score	Explanation
PI-4 Stock and monitoring of expenditure payment arrears	C+	Scoring Method M1
(i) Stock of expenditure payment arrears.	A	As of December 31, 2007 there were no payment arrears.
(ii) Availability of data for monitoring the stock of expenditure payment arrears	C	Data was provided to assess the level of payment arrears as of December 31, 2007. However, no data about arrears are produced annually or following routine procedures.

3.2. Comprehensiveness and Transparency***PI-5 Classification of the budget***

This indicator measures the budget classification system used for formulation, execution, evaluation and reporting of the central government's budget for 2007, the last budget year closed at the time of the assessment.

(i) Classification system used for formulation, execution and reporting of the central government's budget

Article 13 of the *General Law on the National Budget System* (Law No. 28411 of January 1, 2005) establishes the structure of public spending, following institutional (related to the administrative unit), economic, functional, programmatic and geographic classifications. The

³⁶ Although no payment arrears are reported in the current period and in recent periods, it has been found with a certain degree of difficulty that some MDAs undertook expenditure obligations outside the budget in previous years, in 1994 and 2000-2001 (under adjusted budgets). This practice is not in force and it was not widespread; furthermore, there is a budget regularization operation for such a case (payment of judgments, pursuant to article 70 of the General Budget Law).

³⁷ Government Finance Statistics Manual.

law also explicitly defines the functional programmatic classification structure by specifying sixteen (16) public expenditure categories.³⁸ This classification system produced uniform, consistent documentation based mainly on the 1986 version of GFSM standards. Beginning in 2009, the Peruvian budget will use new classifiers that are consistent with the standards set forth in the most recent version of the GFSM (IMF, 2001).

There is a severe compatibility and consistency issue between the 2007 budget classifier and the National Financial Statement chart of accounts; this incompatibility is adequately described in the Explanatory Recitals of the Public Sector Budget Bill for Fiscal Year 2009, submitted by the MEF to the Peruvian Congress (MEF, 2008: 96) last August:

[...] current budget classifiers [prior to year 2009] do not have a unique relation to the government chart of accounts, so as to obtain on a timely and consistent way the public financial information. At present, the record of a budget category may be linked to one or more accounts under equity accounting, thereby enabling those responsible for the accounting records to use their discretion to choose the appropriate ledger account for the budget transaction being made; this issue may lead to manual-intervention accounting, so that the book accounts may therefore not necessarily be produced in homogeneous fashion. Thus, current budget classifiers would not encourage a timely, reliable method of accounting, useful in support of both controls over spending and fiscal policy decisions [...].

This assessment of the 2007 budget classifiers agrees with this observation.

Reforms

The formulation of the 2009 budget entails some substantial progress with respect to budget classification, including the use of the 2001 GFSM standards and the extension of the functional classification to cover twenty-five expenditure categories (versus the sixteen current categories). This seeks to adapt national classifiers to international standards, to improve the budget's reporting capacity and to consolidate the result-based budget component, all without affecting the comparison of historical data.³⁹ The table below presents the new functional classification and 2001 GFSM/COFOG equivalents:

³⁸ The functional classification of expenditure, as established in Law No. 28411, is as follows: legislature; justice; administration and planning; agricultural; social security and protection; communications; defense and national security; education and culture; energy and natural resources; industry, trade and services; fishing; foreign affairs; health and sanitation; labor; transport; housing and urban development.

³⁹ See Executive Decree No. 068-2008-EF of May 25, 2008, the purpose of which is the harmonization and systematization of information for statistical use, and the study and analysis of fiscal subjects, differentiating the "Functional Classifier" from the "Programmatic Classifier".

Table 3.3 Functional Classifier

CLASSIFIER STANDARIZATION	
INTERNATIONAL CLASSIFIER	PERU
1 General Public Services Exec. and legislative organs, financial and fiscal affairs, external affairs Foreign economic aid / General services. Basic Research / Research and Development. General Public Services n.e.c. Public debt transactions / Transfers of a general character	1 Legislature
	2 Foreign Affairs
	3 Planning, management and contingency reserve
	4 Public Debt
2 Defense	5 Defense and National Security
3 Public Order and Safety	6 Public Order and Safety
	7 Justice
4 Economic Affairs - Economic, commercial and labor affairs - Agriculture, forestry, fishing and hunting - Fuel and energy - Mining and mineral resources, manufacturing, construction - Transport - Communication - Other industries - Sectoral economic affairs research and development - Economic affairs n.e.c.	8 Labor
	9 Trade
	10 Tourism
	11 Agriculture
	12 Fishing
	13 Energy
	14 Mining
	15 Industry
	16 Transport
	17 Communications
	18 Environment
5 Environment Protection	19 Sanitation
6 Housing and Community Amenities	20 Housing and urban development
7 Health	21 Health
8 Recreation, Culture and Religion	22 Culture and sports
9 Education	23 Education
10 Social Protection	24 Social Protection
	25 Social Security

Source: MEF, 2008: Explanatory Recitals.

It should also be noted that, beginning with fiscal year 2009, the budget classifiers will fully match the chart of accounts, a feature that will significantly improve the quality and the efficiency of budget monitoring and evaluation, as well as the consistency of the National Financial Statements.

Indicator	Score	Explanation
PI-5 Classification of the budget	B	Scoring Method M1
(i) The classification system used for formulation, execution and reporting of the central government's budget	B	Budget formulation and execution is based on administrative, economic and functional classifications (using at least the ten main COFOG functions), using standards that can produce consistent documentation according to those standards.

PI-6 Comprehensiveness of information included in budget documentation

The annual budget bill documentation, as submitted to the Legislature for scrutiny and approval, should provide a full picture of the central government's fiscal forecasts, budget allocations, and out-turns from previous years. In that sense, PI-6 measures to what extent the documentation

included in the budget bill for fiscal year 2009 –that is, the last budget submitted to the legislature at the time of the assessment– is sufficient to comply with this objective.

Article 21 of the General Law on the National Budget System (Law No. 28411 of January 1, 2008) provides that the Public Sector Budget Bill, as sent to the Peruvian Congress, shall consist of legal provisions regulating the aspects associated with budgetary matters and the following supporting documents: (i) an Explanatory Recitals section, including a statement of fiscal policy objectives and macro-economic assumptions, (ii) an annex on subsidies for legal entities, (iii) explanatory tables summarizing revenues and expenditures, including the details of installments payable to international organizations, (iv) the allocation of institutional expenditure at the regional level, (v) tables illustrating the functional programmatic classification, and (vi) annexes containing expenditure statements at the level of Budget Implementation Agency, Functions, Programs, Activities, Projects, Generic Expenditure Groups and Financing Sources. The Public Sector Budget Bill for Fiscal Year 2009 submitted to the Peruvian Congress formally complies with this legal requirement.

To evaluate the adequacy of the documentation attached to the budget bill analyzed for this exercise, the information requirements established in Table 3.4. should be met. However, before beginning with the assessment, the connection between the budget and the 2009-2011 MMM –a core document for budget formulation– should be established. The MMM⁴⁰ that supplements the budget bill specifies the base economic assumptions (used for three-year projections), including estimates of economic growth, inflation and exchange rates. The MMM also provides the fiscal targets for any deficit (surplus) and for any increase in public spending, consistently with fiscal rules set forth in the Fiscal Responsibility and Transparency Law (Law No. 27245 of December 24, 1999 as amended). The information contained in this document enables an appreciation for the effects of the proposed fiscal policy on the fiscal sustainability, macro-economic balance and public debt as reflected in the budget. This understanding is also presented in the Explanatory Recitals attached to the budget bill.

The Explanatory Recitals present summarized information on the revenues and expenditures included in the budget bill, in accordance with the budget classification as defined by law. Nevertheless, it does not provide for equivalent data, broken down by budget items, pertaining to the previous and current year. These limitations hinder the analysis of budget allocations and the scrutiny of the budget bill by the Legislature; however, a large part of this required information is available in the budget execution reports prepared by the DNPP of MEF and in that ministry's Economic Transparency website.⁴¹

⁴⁰ The MMM includes a statement of fiscal policy principles signed off by the Ministry of Economy and Finance; the statement contains economic policy guidelines and fiscal policy objectives in the medium term, including policy measures and estimated out-turns for the General Government and the Consolidated Public Sector and financing thereof.

⁴¹ www.mef.gob.pe (user-friendly consultation).

Table 3.4 summarizes whether the information provided complies with the requirements of the PEFA Framework when assessing the adequacy of the information included in the budget documentation:

Table 3.4. Information on the contents of budget documentation

Documentary requirement	Compliant	Document
Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate	YES	2009-2011 MMM, and document attached to the budget bill.
Fiscal surplus (deficit)	YES	2009-2011 MMM.
Deficit financing (surplus use)	YES	2009-2011 MMM.
Public debt stock	YES	2009-2011 MMM.
Financial assets	NO	The 2009-2011 MMM presents estimates of various financial assets individually and separately, but fails to include a consolidated, detailed analysis thereof.
Previous budget year out-turns (2007)	YES	This information is sent to Congress one month prior to the formal submission of the budget bill in the form of the documents designated as "2007 Overall Assessment of Budget Management" and "Annual Statistics of the Public Sector Budget at the Closing of 2007", pursuant to Law No. 28411.
Current budget year out-turns (2008)	NO	This documentation is not attached to the budget bill, but it is readily available at the MEF's website.*
Summarized budget data for both revenue and expenditure according to the main heads of the classification used	YES	Explanatory Recitals and Annexes to the Public Sector Budget Bill for Fiscal Year 2009.
Explanation of budget implications of new policy initiatives	YES	The 2009-2011 MMM and the Explanatory Recitals attached to the budget bill describe the new policy initiatives (especially with respect to revenue) and their connection with the budget. Impacts are not actually quantified, but the budget approval dynamics enable the Legislature to gain such information during sector budget substantiation sessions; these are public hearings at which the ministers have a mandate to attend pursuant to the Constitution.

* Although this kind of documentation is not attached to the budget bill, and, as mentioned in the previous narrative, quarterly evaluation reports including this information are sent to Congress.

(i) Share of the required information in the budget documentation most recently issued by the central government

Documentation attached to the Public Sector Budget Bill for 2009 fulfills seven of the nine methodology conditions required in order for this comprehensiveness indicator to be met.

Indicator	Score	Explanation
PI-6 Comprehensiveness of information included in budget documentation	A	Scoring Method M1
(i) Share of the required information in the budget documentation most recently issued by the central government	A	Recent budget documentation covers between seven and nine of the nine information benchmark parameters.

PI-7 Extent of unreported government operations

To measure the extent of extra-budgetary operations transacted in 2007 –i.e., the last budget year closed at the time of the assessment– the methodology requires, on the one hand, calculating the level of revenues and expenditures not included in routine fiscal reports and, on the other, verifying whether the reports accurately present the information on revenues and expenditures with respect to projects funded by international cooperation loans and grants. The fiscal reports to be considered are those which provide for public revenue and expenditure programming, in-year execution of budgets, and financial statements submitted at the close of the fiscal year (subsequently included in the National Financial Statement and audited by the National Auditor General’s Office).

(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports

The scope of this assessment, according to the PEFA Framework, covers central government operations, including its autonomous government agencies. Before assessing this indicator, the institutional composition of the budget in Peru should be established in relation to the framework’s requirements, which initially excludes sub-national governments and state-owned enterprises.⁴² In this sense, the focus of the assessment lies with the central (or National, in the case of Peru) government’s approved budget documents, according to the following classification:⁴³

- Central Administration, including the Legislature and the Judiciary, together with the ministries, decentralized public institutions, autonomous constitutional agencies⁴⁴ and universities.

⁴² In Peru, state-owned enterprises fall under the authority of the FONAFE and are not part of the public sector budget.

⁴³ This institutional classification of the Peruvian budget is contained in the Fiscal Transparency and Accountability Act (Law No. 27958 of May, 2003).

⁴⁴ Autonomous constitutional agencies included in this classification are the eight agencies mentioned in Section 1, under the heading “Scope of the assessment as provided by the report”.

- All remaining entities, including enterprise-class public institutions (ETEs) at the national level,⁴⁵ the Superintendence of Banking, Insurance Institutions and AFP Pension Funds (SBS), the Health Social Insurance of Peru (EsSalud), public welfare institutions and special funds.⁴⁶

Both central administration institutions and all remaining entities listed above are public institutions pursuant to the Public Sector Budget Law for Fiscal Year 2007 (Law No. 28927 of December 12, 2006), and have an allocated, executed and reported budgets, in accordance with the applicable legal provisions.

The exception to this rule are EsSalud and the SBS, which are not part of the annual budget law because they are autonomous in terms of administrative, economic, financial and budget management, and they do not receive resources from the Public Treasury.⁴⁷ However, the activities carried out by these institutions cannot be deemed to be of an extra-budgetary nature, considering that their respective budgets are formally approved according to institutional mechanisms established by law, and in compliance with the macroeconomic framework defined in the Fiscal Responsibility and Transparency Law. Additionally, the budget execution of these institutions is regularly reported to MEF, their out-turns are included in the National Financial Statement and the management of both entities is subject to audits undertaken by the National Auditor General's Office. Thus, their operations are covered in routine government fiscal reports.

Considering the institutional structure of the government's budget for 2007, apart from the foregoing exceptions, it can be asserted that there are no significant extra-budgetary operations in Peru's central government.

Similarly, budget revenues classified into: (i) ordinary (tax and non-tax) resources, (ii) resources directly collected by institutions (income from charges, toll, fines, sale of property, rent from property, commissions, provision of services, among others), (iii) earmarked resources (income revenues, royalties, and other participatory shares, to be transferred to subnational governments), (iv) official credit operations (both external and domestic), and (v) grants and transfers, all comprise the sources available for funding the central government's budget. Regular fiscal reports, including the audited National Financial

⁴⁵ The ETEs comprise the SUNAT and regulatory and oversight agencies. There is also a considerable number of enterprise-class entities at the local level which pertain to municipal governments, not included in this analysis.

⁴⁶ The main entities are the Fiscal Stabilization Fund (FEF), the Consolidated Pension Reserve Fund (FCR) and *Fondo Mi Vivienda* (FMV, a housing fund).

⁴⁷ EsSalud is autonomous with respect to budget by virtue of the Law establishing the Social Health Insurance (Law No. 27056 of January 30, 1999) and the Law on the Intangible Nature of Social Security Reserves and Funds (Law No. 28006 of June 18, 2003); while the SBS's autonomy stems from a constitutional mandate and from the General Law on the Financial and the Insurance Systems and Charter of the Superintendence of Banking and Insurance Institutions (Law No. 26702 of December 9, 1996).

Statements (Cuenta General de la República), do not reflect the existence of unreported revenue, that is, excluded from the budget.

(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports

Income and expenditure information on programs and projects funded by international cooperation agencies through loans and grants is included in fiscal reports, although such information is neither integrated nor combined. Donor resources are operated from the APCI, while external loans are recorded jointly with its linked non-refundable technical cooperation, at the DNEP of MEF. The execution units in charge of managing the programs and projects funded by grants and loans are responsible for recording these resources in the annual budget of the relevant agency, and for reporting execution of those investments to the DNPP through the SIAF.

Fiscal reports include the budgetary information recorded in the SIAF and report execution data sorted by execution unit, program, project and financing source. Nevertheless, for grants, registration of existing data on disbursements and monitoring of the physical/financial progress is made in reports from the implementing unit to the international cooperation agency or agencies involved. The APCI gathers, *ex post*, data on disbursements actually made by donors and compares them with the amounts committed in the cooperation agreements and, thus, rebuilds the profile of external aid funds.⁴⁸ In 2007, donor-funded revenue represented less than 0.5% of the PIA, but these figures were modified during the fiscal year according to newly agreed support commitments.

Official credit operations are monitored at the DNEP and their performance is defined both by the physical/financial progress of the programs and projects, and by the restrictions established by the Peruvian government's macro-economic program. Fiscal reports include investment loans, sorted by implementation unit, program, project and activity. Disbursements are also agreed and monitored by the MEF.

Indicator	Score	Explanation
PI-7 Extent of unreported government operations	A	Scoring Method M1
(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported, i.e., not included in fiscal reports	A	The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of expenditure).
(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports	A	Fiscal reports and financial statements cover the central government's activities, including at least 90% of the programs and projects funded by the international community.

⁴⁸ The most recent available data on the programming and execution of grants (non-refundable international cooperation) date back to 2006.

PI-8 Transparency of Inter-Governmental Fiscal Relations

The general government in Peru is comprised of central government institutions, 26 regional governments and 1,834 local governments, both at the provincial and district levels. Considering this structure, this indicator seeks to measure how transparent are the fiscal relations between the three levels of government, based on the evaluation of the following elements: (i) the rules in place for horizontal allocations to regional and local governments of unconditional and conditional transfers from central government, (ii) timeliness and reliability of information provided by the central government to sub-national governments for the formulation of their own annual budgets, and (iii) reporting and recording of consolidated data on sub-national budget execution (revenues and expenditures). This indicator was assessed using the budget for fiscal year 2007 and the available information on all sub-national government entities receiving transfers from the central government.

The legal framework for decentralization in Peru stems from Chapter V, Articles 188 through 199 of the 1993 Political Constitution and from the Law on Decentralization Bases (Law No. 27783 of July 21, 2002), whereby the general criteria and principles underpinning the decentralization process are established. The law further regulates the arrangement of regions and municipalities as well as the competencies for the three levels of government. It also determines how resources are allocated to sub-national governments. Subsequently, the Regional Governments Charter (Law No. 27867 of November 17, 2002) and the Municipalities Charter (Law No. 27972 of May 26, 2003) were enacted. These laws regulate the structure, organization, competencies and functions of those sub-national government levels. Finally, by virtue of Legislative Decree No. 955 of February 5, 2004, the Fiscal Decentralization Law was approved, thereby clarifying the rules on budget execution and public borrowing, in order to assure financial sustainability and global macroeconomic balance.

(i) Transparent and rules-based systems in the horizontal allocation across sub-national governments of unconditional and conditional transfers from central government (both budgeted and actual allocations)

The sources of sub-national government budget financing for 2007 are determined by law and include:⁴⁹

- Ordinary resources –i.e., national resources allocated by the central government.
- Earmarked resources, mostly from the tax sharing scheme applicable to the income tax collected from productive activities undertaken by companies located in the regions and known as canon (for mining, hydroelectricity generation, gas, oil, forestry and fishing activities), in addition to the sharing of Customs revenues and royalties. Local

⁴⁹ MEF-DNPP, Public Sector Budget for Fiscal Year 2007.

governments receive, in addition, a transfer equal to 2% of the tax base for the value-added tax (IGV), designated as Municipal Promotion Tax (IPM), which is allocated through the Municipal Compensation Fund (FONCOMUN).

- Resources are also collected directly through local taxes, charges, patents and licenses levied in the regions and municipalities.⁵⁰
- Other resources, including loans, donations and other transfers.

Ordinary resources (ROs) and resources collected directly (RDRs) are largely used to finance current expenditures, including administrative costs, delivery of devolved public services (health, education and transport), and certain social programs (such as the Vaso de Leche school meal program and nutritional programs). Earmarked resources (RDs) and some specifically defined ROs –i.e., those established to finance the Regional Compensation Fund (FONCOR), social productive infrastructure projects and the Regional and Local Public Investment Promotion Fund (FONIPREL)⁵¹– are allocated to fund investment spending.⁵²

The allocation of ROs to cover current expenditures and region-wide service delivery are established in article 9 of Decree-Law No. 955, which provides for a staged allocation on the basis of historical financing needs in relation to the commitments undertaken by and transfer of competencies to regional governments.⁵³ Moreover, allocations with respect to the FONCOR and the social programs in place in the regions are designed according to, inter alia, poverty, unmet basic development needs, border location and population criteria. The General Directorate of Social and Economic Affairs (DGAES) of MEF prepares the distribution rates for allocating these resources among the regional and local governments. In the case of social programs, resources are allocated in close coordination with the Ministry of the Woman and Social Development.

⁵⁰ Among local governments, financing sources includes municipal taxes. Said taxes include: (i) property tax; (ii) housing sales excise; (iii) motor vehicle tax; (iv) betting tax; (v) gaming tax; (vi) tax on non-sport public events; (vii) casino gaming tax; (viii) slot machine gambling tax.

⁵¹ The FONIPREL is a competitive fund whose main purpose is to co-finance public investment projects and pre-investment studies aimed at reducing gaps in basic infrastructure and service delivery, attempting to achieve the largest possible effect on the reduction of poverty and extreme poverty in the most disadvantaged areas of the country. This Fund is attached to the MEF and is managed by a Managing Board in charge of the general management and a Technical Secretariat responsible for the requests for proposals. The FONIPREL may co-finance up to 90% of the development of pre-investment studies or the execution of local and regional governments' investment projects. The activities it finances are intended to reduce gaps in basic infrastructure and service delivery in eight priority areas: basic health services, sanitation services, child malnutrition, electrification in rural areas, basic education services, agricultural infrastructure, road infrastructure, and rural telecommunications. This fund only began transferring resources to sub-national governments in 2008.

⁵² ROs intended to cover capital expenditures at the sub-national level account for 10% of the overall transfers from this source and 6% of overall inter-governmental transfers.

⁵³ 92% of ROs allocated to regional governments are used to finance current expenditures.

Allocation of RDs associated with fees for mining, hydroelectricity generation, oil, gas, forestry and fishing activities are defined in the Law on *Canon* (Law No. 27506 of July 10, 2001), as subsequently amended. This law specifies the natural resource exploitation activities that give rise to the participation of subnational entities on income tax revenues and provides for the allocation of those fees among the regional and local governments with jurisdiction over the activity involved. The allocation of these resources among the different levels of government is set forth in the law, together with the factors establishing the manner of allocating resources among the different sub-national governments in the areas of resource exploitation. In these cases, the DGAES is responsible for preparing and approving the distribution rates to be applied, based on (i) official population data and information regarding unmet basic development needs furnished by the INEI, (ii) production information provided by the sectors governing extraction and refining activities, mainly the Ministry of Energy and Mines, the Ministry of Production, and the Ministry of Agriculture, and (iii) tax collection information processed by the SUNAT. Additionally, the distribution rates applicable to the resources allocated through the FONCOMUN are prepared on the basis of SUNAT information and indicators supplied by the INEI.

Table 3.5 below broadly summarizes how resources were transferred from the central government to the sub-national governments, broken down according to the horizontal allocations.

Table 3.5. Budget Allocation of Inter-Governmental Transfers

Inter-Governmental Transfers Description	Programmed (PIA)		Executed	
	Million PEN	(%)	Million PEN	(%)
Resources from CG Transfers	15,944	100.0	19,919	100.0
Ordinary Resources	9,479	59.5	9,781	49.1
Earmarked Resources	6,465	40.5	10,137	50.9
Fees and Additional Fees, Royalties	3,980	25.0	7,331	36.8
Customs Revenues and Sharing	2,485	15.6	2,806	14.1
Municipal Compensation Fund				
Memorandum No. 1:				
Ordinary Resources				
Current Expenditure	8,513	53.4	8,603	43.2
Memorandum No. 2:				
Overall SN Government Budget	18,987			
CG Transfers (% of the overall amount)	84.0			

Source: 2007 Budget Law, SIAF-Public Sector, National Financial Statement.

Central government transfers represent 84% of the overall resources of sub-national governments' budgets. 40% of these transfers are received from a financing source designated as earmarked resources (RDs). These are allocated among the various sub-national governments following clear, transparent rules. The remaining 60% consists of ordinary resources (ROs). As described above, ROs transferred to cover capital expenditures (investments) and social program outlays are also allocated using indicators that are clearly defined by the applicable laws. The ROs intended to cover current expenditures, which accounts for 50% of the aggregate resource transfers to regional governments, is allocated as follows: 95% to cover active payrolls (mostly corresponding to Scheme No. 276, permanent educational and health-care positions, and non permanent teacher contracts) and pensioners (mainly under Scheme No. 20530), pursuant to the applicable laws. The remainder of less than 3% of the transfers, which is used to pay for goods and services and other current expenditures, is based on historical information, adjusted in accordance with needs and/or demand requests.

(ii) Timeliness of reliable information to sub-national governments on their allocations from central government for the coming year

The requirement for the central government to provide reliable information to sub-national governments on budget ceilings to enable timely budget formulation is governed by article 15 of the General Law on the National Public Budget System (Law No. 28411 of January 1, 2005). This law establishes that June 5 of each year is the deadline for providing that information. Pursuant to this instruction, the DGAES issued Directorate Resolution No. 001-2006-EF/65.01 of June 28, 2006 approving the publication of estimates of the sub-national governments' public funds requirements, to be used for the formulation of their budgets for fiscal year 2007. Public fund estimates cover the use of earmarked resources for regional and local governments resulting from *canon*, royalties and other tax-sharing revenues. Although it was approved with a delay, this resolution was issued more than two months prior to the August 30, 2006 formal submission of the Public Sector Budget Bill for Fiscal Year 2007.

(iii) Extent to which consolidated fiscal data (at least on revenue and expenditures) is collected and reported to the central government, according to sectoral categories

Sub-national governments are regulated by the budgetary provisions contained in the Public Sector Budget Law for Fiscal Year 2007 (Law No. 29827 of December 12, 2006); therefore, they are under a legal obligation to execute their budgets through the SIAF, and to send the information on revenues and expenditures on a quarterly basis to the MEF for preparation of the corresponding quarterly financial evaluation reports. Regional governments regularly comply with this formal requirement.

In 2007, the SIAF only collected information from 736 local governments –slightly over 40% of the total of those units– but they accounted for 77% of budgeted resources allocated to that level of government. With very few exceptions, the local governments annually report their financial statements to the National Public Accounting Directorate (DNCP) of MEF so as to enable preparation of the overall closing assessment on budget execution and the National Financial Statements. More than 90% of sub-national expenditures are consolidated into annual reports within ten months of the end of the fiscal year.

Reforms

By late 2007, and definitely from the beginning of 2008, all local governments recorded and reported budget and financial information through the SIAF module adapted for local governments (SIAF-GL). This also enabled a considerable improvement in compliance with the obligation of local governments to send accounting information to the DNCP on a quarterly basis.

Indicator	Score	Explanation
PI-8 Transparency of Inter-Governmental Fiscal Relations	A	Scoring Method M2
(i) Transparent and rules based systems for the horizontal allocation among sub-national governments of unconditional and conditional transfers from central government (both budgeted and actual allocations)	A	The allocation of more than 97% of the transfers is determined by transparent and rules-based systems.
(ii) Timeliness of reliable information to sub-national governments on their allocations from central government for the coming year	A	Sub-national governments are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting processes.
(iii) Extent to which consolidated fiscal data (at least on revenue and expenditures) is collected and reported to the central government, according to sectoral categories	A	Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for 90% (by value) of sub-national government expenditure and consolidated into annual reports within ten months of the end of the fiscal year.

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

This indicator seeks an assessment of the central government's efforts to monitor and manage fiscal risks arising from activities at the sub-national levels of government, autonomous government agencies and public enterprises, including state-owned banks. The review covers fiscal management during 2007, the last budget year completed at the time of the assessment.

The legal framework for fiscal risk oversight is set forth in the Law on the Framework for Public Sector Financial Management (Law No. 28112 of November 28, 2003), establishing the budget, treasury, borrowing and accounting systems for the management of State resources. The laws regulating each of these systems and, in particular, the General Law on the National Budget

System (Law No. 28411 of January 1, 2005) defines the tools for programming, implementing, recording and overseeing public sector revenues and expenditures. The General Law on Public Borrowing (Law No. 28563 of June 25, 2005) sets out the rules applicable to the contracting of external and domestic loans by public sector institutions. These rules are annually adjusted by means of specific laws defining the ceilings for expenditure and public borrowing in accordance with the estimated revenues and consistent with the economic forecasts contained in the MMM.⁵⁴

The fiscal rules that sub-national governments should implement to maintain adequate control of fiscal risks are comprehensive and are contained in the Fiscal Responsibility and Transparency Law (Law No. 27245 of December 24, 1999, as amended) and in the Fiscal Decentralization Law (Decree-Law No. 955 of February 5, 2004 and regulations thereof), which jointly establish limits on the growth of public spending, debt stock and debt service commitments. Article 50 of the General Law on Public Borrowing provides that sub-national governments shall obtain a favorable rating from a credit-rating firm for any new individual or accrued credit transaction in excess of the ceiling established in the annual public borrowing law (US\$ 5 million for 2007).⁵⁵

(i) Extent of central government monitoring of key autonomous government agencies and public enterprises

Article 3 of the Public Sector Budget Law for Fiscal Year 2007 (Law No. 29827 of December 12, 2006), specifies that its provisions shall be applicable to autonomous government agencies, which in Peru include ETEs at the national level and any other entities whose budgetary credit is governed by the law. These are the same institutions that have a legal obligation to execute their budget through the SIAF and to send revenue and expenditure data quarterly to the DNPP for preparation of the relevant quarterly and year-end financial and management reports.⁵⁶

Law No. 29827 does not directly apply to public enterprises, which fall under the budget and jurisdiction of FONAFE, the institution established by virtue of Law No. 27170 of September 9, 1999 to *regulate and ordain the State's enterprise activities*.⁵⁷ FONAFE is

⁵⁴ The Law on Transparency and Access to Public Information (Law No. 27086, as recently amended) specifically states that the MMM shall contain an analysis of fiscal risks deriving from substantial variations in macroeconomic assumptions, as well as provisions on the contingency measures to be adopted under such circumstances. MMMs include sensitivity analyses in the event of variations in key macroeconomic variables; however, they make no specific reference to the possible policy to be followed if such variations actually occur.

⁵⁵ Law on Public Sector Borrowing for Fiscal Year 2007 (Law No. 28928 of December 12, 2006).

⁵⁶ The National Financial Statement contains an assessment of public debt, but it fails to include a systematic study of the possible contingencies and other potential fiscal risks.

⁵⁷ Public municipal enterprises and Petróleos del Perú S.A. (Petroperú) do not fall under the purview of FONAFE; however, government financial institutions, including the National Bank of Peru, do come under FONAFE. Law No. 28840 of July 19, 2006 withdrew Petroperú, the country's major state-owned enterprise, from the ambit of FONAFE; Petroperú has a separate Board of Directors, which reports directly to the government's executive branch.

governed by a Board of Directors, whose main functions include approving the consolidated budget of state-owned enterprises, issuing its own management regulations, acting as the holder of the State's shares, and managing the resources derived in this capacity. Information on state-owned enterprises' budget execution and their revenues and expenditures is sent quarterly to MEF and the Peruvian Congress, together with financial statements, which in turn are included in the National Financial Statement. FONAFE's borrowing policy is in line with the guidelines set forth in the MMM, and the provisions of the General Law on the National Public Borrowing System (Law No. 28563).

MEF issues no specific report on the potential fiscal risks arising from the performance of autonomous government agencies and public enterprises under the scope of FONAFE; however, MEF regularly uses the information sent to and collected by the SIAF to assess overall financial management and the consistency of budget execution against the macroeconomic policy objectives established in the MMM. The DGAES of MEF is responsible for this activity, and regularly release reports on the fiscal situation, mainly through the *Fiscal Transparency Bulletin*.

(ii) Extent of central government monitoring of sub-national governments' fiscal position

The Constitution establishes two levels of sub-national government in Peru: the first level includes 26 regional governments, and the second includes 1,834 local governments, among provinces and districts.

The Public Sector Budget Law for Fiscal Year 2007 (Law No. 29827) includes regional and local governments among the institutions governed by the general budget regulations; therefore, they are required to execute their budgets through the SIAF and send the information on revenues and expenditures to DNPP every quarter. The information received from sub-national governments through the SIAF is included in the quarterly financial evaluation reports prepared by the MEF.⁵⁸ Additionally, sub-national governments annually send their financial information to the DNCP for inclusion and consolidation in the overall budget assessment report and the National Financial Statement. Coverage provided by this information is nearly total.⁵⁹

⁵⁸ In 2007, the SIAF collected information from the 26 regional governments (100%), but only from 736 local governments, slightly over 40% of the total number of institutions and 77% in terms of initial institutional budget for this level of sub-national government.

⁵⁹ The 2007 National Financial Statement reports that 100% of regional governments submitted their financial statements to MEF within the established time frame, while 11% of the local governments submitted the information with a delay; only 4% failed to report any information at all. That year, most of the local governments reported their financial statements to the DNCP through the National Accounting Integral Information System (SICON).

Despite explicit rules in force on fiscal responsibility, and the restrictions on sub-national government borrowing imposed by the General Law on Public Borrowing, the Fiscal Transparency and Accountability Law and the Fiscal Decentralization Law, short-term sub-national debt shows an increasing trend, particularly at the local government level. In this sense, annual consolidation of fiscal information from sub-national governments is not sufficient for MEF to monitor progress of this indicator through the DGAES and, thus, to track the inherent fiscal risk. As was the case for decentralized public agencies and state-owned enterprises, MEF does not make issue official reports on sub-national government fiscal risks; however, it does use the information collected to monitor compliance with the targets established in the MMM. This information is included in the *Fiscal Transparency Bulletin*.

Reforms

By late 2007, and definitely from the beginning of 2008, all local governments recorded and reported budget and financial information through the SIAF-GL module. This enabled an improved compliance with the obligation of local government units to send quarterly budget and accounting information to MEF and the DNCP. Finally, the development of a SIAF module for the recording sub-national government debt has been completed.

Indicator	Score	Explanation
PI-9 Oversight of aggregate fiscal risk from other public sector entities	B+	Scoring Method M1
(i) Extent of central government monitoring of autonomous government agencies and public enterprises	A	All major autonomous government agencies and public enterprises submit fiscal reports to central government at least on a half-yearly basis, as well as annual audited accounts. The central government consolidates fiscal risk issues into a report at least annually.
(ii) Extent of central government monitoring of sub-national governments' fiscal position	B	The net fiscal position is monitored at least annually for the most important level of sub-national government, and the central government consolidates overall fiscal risk into a report.

PI-10 Public access to key fiscal information

Transparency of fiscal information is assessed, first, by evaluating whether the documentation is available and readily accessible to the general public or, at least, to the relevant stakeholders; and, second, by weighing the quality, integrity and timeliness of the information that is available. This assessment mainly focused on central government institutions and the information generated during fiscal year 2007, the last completed budget year.

The right of access to public information, established in Article 2(5) of the 1993 Political Constitution of Peru, is governed by the Law on Transparency and Access to Public Information (Law No. 27806 of August 3, 2002) as amended; this law establishes that the State is obligated to guarantee the transparency of actions of the national public service, and to provide the institutional capacity needed to deliver any information demanded by the citizenry with respect to those actions. Law No. 27806 underscores the need for transparency in public financial management, particularly with regard to budgetary, financial, accounting and taxation issues, to enable adequate oversight and accountability on how public resources are used.

Public information is available for each central government institution through a transparency website that provides general information about the public agency involved, the procedures it has in place, the applicable legal provisions, the communications released, and the scheme for the procurement of goods and services, in addition to the complete names of all officials responsible for delivery of information and website maintenance. Table 3.6 lists the transparency websites available for access to public information for selected major central government institutions.

Information specifically concerning public financial management is included in another website, designated as “*Transparencia Económica*” (Economic Transparency), and posted on MEF’s website. This website includes the text of applicable laws as well as historical details of macroeconomic indicators, transfers to sub-national governments, payroll expenditures, tax collections, external and domestic debt, public investment and the National Financial Statement.⁶⁰ The economic transparency website also enables monitoring of the daily progress of budget execution from a user-friendly consultation module that contains the information recorded annually, quarterly and monthly in the SIAF since 1999, arranged according to level of government, functions and programs, financing source, generic economic type of expenditure and regional allocation.

Accessing information not readily available through printed or electronic media is also subject to a regulated procedure. In nearly all cases, the institutional transparency websites allow access by the general public to a consultation module through which they can request and obtain the needed information. The inquiry will either be answered or the information delivered within seven working days (which, exceptionally, may be extended by an additional five days), as established by law.⁶¹ The law allows for penalties to be imposed on public officials for failure to comply with these requests within the stipulated time frame. The public has made regular use of this procedure and the government generally complies within the established time frames.

⁶⁰ <http://transparencia-economica.mef.gob.pe>

⁶¹ This procedure is also available manually.

Table 3.6. List of transparency / access to information websites pertaining to selected central government institutions

Public entity	Website	Transparency Website
Ministries		
Presidency of the Council of Ministers	http://www.pcm.gob.pe	Transparencia Pública
Ministry of Agriculture	http://www.minag.gob.pe	Acceso a la Información Pública
Ministry of International Trade and Tourism	http://www.mincetur.gob.pe	Transparencia
Ministry of Defense	http://www.mindef.gob.pe	Transparencia y Acceso a la Información
Ministry of Economy and Finance	http://www.mef.gob.pe	Transparencia y Acceso a la Información
Ministry of Education	http://www.minedu.gob.pe	Transparencia y Acceso a la Información Pública
Ministry of Energy and Mines	http://www.minem.gob.pe	Portal de Transparencia
Ministry of the Interior	http://www.mininter.gob.pe	Transparencia
Ministry of Justice	http://www.minjus.gob.pe	Transparencia
Ministry of the Environment	http://www.minam.gob.pe	Transparencia
Ministry of the Woman and Social Development	http://www.mimdes.gob.pe	Transparencia
Ministry of Production	http://www.produce.gob.pe	Transparencia
Ministry of Foreign Affairs	http://www.rree.gob.pe	Transparencia en la Gestión Pública
Ministry of Health	http://www.minsa.gob.pe	Transparencia
Ministry of Labor and Employment Promotion	http://www.mintra.gob.pe	Transparencia Administrativa
Ministry of Transport and Communications	http://www.mtc.gob.pe	Nosotros/Transparencia
Ministry of Housing, Construction and Sanitation	http://www.vivienda.gob.pe	Transparencia
Autonomous constitutional agencies		
National Elections Court	http://www.jne.gob.pe	Transparencia
National Office of Election Processes	http://www.onpe.gob.pe	Gestión Transparente
National Identification and Civil Registry	http://www.reniec.gob.pe	Transparencia Administrativa
National Judicial Council	http://www.cnm.gob.pe	Transparencia
Constitutional Tribunal	http://www.tc.gob.pe	Transparencia
Public Prosecution (Attorney General's Office)	http://www.mpfj.gob.pe	Transparencia
Office of the Ombudsman	http://www.defensoria.gob.pe	Transparencia
National Auditor General's Office	http://www.contraloria.gob.pe	Transparencia y Acceso a la Información Pública
Other representative institutions		
Central Reserve Bank of Peru	http://www.bcrp.gob.pe	Transparencia
National Tax Administration Agency	http://sunat.gob.pe	Transparencia
State Procurement Council	http://consucode.gob.pe	Transparencia
FONAFE Holding entity of public enterprises	http://fonafe.gob.pe	Transparencia

Table 3.7 summarizes the level of compliance with the information requirements associated with this indicator, which measures the extent to which information is available to the general public in a timely manner.

Table 3.7. Access to public information indicators

<i>Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the Legislature.</i>	YES. The Budget Bill for fiscal year 2009 was submitted to the Peruvian Congress on August 30, 2008 and the accompanying bills were published in El Peruano Official Gazette on September 13, 2008. This information, together with the 2009-2011 Multiannual Macroeconomic Framework, the document of the Explanatory Recitals and the annexes to the Budget Bill, were all available at the MEF's website (www.mef.gob.pe) two days after being officially submitted.
<i>In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.</i>	YES. In-year budget execution reports for year 2007 were routinely made available to the general public and updated daily. This information could be accessed through a user-friendly consultation module on MEF's economic transparency website (www.transparencia-economica.mef.gob.pe). The consolidated annual evaluation report on the 2007 public sector budget, known as "2007 Overall Assessment of Budget Management", was sent to Congress within the legal limit of sixty days from the closing of the corresponding budget year (March 31, 2008) and made available to the public at the MEF's website two days after official submission.
<i>Year-end financial statements: The statements are made available to the public through appropriate means within six months of completing the audit.</i>	YES. The National Sheet Financial Statements are prepared on or before June 30 of the year following the fiscal year, and submitted to the National Auditor General's Office (CGR) for review. The CGR is required to issue the audit report by August 31 of the same year and send it to the Executive Branch, which is required to submit the CG and the audit report together to Congress, on or before November 15. After submission to Congress, the CG is published on MEF's website (www.cpn.mef.gob.pe). During this assessment, the 2007 CG process had yet not been completed; however, the CG for 2006 is available to the general public.
<i>External audit reports: All reports on central government consolidated operations are made available to the public through appropriate means within six months of completing the audit.</i>	YES. The 2007 National Financial Statements Audit Report is available at the website of the National Auditor General's Office (www.contraloria.gob.pe) under the heading "Informes de Control" (Oversight Reports).
<i>Contract awards: Award of all contracts with values above or approximately equivalent to US Dollars 100,000 are published at least quarterly through appropriate means.</i>	YES. Each central government institution posts its information on the procurement of goods and services being processed throughout the fiscal year at their transparency websites. This information is also available at the link "Portal de Adquisiciones y Compras del Estado" (State Procurement Website, or PACE) of the National Auditor General's Office (www.contraloria.gob.pe/pace_old) and at CONSUCODE's website (www.consucode.gob.pe).
<i>Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).</i>	NO. Although there is information available at the sub-program level, such as primary education or collective health, there is no budget information being publicized at the basic service unit level.

(i) Number of the above listed indicators on public access to key information (Table 3.7) that are actually met (in order to count in the assessment, the full specification of the information benchmark must be met)

As presented in Table 3.7, the government makes available to the general public five out of the six types of information required within the time frames provided and through the appropriate public access means.

Indicator	Score	Explanation
PI-10 Public access to key fiscal information	A	Scoring Method M1
(i) Number of the above listed indicators on public access to key information (Table 3.7) that is actually fulfilled	A	The government makes available to the public between 5 and 6 of the 6 required types of information.

3.3. Policy-Based Budgeting Process

PI-11 Orderliness and participation in the annual budget process

(i) Existence of and adherence to a fixed budget calendar

Article 78 of the Political Constitution of Peru (1993) establishes an August 30 deadline for submitting the annual budget to Congress. This deadline has been complied with in relation to the Budget Laws for fiscal years 2006, 2007 and 2008. With respect to budget programming, article 15.4 of the General Law on the Budget System (Law No. 28411 of January 1, 2005) provides that MEF shall determine budget ceilings for each agency and notify each entity of its ceiling within the first five working days of June. The Directive on Public Sector Budget Programming and Formulation, promulgated by means of a MEF Directorate Resolution, defines the calendar for Budgeting Programming meetings with MEF.⁶²

In practice, budget directives and circulars are issued outside the time periods provided by law, which reduces the time available for the sectors to prepare their proposals. The directive for the preparation and formulation of the 2008 budget was completed only on June 25, 2007;⁶³ that directive defines no date prior to August 30 for the various budget preparation and formulation stages, but merely provides a schedule for budgeting meetings, beginning on July 9. That same year, the budget circular was sent subsequent to the issuance of the directive (on July 6, 2007). The entities have thus had slightly more than four weeks to carry out the detailed programming, because the budget bill is required to be reviewed during the last two weeks of August, prior to its being submitted to Congress on the constitutionally mandated date of August 30.⁶⁴

Notwithstanding the tight schedule, most of the entities responded well because of the ongoing coordination between them and MEF/DNPP, and because the structure of expenditures is inertial (determined by austerity conditions that have been in place for several years).⁶⁵

⁶² Article 8, Annex I of Directive No. 006-2007-EF/76.01, approved by virtue of Directorate Resolution No. 024-2007-EF/76.01.

⁶³ MEF, Sector Public Budgeting Process, Directorate Resolution No. 024-2007-EF/76.01, published in *El Peruano* Official Gazette on June 28, 2007.

⁶⁴ Work session held with DNPP.

⁶⁵ See Inter-American Development Bank / Peruvian Economy Institute, 2007: Section 6.1, "Budget Bill Preparation and Formulation."

(ii) Guidance on the preparation of budget submissions

Pursuant to the law, budget ceilings should be approved by the Council of Ministers before being presented to the various budget entities.⁶⁶ This law has been complied with and the circular sent to the entities is clear and detailed with respect to their ceilings.⁶⁷

(iii) Timely budget approval by the Legislature

The Political Constitution of Peru (1993) provides that Congress has until November 30 to approve the budget bill (Article 80).⁶⁸ As provided in the Constitution, Budget Bills for fiscal years 2006, 2007 and 2008 were enacted by Congress on November 26, 2005, on November 30, 2006, and on November 30, 2007, respectively.⁶⁹

Indicator	Score	Explanation
PI-11 Orderliness and participation in the annual budget process	A	Scoring Method M2
(i) Existence of and adherence to a fixed budget calendar	B	The budget process is institutionalized. The deadlines for the budgeting process established by law are clear. Some of these deadlines are not complied with and the budgeting process therefore starts later than provided. However, budget entities have more than four weeks to complete their detailed estimates.
(ii) Guidance on the preparation of budget submissions	A	The budget circular reflects ceilings approved by the Council of Ministers prior to the circular's distribution to the agencies. The budget circular is comprehensive and clear.
(iii) Timely budget approval by the Legislature	A	All three budget bills (2006, 2007 and 2008) have been approved and the laws enacted before the end of the preceding fiscal year.

PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting**(i) Preparation of multi -year fiscal forecasts and functional allocations**

The Law provides that MEF is to publish the Multiannual Macroeconomic Framework (MMM),⁷⁰ a comprehensive document containing the macroeconomic forecast for the following three years –the year for which the budget was prepared and the two subsequent years– as well as statistics for the previous year's budget execution and a review of the year

⁶⁶ The law referred to is the General Law on the National Budget System (Law No. 28411 of January 1, 2005), Section 15.2.

⁶⁷ The 2007 circular regarding preparation and formulation of the 2008 Budget Bill was sent to the relevant entities on July 6, 2007 and included an explanatory page with the different applicable ceilings: for current expenditures related to capital outlays; and also for current expenditures including amounts provided for payroll, provisional obligations, goods and services and other current expenditures. (Source: MEF-DNPP, Official Circular 023-2007-EF/76.12).

⁶⁸ Article 23.1 of the General Law on the National Budget System (Law No. 28411 of January 1, 2005) further provides that the Budget Bill for a given fiscal year is to be approved on or before December 31 of the previous year.

⁶⁹ Legislature (Peruvian Congress), laws Nos. 28652, 28927 and 29142.

⁷⁰ Article 9 of the Fiscal Prudence and Transparency Law (No. 27245 of December, 1999) as amended by the Fiscal Responsibility and Transparency Law (Law No. 27958 of May, 2003).

in progress. This statistical information focuses on compliance with fiscal regulations, such as (i) the requirement that non-financial public sector expenditure be monitored, and (ii) that fiscal surpluses be generated to enable a reduction of the overall stock of public debt. The MMM is prepared on a rolling annual basis (i.e., it always forecasts the following three years). Preparation of the MMM falls under the responsibility of the DGAES of MEF, with the opinion of the BCRP. The MMM is subject to the approval of the Council of Ministers in May of each year.⁷¹

The MMM includes the economic policy guidelines and the medium term objectives for fiscal policy, coupled with the expected economic out-turns and the corresponding financing requirements (revenues, fiscal expenditure and public debt stock). In turn, the projected results are measured against fiscal policy sustainability indicators. The fiscal forecasts are based on economic classifications of revenues and expenditures, but they contain neither functional nor sectoral classifications. As already mentioned, the MMM is prepared annually, taking into account updated aggregate economic assumptions. The Public Budget Bill for the next year must be approved by the Council of Ministers, before August 30 of the current year, and it needs to be consistent with the assumptions and targets established in the MMM.

The General Directorate of Public Sector Multi-year Programming (DGPM) of the MEF is in charge of the SNIP, a system created by law to optimize the use of public resources allocated for investment activities.⁷² The SNIP is intended to provide the framework for preparing a Multi-year Public Investment Plans (PMIP) for periods of no less than three years. A sector PMIP has been prepared for the period 2009-2011, but some sectors have not sent timely information (Health, Transport and Communications, Defense and Foreign Affairs). Additionally, the PMIP consists exclusively of investment outlays, and not the current expenditure related to the projects.

(ii) Scope and frequency of debt sustainability analysis

The MMM contains a section on Public Debt Sustainability Analysis (DSA), based on overall debt (both domestic and external). For the fiscal years included in the assessment, namely 2005, 2006 and 2007, the MMMs for the periods 2006-2008, 2007-2009 and 2008-2010 have been approved, and are all available for review on MEF's website. The 2006-2008 MMM considered the backward-looking and forward-looking

⁷¹ Over the last three years, the MMM was approved at the sessions of the Council of Ministers held on May 18, 2005, May 24, 2006 and May 30, 2007. The MMM may be reviewed –the usual practice was to have it reviewed in August– because the budget bill sent to Congress must be consistent with the provisions contained therein. The macroeconomic review has mainly focused on the dynamics of the international situation and its effect on the prices of commodities.

⁷² Law establishing the National Public Investment System (Law No. 27293 of June 28, 2000) and Executive Decree sanctioning the Directive for Public Investment Multi-year Programming (Executive Decree No. 176-2006-EF of November 18, 2006).

approaches as the basis for assessing DSA. Subsequently, the MMMs for the periods 2007-2009 and 2008-2010 presented this analysis using the traditional approach and the value-at-risk approach with respect to fiscal sustainability.⁷³

(iii) Existence of sector strategies with multi-year costing of current and investment expenditure

The law provides that budget entities are to prepare their institutional operation plans in accordance with their respective Strategic Institutional Plans (PEIs), which in turn have to be consistent with the Multi-year Sector Strategic Plans (PESEM).⁷⁴ Government agencies provide information in their institutional strategic plans; these plans are reviewed annually and support the institutional budget bill, which is evaluated by the MEF and the National Budget and Financial Statements Congressional Committee (CPCG). The projection for investment expenditures should include contingency funding that may be needed to continue executing projects that are included during the multi-year period. However, the strategy does not include a multi-year estimate of current expenditure; thus, there is limited consistency between the strategy and the aggregate fiscal forecasts.⁷⁵

(iv) Linkages between investment budgets and forward expenditure estimates

Budget programming of public investment projects rests with the agencies; and agency programs must cover execution, operation and maintenance.⁷⁶ Projects included in the budget are executed after approval by the SNIP, which evaluates their technical and economic viability. The law provides that the Public Investment Multi-year Program (PMIP) is to be prepared on the basis of sector strategic plans and regional development plans.⁷⁷ Additionally, the Directive for Public Investment Multi-year Programming⁷⁸ was approved and the Public Investment Multi-year Programming Data Sheet was published, PMIP-01. In 2007, the agencies submitted their strategic institutional plans in support of their budget projects. The most significant agency investments are included in the sector strategies and take account of their maintenance requirements. In turn, sub-national government investments are largely the product of the national government's sector strategies and the participative practices built into the budget process.

⁷³ The IMF routinely analyzes external debt sustainability. See the last analysis at IMF, 2009.

⁷⁴ General Law on the National Budget System (Law No. 28411 of January 1, 2005), Section 71.1.

⁷⁵ Performance indicators and result-based budgeting have been incipiently used in the last years.

⁷⁶ Subsection "d" of Final Provision Five of the Public Sector Budget Law for Fiscal Year 2006, which provides that agencies are to program the financing of public investment projects throughout their execution, operation and maintenance stages.

⁷⁷ Pursuant to Section 20.1 of Directive No. 004-2002-EF/68.01, General SNIP Directive as approved by virtue of Directorate Resolution No. 012-2002-EF/68.01.

⁷⁸ As approved by virtue of Executive Decree No. 176-2006-EF of November 18, 2006.

Indicator	Score	Explanation
PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	B	Scoring Method M2
(i) Multi-year fiscal forecasts and functional allocations	C	The MMM includes a forecast of economic aggregates for the next three years, with a detail of fiscal expenditure according to the economic classification.
(ii) Scope and frequency of debt sustainability analyses	A	The MMM contains an overall public debt sustainability analysis, which was undertaken in each of the three last years (2005-2007).
(iii) Existence of costed sector strategies	C	Most of the agencies implement costed sector strategies, but these are not necessarily consistent with fiscal forecasts.
(iv) Linkages between investment budgets and forward expenditure estimates	B	The majority of investments are based on relevant sector strategies and subsequent requirements with regard to current expenditures.

3.4. Predictability and Control in Budget Execution

PI-13 Transparency of taxpayer obligations and liabilities

The National Tax Administration Agency (SUNAT) is a decentralized government institution of the Ministry of Finance, with legal authority under public law, its own equity and economic, administrative, functional, technical and financial independence. In 2002, SUNAT absorbed the National Customs Superintendency and assumed its legally vested duties, powers and authorities. Its main function is to administer, collect and oversee the central government's internal and customs taxes.

SUNAT is a well regarded professional entity, staffed by a team with strong technical credentials who follow high ethical standards. A significant percentage of its staff has professional degrees. Employment at SUNAT is only attainable through open competition, and promotions are awarded according to transparent, merit-based processes. All significant transactions with respect to both taxes and customs duties can currently be made electronically (Internet). This includes activities such as registration with the Single Taxpayers' Registry (*RUC*), declarations, inquiries, and payments as well as other incidentals.

(i) Clarity and comprehensiveness of tax liabilities

The Tax Code, and the tax and customs regulations (together with their associated rules) are the essential legal references as regards taxes.⁷⁹ This legislation is available in the Official Gazette (*El Peruano*) or in the SUNAT website (www.sunat.gob.pe). The tax legislation is

⁷⁹ Single ordained text of the Tax Code (Supreme Decree 135-99-EF of August 19, 1999), General Administrative Procedure Law (Law 27444 of April 11, 2001), Law regulating the Contentious Administrative Procedure (Law 27584 of December 7, 2001), Law of Customs Crimes (Law 28008 of June 19, 2003), General Customs Law (Supreme Decree 129-2004-F of September 12, 2004), Customs Tariff (Supreme Decree 017-2007-EF of February 18, 2007).

considered to be comprehensive and clear, and it is very extensive. SUNAT's discretionary powers are subject to strict limitations, based on explicit criteria. As a rule of thumb, the law must be enforced and the rates and the taxable bases are not negotiated.⁸⁰ However, there are many, complex procedures, which is evidence of a need to simplify the regulations.

(ii) Taxpayer access to information on tax liabilities and administrative procedures

In Peru, tax information is easily accessible. There is a National Taxpayer Services Intendancy specialized in information services and dissemination of tax regulations. A tax information dissemination strategy has been devised. There are 55 taxpayer service centers within the national territory (10 in Lima) that provide information in Spanish on tax liabilities and administrative procedures. SUNAT has published a number of brochures and tax guides, which are readily available to the taxpayer. In addition, it provides services through its Virtual Office and tax guidance through an Inquiries Center (the guidance offered includes the interpretation of laws and regulations enforced by SUNAT). Any inquiry is published on the institution's web site, sorted by date and subject. These inquiries are of a binding nature for SUNAT, thereby ensuring transparency.

SUNAT has also issued written guidance and continues broadcasting radio programs in Quechua and Aimara in addition to informative videos for TV sets in waiting rooms for the linguistic minorities in the area of Puno. Through its Tax and Customs Administration Institute (IATA), SUNAT promotes a tax payer culture at schools throughout the country. It also holds regular meetings with the Chamber of Commerce and other entities. For those entities with Internet access, SUNAT's site is a rich and detailed source of tax legislation.

(iii) Existence and functioning of a tax appeals mechanism

There is a three stage process that a taxpayer can follow to pursue a claim against or a challenge to a SUNAT decision related to tax liability: (1) the taxpayer begins by making a claim directly to SUNAT, which must make a decision on it within 45 days; (2) if the taxpayer is not satisfied with SUNAT's decision, he can appeal it to the Tax Court (MEF's resolution authority);⁸¹ and (3) if he is still not satisfied, the taxpayer can appeal to the Judiciary (this is rare, because judicial processes are long and expensive).

⁸⁰ This opinion is shared by private sector representatives (work session with the chairman and some managers of the Chamber of Commerce in Lima). In order to eliminate the uncertainty of the tax obligation resulting from amendments to the regulations for the companies that have made significant investments in the country (hydrocarbons, mining, telephony, etc.), the Government (not SUNAT) has entered into tax stability agreements with these taxpayers; those agreements were not based on its discretionary powers but on SUNAT's legal authority.

⁸¹ Article 98 of the Tax Code establishes the Tax Court's operation procedures. Although this Court reports administratively to the MEF, it is independent.

The current mechanism has problems. In the first stage, SUNAT is not independent because it is a party to the appeal as well as the judge. There are also issues of access to the process, since the first two stages are open to all taxpayers at very low cost. Therefore, and also for cultural reasons, taxpayers misuse the appeals system, which does not filter claimants based on the types of claims. The current design of the claims system could be modified to make it more efficient and fair.⁸²

Indicator	Score	Explanation
PI-13 Transparency of Taxpayer Obligations and Liabilities	B +	Scoring Methodology M2
(i) Clarity and comprehensiveness of tax liabilities	A	The tax legislation in Peru is comprehensive and limits strictly SUNAT's discretionary powers. There is scope for SUNAT to simplify its procedures and regulations.
(ii) Taxpayer access to information on tax liabilities and administrative procedures	A	Through SUNAT's 55 service centers around the country, taxpayers have ready access to comprehensive, user friendly and up-to-date information on tax liabilities and administrative procedures for all major taxes. Also, SUNAT organizes education campaigns and answers taxpayers' inquiries through its website.
(iii) Existence and functioning of a tax appeals mechanism	C	The first stage of the current claims system has SUNAT serving as both a party to a claim as well as the judge. There are also issues of access that should be addressed. It would be beneficial to taxpayers to redesign the claims system to make it more efficient and fair.

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

(i) Controls in the taxpayer registration system

Taxpayers are registered in a Single Taxpayers' Registry (RUC).⁸³ The RUC is a computer registry maintained by SUNAT; it contains the taxpayers' identification data and tax obligations. After having their registration confirmed in the RUC, taxpayers receive an eleven-digit RUC number, which identifies them with SUNAT. This number is permanent, and exclusively used by its holder. The use of the RUC number is mandatory for all activities involving tax administration, with SUNAT directly and other related agencies (include, *inter alia*, private banks and pension contributions systems). All domestic or foreign individuals or legal persons, undivided shares, de facto companies or other collective entities, domiciled within or outside the country that are taxpayers and/or create tax liabilities managed and/or collected by SUNAT must register with the RUC. Currently, pre-registration in the RUC

⁸² Opinion of private sector representatives (work session with the chairman and some managers of the Chamber of Commerce in Lima).

⁸³ Legislation and regulatory sources: Single ordained text of the Tax Code (Supreme Decree 35-99-EF of August 19, 1999), Superintendence's Resolution approving the regulatory provisions of Legislative Decree 943 that approved the Single Taxpayers' Registry Law (Law 210-2004/SUNAT of September 19, 2004), Superintendence's Resolution amending the Superintendence's Resolution 210-2004/SUNAT, approving the regulatory provisions of Legislative Decree 943 (298-2004/SUNAT, published on December 7, 2004).

may be done electronically by individuals with an national identity document (DNI), using SUNAT's website. This procedure is available to taxpayers domiciled anywhere in the country (except for Loreto). Following pre-registration, the taxpayer must still go to a Taxpayer Service Center (CSC) to complete the procedure and activate his/her RUC registration.

The RUC is linked to the National Identification and Civil Status Registry (RENIEC). The linkage with other public registries such as the National Superintendency of Public Registry Offices (SUNARP) is only currently being initiated, and the requisite systems have not yet been completed.

(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

Article 166 and subsequent sections of the Tax Code govern tax violations and penalties in general.⁸⁴ These sections are supplemented by the recent Superintendence's Resolution 063-2007/SUNAT of April 1, 2007, approving the Grading System Regulations applicable to Tax Code violations. This system provides for flexibility in establishing penalties, seeking favorable changes in the taxpayers' behavior based on criteria including: recurrence, acknowledging the violation or fulfilling its remedy; the objective and general application of this flexibility are specified in the regulation. The current legal framework for the penalties assumes different levels of noncompliance and thus is very detailed. In this framework, tax violations arise from the failure to perform the following obligations: (i) to register or keep current one's registration; (ii) to issue, require or retain proofs of payment; (iii) to keep books and/or other records that verify financial activity; (iv) to file declarations; (v) to enable control by Tax Authorities by providing required documentation or appearing before them when called.⁸⁵ Penalties include: fines, confiscation, temporary restraint on vehicles, temporary closure of premises or offices, restraints on using independent professionals, and temporary suspension of effective licenses, permits, concessions or authorizations to carry out activities or provide public services. For example, for failure to register with the Tax Authorities' registries (article 173), for failure to issue and/or grant proofs of payment or supplementary documents (article 174) or for failure to file a tax return (article 176); the penalty ranges from 0.4 to 1 tax unit (UIT).⁸⁶ For false returns and unrecorded revenues, the penalty is fixed at 50% of the unrecorded revenues.

SUNAT applies the penalties automatically and objectively, as stipulated in the legal framework (Code and Grading System).⁸⁷ The Grading System reduces the penalties

⁸⁴ The Customs-related Crimes Law (Law 28008 of June 19, 2003) governs the penalties for customs-related crimes.

⁸⁵ Tax Code, article 172.

⁸⁶ An amount fixed in the regulations, which may be adjusted from one year to the next. For 2007, the UIT was S/. 3450 (approximately US\$1250).

⁸⁷ Tax Code, section 180. Its exhibit presents three tables with a detail of the penalties. Refer to additional information in the Superintendence's Resolution approving the Grading System Regulations applicable to Tax Code violations (063-2007/SUNAT, April 1, 2007).

according to the taxpayers' behaviors. Once the Grading System has been applied in a case, SUNAT has limited flexibility in the application of relevant penalties.⁸⁸

(iii) Planning and monitoring of tax audit and fraud investigation programs

SUNAT has devised a tax audit strategy based on clear and detailed risk evaluation criteria,⁸⁹ which is very well organized. This strategy focuses on the largest 1800 taxpayers (who contribute 80% of tax revenues collected); however, it also includes other taxpayers, based on risk profiles. The strategy also intends to establish segmentation by type of taxpayer and the amount they owe. The process involves establishing the taxpayer's specifications to enable treating his case uniquely. The noncompliance risk factors are identified and addressed by regulatory initiatives, and oversight activities. In this context, SUNAT has given adequate priority to anchoring its oversight activities in an exhaustive information management system, and on detailed analysis of inconsistencies and risk derived by information matching (i.e., the system that matches information in the internal taxes database detects a series of inconsistencies when comparing information from tax filings with related information provided by third parties). Customs uses similar systems to detect inconsistencies and fraud.

Indicator	Score	Explicación
PI-14 Effectiveness of measures for taxpayer registration and tax assessment	A	Scoring Methodology M2
(i) Controls in the taxpayer registration system	B	Taxpayers are registered in the RUC, with linkages to the RENIEC and developing linkages to other relevant government registration systems.
(ii) Effectiveness of penalties for non-compliance with registration and reporting obligations	A	Penalties exist for most relevant areas and are applied automatically and objectively by the SUNAT, as established by the legal framework.
(iii) Planning and monitoring of tax audit and fraud investigation programs	A	There is an audit strategy with clear and detailed risk assessment criteria for all major tax areas.

PI-15 Effectiveness in collection of tax payments

(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years)

In 2006 and 2007, the debt recovery ratio was 62.3% and 50.5%, respectively, resulting in an average of 56.4% for those years, as shown in table 3.8.

⁸⁸ In this context, the strict application of the penalties is part of the SUNAT' oversight strategy. According to the SUNAT's information, from 2000 to 2005 the IGV evasion was reduced by approximately 12 points from 50% to 38.5%.

⁸⁹ The risk management system is one of the best in the continent and, as regards customs, it is by far the most effective (38% of effectiveness) (comment made by the World Bank's team).

Table 3.8. Debt Recovery Ratio (In %)

Year 2006	Year 2007	2006-2007 Average
62.3%	50.5%	56.4%

Source: SUNAT

This ratio indicates the percentage of debt (payment orders) transferred to the Tax Authorities' coercive collection agencies in a certain fiscal year that was collected within the three months following assignment of the debt to those agencies.⁹⁰ The decline in the ratio in 2007 was due to an exogenous event, it reflected a natural disaster –an earthquake in the south of Peru– which affected the recovery of debts in SUNAT's regional offices in the area of the quake.

The total stock of taxpayer debt (net of challenges) that is currently due is low; since about 70% of arrears are more than three years old, and consist mainly of obligations of taxpayers who are not currently registered in the RUC or have been suspended temporarily, that portion of taxpayer arrears is at least illiquid debt or a loss. Of the remaining 30% that are due from active taxpayers, a fiscal domicile has not been found for about 30% of that remainder. These data indicate the extent to which the concealment of debtors and their property is commonly used to defeat SUNAT's collection systems.

About 10% of the 2007 taxpayer arrears (excluding social security contributions) is attributable to public sector entities,⁹¹ mainly for General Sales tax remissions (in the case of public sector enterprises) and Income Tax withholdings. 50% of the arrears of the public sector are from businesses that come under FONAFE's umbrella; about 15% are attributable to provincial or district municipalities, while 10% are attributable to public budget execution units, and another 10% are attributable to ETEs.⁹²

The information available indicates that the average tax debt collection percentage was below 60% in the period 2006-2007.

(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration

A taxpayer who carries out taxable transactions in the domestic market or with customs⁹³ may settle his or her tax obligations in a private commercial bank or at the State Bank, Banco de la Nación.⁹⁴ The payment can be made using cash, check, credit card or electronic transfer. The tax collection system allows all revenues to be transferred daily to the Public

⁹⁰ The recovery ratio could be even higher if the debts collected after the referred three months are considered.

⁹¹ SUNAT's Communication.

⁹² Idem.

⁹³ In the case of customs taxes, the customs agent is responsible for making the payment on behalf of the taxpayer or foreign trade user.

⁹⁴ The report is filed electronically in the *Programa de Declaración Telemática* (PDT) format, which provides all the tax information required by the SUNAT.

Treasury's Main Account,⁹⁵ which is held at the Banco de la Nación (which also centralizes in the Single Treasury Account the DNTP's other main accounts).⁹⁶ SUNAT provides daily information about the composition of the taxes paid into the DNTP's current account. Likewise, the Banco de la Nación forwards electronically to DNTP (and BCRP) its Treasury Report every day; this report includes a summary of transactions and balances of the government's bank accounts. Thus, there are daily reports of taxpayers' gross payments and their distribution: Public Treasury revenues, the collection fee paid to SUNAT and the treasury fee for Banco de la Nación's services. Furthermore, SUNAT has collection agreements with private commercial banks, and pays a fee for their services. Private commercial banks transfer electronically and daily their collections to the Treasury main account with the Banco de la Nación. Thus, SUNAT has timely information every day on the amount of the tax revenues paid, which is then to be transferred to the Public Treasury.⁹⁷

(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury

As established by Directive 004-2007-EF/93.01, as approved by Directors' Resolution 009-2007-EF/93.01, SUNAT remits quarterly financial information to MEF related to the collection of ordinary revenues for the Public Treasury; this information covers, tax collections, refunds, uncollected taxes and collection transfers to the entities that are entitled to a joint share of tax revenues together with the Public Treasury. The tax debt of each of the reporting public sector entities is also forwarded to MEF every semester, for use in preparing the National Financial Statements.

Also, according to Directive 009-2008-EF/76.01, as approved by Directors' Resolution 013-2008-EF/76.01, a reconciliation of the public sector revenues budget is performed between SUNAT and MEF; this activity includes the signing of minutes by the National Public Accounting Directorate and the National Public Treasury Directorate, attesting to the taxes collected by SUNAT during the year. This signed document is the final step in the monthly reconciliation of collected taxes.

Every day, SUNAT forwards information on its collection using a SUNAT-MEF dedicated interconnection line, and that data is subsequently uploaded to SIAF. The data covers payments collected, by tax category and other variables.

Finally, financial and budget information on tax collections prepared by SUNAT is audited yearly by the National Auditor General's Office, which sends a copy of its report to the MEF.

⁹⁵ Article 26 of the Public Sector Financial Management Framework Law (Law 28112 of November 27, 2003).

⁹⁶ The Single Treasury Account was created by article 25 of Law 28112.

⁹⁷ In the case of tax payments with checks, the transfer is made once the relevant check has cleared (usually 24 hours) through the Electronic Clearing House.

Indicator	Score	Explanation
PI-15 Effectiveness in collection of tax payments	D+	Scoring Methodology M1
(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years)	D	The ratio of average collection of tax arrears was below 60% (2006-2007).
(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration	A	Tax revenue collections are transferred by SUNAT (internal and customs taxes) to the DNTP daily.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	A	Complete and regular reconciliations take place monthly.

PI-16 Predictability in the availability of funds for commitment of expenditures⁹⁸

The Public Sector Financial Management Framework Law (Law 28112 of November 27, 2003) currently refers to public financial management systems, including those for Budget, Treasury, Debt and Accounting. The General National Budget System Law (Law 28411 of January 1, 2005) establishes the general principles governing the budget process, the approval mechanisms and the general restrictions on how it is implemented; these restrictions include those that apply to the management and authorization of resources spent within the budgetary limits. Accordingly, the Public Sector Budget Law is approved yearly (for fiscal 2007, Law 28907 of December 11, 2006); it also sets out expenditure control measures to be applied during the fiscal year covered by the approved budget. In turn, the General National Treasury System Law (Law 28693 of March 21, 2006) establishes the system's regulatory principles, its field of application, the powers of the system stakeholders, and the processes governing the management of public funds.

Within this framework, DNTP issues directors' resolutions approving Treasury directives that govern the operations of the different processes for which it is responsible, including those relating to expenditure commitments and the availability of funds to cover them. Until 2006 this was an annual practice of DNTP; since 2007, the Directive⁹⁹ has become permanent nature, with no new annual resolutions likely to be required.

The evaluation of this indicator was made for the fiscal period 2007, which was part of a period of fiscal expansion where public resources were readily available and growing (in local and foreign currency), public debt was well managed, and domestic capital markets grew.

⁹⁸ The evaluation and analysis of this indicator required joint work with officials of the DNPP and the DNTP of the MEF, Banco de la Nación's Finance Management and some ministries, departments and sector offices (Ministry of Health and Ministry of Education), with the idea of gathering different perspectives on the performance of these systems and the related processes.

⁹⁹ MEF, Treasury Directive 001-2007-EF/77.15.

Thus, the Treasury did not face liquidity or cash flow problems that might have necessitated delays in commitments payments.

(i) Extent to which cash flows are forecast and monitored

DNTP prepares an annual cash flow projection, covering the Public Budget enacted by the President of the Republic, usually in December before the beginning of the fiscal year. The annual cash flow forecast is prepared by the Public Treasury Programming Office within DNTP. The decisions on the maximum ceiling for allocating Treasury resources are made monthly by the Public Treasury Account Committee.¹⁰⁰ This Committee meets every month, generally before the 10th, to review updated revenues forecasts (prepared using SUNAT's estimates), evaluate the Monthly and Quarterly Commitments Program (which are updated monthly), and determine the expenditure ceilings for the month. These decisions are documented in a set of Agreements reached by the Treasury Account Committee. DNPP and DNTP take note of these agreements; establish the respective programs for commitments and for expenditures, and input the availability of funds in the SIAF-SP for each budget implementation agency, based on budgetary item allocations. The MDAs learn through SIAF of the commitments approved for the month; and, if they have higher requirements, they can request an increase in the approved funding levels. The time allowed for requesting these adjustments expires on the 20th of each month.

DNTP monitors the Public Treasury's cash flow on a daily basis, using information provided by the Banco de la Nación's Finance Manager; thus, it determines its balances and evaluates the government's ability to meet projected cash flows. The monthly cash projections are updated on an ongoing basis; and when the transactions generate a surplus, the best option for investing the surplus is assessed.

(ii) Reliability and scope of periodic, in-year information to MDAs on ceilings for expenditure commitment

MEF, through the Public Treasury Account Committee and DNTP, conducts an annual indicative programming exercise, and produces monthly fund availability programs for operating purposes. This information is highly reliable, given the rigorous analytical processes followed and the daily updates using timely data from Banco de la Nación and SUNAT.

¹⁰⁰ The Treasury Account Committee (*Comité de Caja*) is comprised of the Vice Minister of Finance (who chairs it), the Vice Minister of Economy, the General Manager of the BCRP, the General Manager of Banco de la Nación and the General Director of Public Budget, each of whom has a voice and a vote. There is also a Technical Secretary of the Treasury Account Committee, who participates in its monthly sessions but has no vote. He reports directly to the Vice Minister of Finance. The Account Committee also invites the General Director of the Public Treasury, the General Director of Public Debt and the Manager of Tax Studies of SUNAT to its meetings.

DNPP approves a Quarterly Commitments Calendar (sub-divided by month), which is prepared based on the institutional commitment calendars forwarded to that agency by all the public entities or MDAs implementing budgets. This calendar is published at the beginning of the quarter; it shows the monthly aggregate distribution allocated by sources of financing. At the beginning of each month, the Commitments Calendar for the period is published, indicating the level of execution for that month. Publication of this report is authorized by a resolution of the directors of DNPP; the distributions reported fall within the expenditure limits authorized by the Treasury Account Committee.

During 2007, the execution of committed expenditures was generally lower than the monthly commitments approved by the Treasury Account Committee. This is partly explained by the capacity of budget implementing entities, and the speed with which they can incur expenditures, especially in the first months of the year. This contrasts with a higher availability of revenues for project execution during the same period. The information provided to the MDAs has a monthly horizon that allows them to plan, with considerable certainty, the expenditures they may incur during the subsequent month. In any case, at the beginning of the fiscal year, the MDAs have submitted a monthly calendar of their commitments within their budgetary limits, which enabled more detailed planning than the monthly estimates of execution. However, some MDAs consider that this process of establishing expenditure thresholds is not satisfactory, and the short-term focus creates uncertainty. In some cases, some budgeted items have been cut back seemingly arbitrarily, as reported by DNPP; apparently, the uncertainties of the cash allocation process has inhibited some MDAs from fully implementing their plans.¹⁰¹ Moreover, they sometimes learn that their cash requirements have not been fully funded when they attempt to use their requested resources through the SIAF, leading them to question the appropriateness of using tight cash controls during a period when the government is enjoying good fiscal health.

(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs

Adjustments to budgetary allocations are generally governed by Law 28411 and, more specifically, by the 2007 Annual Budget Law. MEF does have discretion to make budgetary adjustments, either to make supplementary credits or cuts for extraordinary reasons. During fiscal 2007, MEF provided supplementary credits on two occasions.¹⁰² The first was intended

¹⁰¹ For example, it is reported that a certain amount was requested to acquire a specialized piece of equipment and then it became known that only a percentage of such funds was approved, thus rendering the purchase impossible because it was not possible to purchase half or a portion of that piece of equipment. In this case, an increase was not authorized as requested in a supplementary credit, giving rise to problems in its execution (interview with Ministry of Health's units).

¹⁰² Over the last few years, supplementary credits resulted from economic growth benefits which allowed the government to have more public resources in comparison to the programmed resources.

to provide continuity for the “investment shock” program, which was to be cover special investments and social expenditures from September to December 2006¹⁰³. At the beginning of the second semester of 2007, the second supplementary credit was approved.¹⁰⁴ In each case, the distribution of supplementary resources followed the normal budget process: the Council of Ministers formally approved the projects, and then Congress approved a law based on due justification of the distribution.

Indicator	Score	Explanation
PI-16 Predictability in the availability of funds for commitment of expenditures	B+	Scoring Method M 1
(i) Extent to which cash flows are forecasted and monitored	A	A cash flow forecast is prepared for the fiscal year and it is updated monthly, based on actual cash inflows and outflows.
(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment	B	In 2007 MDAs had relatively reliable basic information one quarter in advance.
(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs	B	In 2007, few budget adjustments took place and they were done following a transparent process.

PI-17 Recording and management of cash balances, debt and guarantees¹⁰⁵

This indicator determines the extent to which the government’s systems to manage cash, debt and guarantees have the capacity to provide accurate and timely information, thereby enabling resources to be made available as needed.

Peru’s Political Constitution refers explicitly to the issue of borrowing and provides that the government’s domestic and foreign debt transactions will be approved by law.¹⁰⁶ The Public Sector Financial Management System Framework Law¹⁰⁷ also defines prudent management of public borrowing and public treasury among its general principles. That law also establishes the systems that are part of the Public Sector Financial Management (Integrated Financial Management System - SAFI),¹⁰⁸ which includes the National Public Debt System and the National Treasury System. The public debt management system must take account of the provisions of the the General Public Debt Law (Law 28563, of June 25, 2005) and the annual Public Sector Debt Law, which is approved together with the Public Budget¹⁰⁹ as well as specific

¹⁰³ Law 28979 of February 15, 2007, for S/. 1,206 million, related to the unexecuted balance of the 2006 budget.

¹⁰⁴ Law 29035 of June 9, 2007, for S/. 2,035 million.

¹⁰⁵ The preparation of this dimension required work sessions with the DNER, DNTP and DNCP at the MEF, as well as with Banco de la Nación’s Financial Manager, the financial agent of the Peruvian government.

¹⁰⁶ Article 75 of Peru’s Political Constitution.

¹⁰⁷ Law 28112 of November 27, 2003.

¹⁰⁸ Law 28112, title I, article 5.

¹⁰⁹ Law 28928 of December 11, 2006, for the 2007 Budget.

directors' resolutions. The General Treasury System Law (Law 28693 of March 21, 2006), together with specific directors' resolutions that are issued annually or as required, govern the Treasury management functions. Some important aspects of this legal framework, which affect public financial management, include:

- MEF is the only authorized issuer of central government debt with a maturity of more than one year;
- Sub-national governments and state-owned companies can acquire debt, subject to certain restrictions that will be verified by MEF's DNEP;
- Ceilings on debt and guarantees are established every year in the annual Public Sector Debt Law.

(i) Quality of debt data recording and reporting

Peruvian public debt is recorded in the Integrated Debt Management System (SIAD), which is managed by DNEP. The SIAD records both the domestic and foreign public debt, and covers the debt of the national government, regional governments and local governments. The SIAD has been created in-house by DNEP (it is not an international standard software, such as SIGADE) to meet the Peruvian debt requirements, and it runs on Oracle. The SIAD retrieves the basic information through an interface developed in the SIAF, which collects the information for the SIAD to organize and classify the data according to its requirements and formats. The SIAD is used to manage the national government's debt and to record, control and monitor the sub-national debt. Sub-national governments report their debt through the SIAF. The debt of public enterprises is currently managed through a special module developed in the SIAF; this module will be superseded upon completion of a web-based system.

Systemically developed information covers virtually all public domestic and foreign debt, including the domestic debt of local governments.¹¹⁰ The reliability and general quality of the database is quite high, in terms of coverage, detail and regular updates. This information is reviewed regularly by DNEP. The balances and flows are reconciled monthly, by comparing the information received with data available from financial entities, public debtor entities and DNEP's physical records. DNEP produces regular and detailed reports on public debt; however, their distribution of this data is restricted and used only by management. These quarterly reports include information on stock, debt service and contracts. Additional summarized statistical and qualitative information is published in MEF's website, which provides comprehensive and timely information about the status of public debt in Peru (www.mef.gob.pe/DNEP/estadistica_cp.php). In addition to statistics, qualitative analytical documents about public debt are publicly available – e.g., the Annual Borrowing and Debt Management Program (PAED), which describes the strategy guidelines

¹¹⁰ Although the scope and score of this dimension will refer, according to the PEFA methodology, to the national government's debt.

to be implemented with regard to managing public debt and specifies the quantitative targets to be met by the end of the year.¹¹¹

Table 3.9. Summary of the debt management system status

Debt data	Status
Domestic	✓
Foreign	✓
Complete	✓
Update/Reconciliation	
Quarterly	✓
Data coverage	
Good	✓
Statistical reports coverage	
Stock	✓
Debt service	✓
Operations	✓
Reporting frequency	
Quarterly	✓
Annually	✓
Occasionally	✓

Source: DNEP, team preparation.

(ii) Extent of consolidation of the government's cash balances

The Single Treasury Account (CUT) is established in Law 28112, and the details are specified in Law 28693. The CUT is maintained and operated at Banco de la Nación (BN), the government's financial agent; and, it is managed by the Bank's Finance Manager, under ongoing supervision of the National Public Treasury Office. Public revenues are collected through several accounts (over 15,000 public accounts) and then flow into the BN's Main Treasury Account. The balances are transferred daily to the BCRP, where they are deposited in special accounts that pay commercial interests to the Treasury. The needs for cash in the BN's Main Account (single expenditure account) are established, and sufficient resources are transferred to it to fund government operations. Law 28112 provides that all government entities must manage their resources in BN's public accounts, although it also establishes that, in exceptional cases and supported by a specific authorization, these accounts can be managed by the private banking system. Currently, the Single Treasury Account covers at least 86% of budgetary funds, transferred among accounts of government entities.¹¹² The accounts of smaller and more remote local governments are gradually being incorporated, thanks to the installation and implementation of the SIAF in those districts.

¹¹¹ Although the strategy is prepared for three years, the dimensions are prepared for one year.

¹¹² Data provided by DNTP's Revenues Office and confirmed by the project records of the IMF-Technical Assistance Program for implementation of the CUT.

The Treasury's account balances are reported daily on line to the Treasury through a special application designed for that purpose in the SIAF; this information is also available in detail in the daily reports forwarded by the BN's Finance Manager for the previous day. The balances on these reports are verified daily at the Treasury (the Revenues Office), matching the physical information received with that obtained from the SIAF. These balances are reconciled monthly at the National Accounting and Statistics Office of the National Public Treasury Directorate at the end of each calendar month.

(iii) Systems for contracting loans and issuance of guarantees

Peru's Political Constitution provides that the government's domestic and foreign debt transactions will be approved by law. Public debt management is based on the General Public Debt Law, and the details are spelled out in each year's law that establishes the annual limits for every type of debt. This legal framework also governs the granting of government guarantees and sureties for public sector credits and public-private partnerships that require this type of transaction.¹¹³ The regulations specify that MEF is the only government agency empowered to authorize debt contracts for terms exceeding one year, and DNEP must implement a detailed management when contracting for debt. Decisions to incur debt involve several interventions by DNEP, which performs the appropriate analysis and informs the government entity seeking the loans or guarantees of the effective regulations, conditionality and limits established for each instance.

Reforms

MEF is in the process of developing more modern and integrated applications for the SIAF (some refer to this process as SIAF 2), which would make it possible to maintain a more comprehensive record of debt transactions of sub-national governments, among other important changes that are expected with this improvement in the information technology platform. The government has sought support and technical advice from the IMF to modernize the CUT to enable the full incorporation of all the budgetary resources.

Indicator	Score	Explanation
PI-17 Recording and management of cash balances, debt and guarantees	B +	Scoring Methodology M2
(i) Quality of debt data recording and reporting	A	Domestic and foreign debt records are complete, and they are updated and reconciled monthly. The data is considered to be of high integrity. Comprehensive management and statistical reports (covering debt service, stock and operations) are produced at least quarterly.
(ii) Extent of consolidation of the government's cash balances	C	The calculation and consolidation of cash balances take place at least monthly.
(iii) Systems for contracting loans and issuance of guarantees	A	Central government's contracting of loans and issuance of guarantees follow transparent criteria within clearly defined fiscal targets. All loans and guarantees are always approved by a single responsible government agency.

¹¹³ For example, guarantees or sureties may be used when the government grants a concession to a private sector entity for the construction of a road or port with financing. On some occasions, the Peruvian government's contribution is oriented to reducing the financing cost (and thus increasing the benefits of a project executed by a public-private consortium). Government sureties are used to support some forms of domestic financing, and the government's sovereign guarantee is negotiated in connection with international financing transactions. These practices have made it possible to obtain considerable reductions in the cost of funding the construction of major public infrastructure.

PI-18 Effectiveness of payroll controls¹¹⁴

The personnel database is not centralized, so that each MDA uses its own database within the central government's system. The Personnel Office (human resources) located at the General Administration Office (OGA) of each MDA manages the databases of personnel appointed and contracted under different labor regimes.¹¹⁵ Since June 2008, the personnel database for administrative service contracts (CAS), which provide certain labor rights and obligations, is also being managed by the Personnel Office. Any change in an employee's status is made at this Office and reflected by an appropriate change in the database. These modifications in the database are made almost automatically when the employee's status changes, so that data reconciliation takes place immediately. The third category relates to the personnel under non-labor, non-personal service (SNP) contracts. The OGA's Procurement and Ancillary Services Office (OASA) manages the database for that category.¹¹⁶ The changes to this database (as well as the data reconciliation) are also made automatically when an employee's labor status changes. The payroll payment process is as follows:

- I. Every month, each Personnel Office (human resources) makes a bulk commitment (total payroll amount, based on the roster of employees in its database).¹¹⁷ The OASA does this work for the staff under SNP contracts. The commitment is made through the SIAF, which authorizes it.
- II. Each OGA's Financial Office verifies that the commitment is authorized and proceeds (in the SIAF) to accrue the respective salary expenses. These expenses are recorded by the Financial Office, which then sets a payment date (that the SIAF must authorize).¹¹⁸
- III. The Financial Office then proceeds with the draft (in the SIAF which must authorize it), issuance of a check or transferring the salary electronically to the employee's account.
- IV. The payment takes place at the Banco de la Nación.
- V. The Control Office supervises the Financial Office, the Personnel Office and the OASA, and conducts the physical control of the payroll documentation prepared by the Personnel Office and the OASA before it is sent to the Financial Office.

Table 3.10 presents the process described above, which takes no more than five days.

Table 3.11 completes the information and focuses on the OGA's responsibilities regarding the payroll.

¹¹⁴ To deal with this indicator, the team members held working sessions with the General Administration Offices of the Ministries of Finance (MEF), Education (MINEDU) and Health (MINSA).

¹¹⁵ The database includes detailed information on each entity's employee: date of birth, address, national identity document number, academic and professional qualifications, start date in civil service, etc.

¹¹⁶ There is a fourth personnel group, the consultants of the Management Support Fund (FAG), who are paid by UNPD. The FAG is managed by the Vice Minister of Economy. This group is not part of the central government's payroll and was not taken into account in the PI-18 analysis.

¹¹⁷ Appointed, contracted personnel for a fixed term and CAS.

¹¹⁸ In general, it is the 20th of each month, according to the DNTP's payment schedule.

Table 3.10. Payroll payment process

Operation	Responsible entity	Personnel involved	Date
I. Bulk commitment	- Personnel Office (Human resources, welfare and training) - OASA	- For appointed employees and contracted employees for a fixed term and those under the CAS system - For those under a SNP contract	- The 15th day of the month (or before)
II. Verification of the commitment and accrual phase	- Financial Office establishes that the commitment is authorized; - Financial Office proceeds to accrue the expenditures	- Appointed employees and contracted employees for a fixed term, CAS and SNP	- The process takes place through the SIAF and is very quick
III. Draft phase	- Financial Office makes the draft	- Appointed employees and contracted employees for a fixed term, CAS and SNP	- The process takes place through the SIAF and is very quick
IV. Payment phase	- Banco de la Nación (or check sent to the employee)	- Appointed employees and contracted employees for a fixed term, CAS and SNP	- The 20th day of the month
V. Control	- Financial Office - Personnel Office - OASA	- Appointed employees and contracted employees for a fixed term, CAS and SNP	—

Table 3.11. Location of personnel data and papers at each entity in the personnel's payment circuit

General Administration Office*	Personnel		
	APPOINTED EMPLOYEE AND FIXED TERM CONTRACTED EMPLOYEE	ADMINISTRATIVE SERVICE AGREEMENTS (CONTRATOS ADMINISTRATIVOS DE SERVICIOS, CAS)	NON-PERSONAL SERVICES (SERVICIO NO PERSONAL, SNP)
1. Financial Office (Accounting, Budget, Treasury)	- Responsible for establishing that the commitment is authorized. - Accrues the expenditure within the SIAF that authorizes it. - Records the expenditure and sets a payment date (within the SIAF). - Proceeds to the draft within the SIAF which authorizes the issuance of a check or makes a draft to the personnel member's account.	- Responsible for establishing that the commitment is authorized. - Accrues the expenditure within the SIAF that authorizes it. - Records the expenditure and sets a payment date (within the SIAF). - Proceeds to the draft within the SIAF which authorizes the issuance of a check or makes a draft to the personnel member's account.	- Responsible for establishing that the commitment is authorized. - Proceeds to accrue the expenditure within the SIAF that authorizes it. - Records the expenditure and establishes a payment date (within the SIAF). - Proceeds to the draft within the SIAF which authorizes the issuance of a check or makes a draft to the personnel member's account.
2. Personnel Office (Human resources, welfare and training)	- Responsible for personnel files - Responsible for committing the total payroll amount through the SIAF, which authorizes it.	- Responsible for CAS personnel files. - Responsible for committing the total payroll amount through the SIAF, which authorizes it.	—
3. Procurement and Ancillary Services Office (OASA)	—	—	- Responsible for SNP personnel files. - Responsible for making the commitment of the total payroll amount through the SIAF that authorizes it.
4. Control Office	- Supervises the Financial Office, the Personnel Office and the OASA. - Performs a physical control of the payroll documents prepared by the Personnel Office (Human Resources) and the OASA.	- Performs a physical control of the payroll documents prepared by the Personnel Office (Human Resources) and by the OASA.	- Performs a physical control of the payroll documents prepared by the Personnel Office (Human Resources) and by the OASA.

* The OGA has a fifth office, the Rationalization Office, which does not participate in the process described above.

(i) Degree of integration and reconciliation between personnel records and payroll data

The personnel database, located at OGA (Personnel Office and OASA) of each MDA, is directly linked to that OGA's payroll (Financial Office). Thus, data consistency is ensured by automatic reconciliation.

(ii) Timeliness of changes to personnel records and the payroll

Any changes to be introduced to the database when an employee's labor status changes are automatically made. They are reflected in the payroll sent monthly by the Personnel Office and the OASA to the Financial Office.

(iii) Internal controls of changes to personnel records and the payroll

The changes in the personnel database (Personnel Office) and in the payroll (Financial Office) reflecting the changes must be –and are– physically documented through the Personnel File and/or Directors' Resolutions. Any changes must be supported by this documentation.

(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers

The Institutional Control Office (OCI) of each MDA conducts a regular audit of the different areas of the entity (MDA).¹¹⁹ The Financial Office, Personnel Office and OASA are among the areas covered. These entities are not necessarily audited every year, but must be audited at least once every two years (only exceptionally is this frequency not followed). Given this context, all central government's entities conduct an audit in stages. This audit covers all the personnel databases (Personnel Office, OASA) and the Financial Office's entire payroll.¹²⁰

Reforms

Currently, DNPP's Programming and Budget Department is implementing the project entitled "Implementation of a module for Public Sector Human Resources Management", the purpose of which is to create a single database for human resources and the payroll, as well as to centralize the control over payrolls and data for public sector human resources. As of the review date (October 2008), the database was 95% complete.¹²¹ The purpose is also to create a link of the database with the RENIEC.

¹¹⁹ See P1-21 below.

¹²⁰ For internal auditors, the database (Personnel Office and OASA), payroll (Financial Office) and controls of OGA's Control Office are considered a system for audit purposes. It comprises the entire salary expenditure circuit (according to the National Auditor General's Office).

¹²¹ Communication of the DNPP's Programming and Budget Department.

Indicator	Score	Explanation
PI-18 Effectiveness of payroll controls	B+	Scoring Methodology M1
(i) Degree of integration and reconciliation between personnel records and payroll data	A	The personnel database, located at the OGA of each MDA, is directly linked to the payroll (also at the OGA). Thus, data consistency is ensured with an automatic reconciliation.
(ii) Timeliness of changes to personnel records and the payroll	A	When the employee's labor status changes, changes are introduced automatically in the database. They are reflected each month in the payroll presented by the Personnel Office and the OASA to the Financial Office.
(iii) Internal controls of changes to personnel records and the payroll	A	The changes in the personnel database and in the payroll reflecting the first changes are physically documented through the Personnel File and/or Resolution.
(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers	B	At least once every two years, the Institutional Control Office of each MDA carries out an audit by stages covering the entire personnel database and the payrolls at the Financial Office.

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

The general guidelines for public procurement include all the items relating thereto.¹²² Article 76 of Peru's 1993 Political Constitution establishes:

The procurement of works and the purchase of supplies with the use of public funds or resources, as well as the procurement or disposal of assets, are to take place mandatorily through public bids and contracts. The procurement of services and projects, whose importance and amount are established by the Budget Law, takes place through public competitions. The law establishes the procedure, exceptions and relevant responsibilities.

In accordance with the Constitution, there is a Single Ordained Text of the Government's Procurement Law and its Regulations.¹²³ With over three hundred sections, this text is the main reference for the government's procurement activities. It establishes the basic elements of the government's procurement system, such as its scope of application (all public sector entities), the cases where it is not applicable and its exemptions, the restrictions to contract with the government, a National Suppliers' Registry, the different selection processes, the mechanisms for filing and processing of procurement process and contract execution-related complaints, and the Government's Electronic Procurement System (SEACE).¹²⁴

¹²² In fact, these general regulations are quite extensive and comprise over fifty instruments including laws, decrees, regulations and directives. The most significant items of the regulations are presented here. For further details, refer to www.consucode.gob.pe.

¹²³ Approved by Supreme Decree 083-2004-PCM.

¹²⁴ The SEACE is the government's official electronic site which allows for information exchange and promotion of procurement, as well as the performance of electronic transactions. The information records in the SEACE and access thereto are free. The regulation obliges all public entities to publish in the SEACE in a timely manner, under the penalty of nullity, information relating to their selection processes: Annual Procurement Plan, calls including bid specifications, responses to inquiries and observations, modified bases, records for filing proposals, tables of contract qualification and award, documents in response to challenges and contracts.

The major regulator or governing entity for procurement is the Senior Council of Government Procurement (CONSUCODE), a government agency attached to MEF. The CONSUCODE exercises its powers at the national level and covers all entities that undertake processes for the procurement of goods, the provision of services and the execution of works.

The Law and its Regulations define the procedures to be used by the entities subject to the general system for the conduct of their procurement (there are no discretionary powers that allow the entities to choose the modality or type of selection process that they might follow).

The law recognizes different types of selection processes:¹²⁵ public bid, public and selective direct award and lower amount award for the processes to select works and goods, public competition, direct and selective award and lower amount award for the processes to select services. As provided for by Law, only public bid processes, public competition and public direct award can be considered “open” because they allow for the participation of any interested supplier. For selective direct and lower amount award processes, the participation may be restricted to those bidders who have been invited (restricted competition).

Table 3.12. Public procurement and types of selection processes

Selection processes	Works	Assets	Services
Public bid	Open	Open	—
Public competition	—	—	Open
Direct public award	Open	Open	Open
—	—	—	—
Selective award	Restricted	Restricted	Restricted
Lower amount award	Restricted	Restricted	Restricted

Source: CONSUCODE, Public Procurement Report, December 2007.

(i) Evidence of the use of open competition to award contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold)

The monetary threshold (ceiling) for procurement set for the national level varies according to the selection process and whether it involves works, goods or services. This threshold is set every year in the annual budget law and is denominated in tax units (UIT).¹²⁶ For 2007 the threshold was one UIT for the processes to procure works, goods and services rendered on the basis the lower amount award (restricted).¹²⁷ This threshold increases gradually

¹²⁵ Each of the procedures provided for by law has its own formalities, terms and requirements. Furthermore, in certain situations, selection processes could be subject to certain modalities, such as inverse auction, framework agreement, corporate purchases and selection on demand from another entity.

¹²⁶ In fiscal 2007 the UIT was PEN 3450 or approximately 1250 United States dollars.

¹²⁷ Procurement equal to or below one UIT is outside the field of application of Law 26850.

depending on whether it involves works, goods or services and the type of process. In fact, for each type of good or service, the threshold increases gradually for open selection processes until reaching a maximum of 60 UIT for the procurement of services, 134 UIT for the procurement of goods and 340 UIT (U\$S 425,000) for the procurement of works.

Table 3.13. Public procurement and monetary threshold for each process

Selection processes	Works	Assets	Services
I. <u>Open</u> :			
-Public bid	340 UIT	134 UIT	—
-Public competition	--	--	60 UIT
-Direct public award	170 UIT	67 UIT	30 UIT
II. <u>Restricted</u> :			
-Selective award	34 UIT	13.4 UIT	6 UIT
-Lower amount award	1 UIT	1 UIT	1 UIT

Source: CONSUCODE, Public Procurement Report, December 2007, p. 11.

Although the budget law clearly establishes these thresholds and the procurement law makes a clear distinction between open and restricted processes, in practice, article 106 (Call for Lower Amount Award) of the *Regulations of the Government Procurement Law* applies.¹²⁸ That section establishes that any selection process for an amount in excess of the 4 UIT thresholds for goods and services and 10 UIT for works must be reported to Prompyme, an entity that advertises the bid among small and medium enterprises (MYPES) so that the processes are executed under open competition conditions.¹²⁹ In 2007 the public sector carried out 212,916 procurement processes, out of which 105,372 (49.5%) were in excess of the above-mentioned thresholds and were conducted under open competition conditions.¹³⁰ In 2007 in the Central Administration (central government, including the autonomous agencies) there was an aggregate of 113,179 selection processes and 50,307 of them (44.5%) exceeded the above-mentioned thresholds. On the other hand, it should be noted that a failure to apply article 106 would have enabled only 13.4% of the selection processes held during 2007 to have been executed under participatory conditions (both open and restricted).

¹²⁸ Approved by Executive Decree DS 084-2004-PCM of November 26, 2004. The section reads: *"The call is made through an invitation that may be given to one or more suppliers, as appropriate, according to the timing, amount and complexity, size or sophistication of the procurement.*

The call for selection processes for the procurement of goods or services whose benchmark values are equal to or higher than four Tax Units (4 UIT) and for the execution of works whose benchmark values are equal to or higher than ten Tax Units (10 UIT) will be notified to the Small and Medium Enterprise Promotion Commission (Prompyme) provided that the purpose of the process relates to economic sectors where there is a competitive offer by MYPES..."

¹²⁹ The CONSUCODE has confirmed that all the selection processes that exceed the 4 UIT threshold for goods and services and 10 UIT for works are published through the SEACE, thus allowing them to take place under open competition conditions (work session with Luis de la Flor and other members of the Systems and Planning, Budget and Cooperation Offices).

¹³⁰ Sources: CONSUCODE, Planning, Budget and Cooperation Office, and www.seace.gob.pe.

(ii) Extent of justification for use of less competitive procurement methods

The Law recognizes cases of exemptions in selection processes, which allow entities to proceed with direct procurement. However, their application is exceptional, with prior validation of the grounds expressly as permitted by the Law¹³¹ through a resolution of the head of the entity (indelegable power) supported by a technical-legal report, and notification of the exception in the Official Gazette and the SEACE; a copy of the resolution and report must be submitted both to the CONSUCODE and the National Auditor General's Office.

(iii) Existence and operation of a procurement complaints mechanism

The Law and Regulations provide administrative review mechanisms that allow participants and bidders in selection processes to challenge decisions made at two clearly defined junctures; these are resolved by agencies different from those which are making the purchases. First, the bidding documents may be challenged. This must be done within five days after the inquiries and observations made by the participants have been responded to, and before the bidding specifications are met; the participants may ask for the process proceedings to be reviewed by the CONSUCODE, and CONSUCODE must answer within 10 business days. CONSUCODE's decision is binding and final (it cannot be challenged in any other way). Secondly, an appeal may be filed regarding a contract award. Within eight days after the contract has been awarded, bidders may resort to the Government's Procurement Court (at CONSUCODE) to challenge the administrative decisions made during the selection process, starting with the request for proposals through decisions taken before the contract is executed (files relating to or refuting appeals).¹³² The Court must render a judgment within the terms established in the Regulations. The Procurement Court's decision completes the administrative proceedings and may only be challenged at the courts through a contentious-administrative action. This action does not suspend the effects of the Court's resolution. The Court also hears punitive proceedings, which relate to complaints for unfulfilled contracts or rules violations by one or more suppliers. The Procurement Court's decisions are posted on the SEACE and CONSUCODE sites.¹³³ These contain the same basic information; but the information on the CONSUCODE's site is presented in chronological order.

Since March 2007 a number of articles of the Regulations of the Procurement Law have been amended by an Executive decree.¹³⁴ These amendments establish that refuting appeals will

¹³¹ The exemption from selection processes is applicable to the procurement made: (i) between entities; (ii) to contract public utilities; (iii) in emergencies or impending shortage; (iv) of a confidential, military secret or internal order nature; (v) where there is a single supplier; (vi) personal services.

¹³² The Regulations set forth that the following actions cannot be challenged: (i) the decisions taken during the selection process; (ii) the decisions taken by the head of the entity affecting the continuity of the selection process; (iii) the decisions rendered after the contract has been awarded and before it is executed.

¹³³ www.seace.gob.pe and www.consucode.gob.pe

¹³⁴ *Amendment to the Regulations of the Government's Procurement Law*, Supreme Decree 028-2007-EF of March 2, 2007.

be directly filed with the Procurement Court and not first with the entity. It has also been established that the Court will hear refuting appeals not only regarding issues of public bid and public competition processes, but also issues of all other types of selection processes.

Under the new supreme decree, the process previously used for filing and resolving procurement-related complaints is still applied and this process is conducted by an external agency that publicly disseminates information on the result of the complaints¹³⁵, its design no longer appears appropriate. Since the new decree has generalized the possibility of filing procurement-related complaints before the Procurement Court, there has been a significant increase in the workload related to appeals. During all of 2007, the Procurement Court rendered 2,234 decisions; as of only August 2008, the Court has already rendered 2,335 decisions, i.e., an estimated increase of over 50% in the caseload on an annualized basis.

The Constitutional Court previously resolved that no fee will be charged for appeals, a factor that might have contributed somewhat to the increase in these proceedings; and, this factor has adversely affected CONSUCODE's budgeted revenues. Since CONSUCODE does not receive funds from the Public Treasury and it must finance the operation of different entities of the public procurement process, such as the Procurement Court and SEACE, this loss of revenue could become an important constraint.

Reforms

In 2008, with the assistance of the World Bank and the IADB, Peru made an assessment of its public procurement systems, using the new framework developed by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD) and the World Bank. This study had not been completed at the time of this evaluation, and therefore its results were not available to the members of the consulting team. However, they met with officials of the World Bank, the IADB and the CONSUCODE who participated in the evaluation and discussed this study and its findings in detail.

On June 3, 2008, the Executive Branch published in the Official Gazette, *El Peruano*, Legislative Decree 1017, which, *inter alia*, approves the new Government Procurement Law. With regard to the arrangements for procurement-related complaints, the new law provides that only procurement processes in excess of 600 UIT (approximately U\$S 600,000) may give rise to appeals through the CONSUCODE tribunal. In addition, the Executive Branch published Legislative Decree 1018, which creates a Procurement Central Entity –Peru Compras– whose duties will be to make corporate purchases and conduct selection processes for the generation of Framework Agreements. As of the time of this evaluation using the PEFA methodology (September-October 2008), Legislative Decrees 1017 and 1018 had not come into full effect because the relevant regulations were yet to be published.

¹³⁵ Refer to www.consucode.gob.pe.

Indicator	Score	Explanation
PI-19 Competition, value for money and controls in procurement	B +	Scoring Methodology M2
(i) Evidence of the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold)	C	Precise data on the method used to award public contracts exists and shows that 44.5% of contracts are awarded on the basis of open competition.
(ii) Extent of justification for use of less competitive procurement methods	A	For the use of non-competitive or less competitive methods, the entity must prepare a technical-legal report that must be published in the Official Gazette and the SEACE; a copy of that resolution and report must be submitted both to CONSUCODE and the National Auditor General's Office.
(iii) Existence and operation of a procurement complaints mechanism	A	A process defined by legislation for submission and timely resolution of procurement process complaints is in place. The process is subject to oversight by CONSUCODE's Procurement Court and data on the resolution of complaints is accessible in the SEACE and CONSUCODE's sites.

PI-20 Effectiveness of internal controls for non-salary expenditure¹³⁶

This indicator evaluates the effectiveness of internal control over expenditure commitments for the procurement of goods and services, temporary workers' compensation, capital expenditures, as well as the staff's discretionary benefits. The effectiveness of control systems will be measured based on their adequacy, the existence of a group of controls for each expenditure process, compliance with those controls, and their flexibility in case of emergency.¹³⁷

The Charter of the National Audit System and Office of the National Auditor General establishes that "the internal control comprises the previous, concurrent and subsequent conservative actions taken by the entity subject to control, so that its resources, goods and transactions are managed properly and efficiently. Its performance is previous, concurrent and subsequent. The previous and concurrent internal controls are the sole responsibility of the authorities, officers and civil servants of the entities, as part of their attributable duties, in accordance with the regulations governing the organization's activities and the procedures established in their plans, regulations, manuals and institutional rules."¹³⁸

¹³⁶ This indicator was prepared based on separate work sessions with officers of the DNPP, DNCP, SIAF, the National Public Treasury Office, the Institutional Control Office and the OGA of the MEF, the General Planning and Budget Office (OGPP) of the Ministry of Health and the National Auditor General's Office.

¹³⁷ The effectiveness of these systems is verified through the regular reports of the National Public Accounting Office, internal and external audit reports, as well as the prior controls made by the OGA in the MDAs.

¹³⁸ Article 7 of Law 27785 of July 22, 2002.

In turn, the General National Budget System Law provides that the “[...] Commitment Calendar constitutes the authorization to execute budget credits, as a function of which the maximum amount to commit for expenditures to be accrued is set, subject to the actual collection of the revenues that provide their funding. Commitment Calendars are modified during the budget year in accordance with the availability of public funds.”¹³⁹ As established by the National Treasury System Law,¹⁴⁰ this cash availability is set every month by DNTP, with the cooperation of the Treasury Account Committee (*Comité de Caja*).

(i) Effectiveness of expenditure commitment controls

Expenditure commitments are controlled through the systematic verification of the existence of the expenditure item to be made in the effective Public Budget, and the availability of cash recorded in the Public Sector Integrated Financial Management System (SIAF). This information is obtained from the Commitment Calendar, approved for each budget implementation agency (entity governed by the General National Budget System Law) by DNPP and recorded monthly in the SIAF. This information is communicated by DNPP to each entity through the SIAF. The payment commitments by the entities are enforced through the SIAF, since the entities cannot make commitments that the system does not allow and they can only make them up to the limit of their monthly allocation. These controls are applicable to all types of expenditure (including capital expenditures) and the commitment is authorized in the SIAF only for those expenditures contemplated in the effective budget, where the cash availability has been authorized by the Treasury.

(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures

The OGAs in the central government’s MDAs are responsible for controlling the processes and procedures within each entity. These offices employ specialists responsible for analyzing and verifying compliance with the processes relating to staff, procurement of goods and services, budget, monitoring and prior control and finance. They are also responsible for ensuring that standards and procedures are followed for each expenditure commitment operation within the budget. These controls are resources in support of management and are considered useful to limit the possible *ex post* observations on these expenditure commitments. In general, the main users do not believe these controls are excessive.¹⁴¹ The ex-ante control may contribute to lengthening the term in which expenditure commitments are made, the operations materialized and the expenditure accrued.

¹³⁹ Article 30 of Law 28411 of December 6, 2004.

¹⁴⁰ Articles 20 and 21 of Law 28693 of March 21, 2006.

¹⁴¹ This observation arises from the interviews with officers of the MEF, Ministry of Health (MINSA) and National Auditor General’s Office.

However, the parties interviewed have not associated the delays in implementing expenditures with the application of these controls, except on limited occasions.¹⁴² These ex-ante control systems limit the possibilities of adverse internal audit findings (by OCIs); however, this also depends on the quality of how well the systems are working.¹⁴³

(iii) Degree of compliance with rules for processing and recording transactions

The SIAF is the first stage for collecting information on errors, or events in which the system users have attempted to go beyond their authorized commitments. The SIAF rejects them, but it does not maintain a log of the rejection rate or the errors made. The system simply does not allow going beyond the payment commitments authorized on a monthly basis, except if changes are made pursuant to a procedure established by DNPP. In this regard, the system is complete and does not allow for violations of the projected expenditure thresholds.

Indicator	Score	Explanation
PI-20 Effectiveness of internal controls for non-salary expenditure	B+	Scoring Methodology M1
(i) Effectiveness of expenditure commitment controls	A	Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations (as revised).
(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures	B	Other internal control rules and procedures include a comprehensive set of controls, which are widely understood, but may be unnecessarily duplicative and lead to delays.
(iii) Degree of compliance with rules for processing and recording transactions	A	Compliance with rules is very high and any misuse of emergency procedures is insignificant.

*PI-21 Effectiveness of internal audit*¹⁴⁴

This indicator evaluates the performance of internal control systems, especially with regard to their effectiveness in identifying important systemic problems of reliability and completeness of the financial and operating information, efficiency and effectiveness of operations, safeguarding of assets, and compliance with laws, regulations and contracts by the government.

The Political Constitution of Peru establishes the National Auditor General's Office (CGR) as the supreme body of the National Oversight System, with responsibility for supervising

¹⁴² The OGPP of the MINSA, the OGA of the Ministry of Education (MINEDU) and the OGA of the MEF.

¹⁴³ Based on statistical data of the National Auditor General's Office, the annual average justified internal audit observations is ten for the national government while in decentralized institutions this average is fifteen observations per month.

¹⁴⁴ This indicator required working sessions with officers of the MEF's OCI and OGA, the MINSA's OGPP and the National Auditor General's Office.

the legality of the government's budget execution, public debt operations and the acts of the institutions subject to control.¹⁴⁵ The Charter of the National Control System and the National Auditor General's Office (Law 27785 of July 22, 2002) sets forth the regulations governing the scope, organization, powers and operation of the National Control System (SNC) and the CGR as guiding entity of that System.

Article 7 of Law 27785 establishes that the internal control covers the ex-ante, concurrent and ex-post conservative actions taken by the entity subject to control, so that its resources, goods and transactions are managed properly and efficiently. The ex-ante and concurrent internal control is the sole responsibility of the authorities and civil servants of the entities as part of the duties attributable thereto, in accordance with the regulations governing the organization's activities and the procedures established in their plans, regulations, manuals and institutional rules. The OGAs are responsible for these duties in the institutional structure of the Peruvian public sector.

The same article 7 establishes that the ex-post internal control is an audit conducted by the senior officials of the executing entity, focused on compliance with the existing regulations. That internal audit is supplemented by the institutional oversight office (OCI), according to its annual plans and programs, which evaluates and verifies the administrative aspects of the use of the government's resources and assets, and how well management and execution were performed in relation to the organization's goals and results.

(i) Coverage and quality of the internal audit function

Institutional Control Offices (*Oficinas de Control Institucional*, OCI) are in charge of the ex-post internal control function in the public entities. The Institutional Control Offices (OCI) maintain a functional relationship with the CGR, and work in conformity with the guidelines and policies established by CGR for that purpose. The OCI's Director reports functionally and administratively to the CGR, subject to its guidelines and regulations. While performing its duties the OCI acts with technical independence within its area of responsibility.¹⁴⁶

Currently, there are 190 OCIs that fully cover all the central government's entities, public enterprises and 26 regional governments.¹⁴⁷ Also, 195 provincial OCIs are responsible for conducting internal audit functions in decentralized entities, including municipal governments. This is insufficient to cover all of Peru's 1834 municipalities, in addition to other decentralized entities. However, the CGR regularly plans internal audits, coordinating the efforts of provincial OCIs to enable achieving this purpose. The CGR estimates that over 85% of total public expenditure is being covered by regular internal audits.

¹⁴⁵ Political Constitution of Peru of December 29, 1993, article 82.

¹⁴⁶ Article 18 of Law 27785.

¹⁴⁷ It should be noted that, according to the PEFA methodology, PI-21 does not measure the quality of the internal audit of public enterprises or subnational governments.

In compliance with the directives issued by the CGR, the OCIs must prepare and submit each year (by November 15) an Annual Control Plan (*Plan Anual de Control*, PAC) containing the strategic areas that will be covered and the actions that will be developed for the internal control of the institution it serves. This PAC is initially submitted to the Ministry or the entity's senior authority for review and approval. It is then submitted to the CGR for review and approval through a resolution.¹⁴⁸ This review ensures that the OCI's main focus is on controlling management systems; however, controls over individual transactions are also incorporated when necessary, based on evidence-based complaints. In general, it is estimated that auditing the controls around the systems take up at least 80% of the OCIs' staff time; the remainder is available to cover individual transactions.¹⁴⁹

Internal audit function is performed in compliance with the professional standards required by the CGR,¹⁵⁰ as stipulated in the operating guidelines, and the associated regulations. The main reference for the OCIs is the Government Audit System (*Sistema de Auditoría Gubernamental*, SAGU), developed by the CGR to guide the recording and exchange of structured information among the SNC's internal audit bodies and designated audit firms. The SAGU is where basic information on the entities is recorded. The information includes control plans, control actions and reports, follow-up on recommendations contained in control reports, and follow-up on legal proceedings.

(ii) Frequency and distribution of reports

Audit reports are disclosed once the audit has been completed. There is no predefined frequency for issuing these reports. However, at the end of each quarter the OCIs must send to the CGR a PAC compliance report, detailing the progress of their internal control audit and explaining any difficulties encountered during their implementation. The CGR compiles these reports, sent by the 385 OCIs distributed throughout the country, and takes action when deemed necessary. These reports supplement the annual reports prepared by the OCIs on the performance of their institutional operating plans and programs.

Internal audit reports are not public and are for the restricted use of the senior authority of the entity being audited and the CGR. When an OCI makes an internal audit finding, it is communicated to raise the awareness of and receive answers from the senior authority of the audited unit, and to expand the information required to review or confirm the finding. Once the finding is communicated, the auditor evaluates the answers based on the supporting documentation and then determines whether it should become an observation

¹⁴⁸ The CGR's Economic Sector Manager is responsible for reviewing the PACs for the MEF, the SUNAT, the BCRP and the BN. Other CGR managers review the PACs of the remaining government entities. The CGR's Planning Manager is responsible for preparing the resolution for the approved PACs.

¹⁴⁹ PACs incorporate man-hours allocated to each risk area and activity of the OCI, where these estimates were obtained from.

¹⁵⁰ These standards are International Financial Reporting Standards, which replace the Generally Accepted Accounting Principles and International Auditing Standards issued by the International Auditing and Assurance Standards Board (IAASB).

(a major issue) or be disregarded. The finding is included in the OCI's report; if it is later disregarded, that fact is duly recorded in the document. Once the OCI's report is completed, it is sent simultaneously to the head of the entity and the CGR.

(iii) Extent of management response to internal audit findings

The internal audit reports sent to the head of the entity must be answered following a format established by the CGR, attaching a copy of a document that evidences what action has been taken on the observations noted in the OCI's report and affirming that there is a person responsible for the corrective action.¹⁵¹ Recent statistics from MEF's OCI show that the extent of corrective actions being taken, those in the process of being fulfilled, those unfulfilled and those that are non-applicable (due to obsolescence or inapplicability). It is expected that at least 60% of the recommendations issued in 2008 have been implemented to date, and that this percentage will increase to about 75% by year-end.¹⁵² The CGR considers that this behavior is similar in most of the OCIs working with the central government and public enterprises. Compliance with recommendations tends to be lower and to take more time at decentralized entities around the country.

Reforms

The OCIs plan to incorporate multidisciplinary staff gradually in their headcount, particularly information systems specialists, who are not currently available. This will enable them to conduct their work in one of the most significant risk areas: Information systems that support public financial management. In addition, the CGR is improving its control systems to obtain ISO 9002 certification.

Indicator	Score	Explanation
PI-21 Effectiveness of internal audit	C+	Scoring Methodology M1
(i) Coverage and quality of the internal audit function	A	Internal audit is operational in all central government entities, and generally meet professional standards. Reviews of systems issues uses about 80% of staff time.
(ii) Frequency and distribution of reports	C	Reports are issued when they are ready and aggregate progress reports are issued quarterly. They are sent to the head of the audited entity and the CGR, but not to MEF.
(iii) Extent of management response to internal audit findings	C	A fair degree of action is taken by many managers to address major issues, but often with delay.

¹⁵¹ Generally, a copy of the memorandum of the minister or head of the institution is provided to the officer in charge of the audited unit and it cites the expected corrective action.

¹⁵² Estimate made by the CGR on the basis of semiannual reports received from the OCIs (including the MEF's OCI), based on a simple average of the actions reported as met.

3.5. Accounting, Recording and Reporting

*PI-22 Timeliness and regularity of accounts reconciliation*¹⁵³

This indicator evaluates the government's capability to reconcile public bank accounts and the frequency of those reconciliations to ensure that the accounting records are of a high quality and generate reliable financial reports.

The General National Treasury System Law (Law 28693 of March 21, 2006) establishes the regulatory principles, scope of application, processes and intersystemic relations, as well as special regulations for the management and operation of the National Treasury System in Peru. The governing body of the National Treasury System is DNTP, which is empowered, *inter alia*, to issue specific stipulated standards and regulations for Treasury management. These regulations have been implemented since 2007, as required by Treasury Directive 001-2007-EF/77.15.

(i) Regularity of bank reconciliations

The reconciliation of the Treasury's bank accounts with the cash journals is conducted at DNTP's National Accounting and Statistics Office. This reconciliation is made daily for the Main Account at the Banco de la Nación (BN) and for other accounts held by the Treasury.¹⁵⁴ Bank account holders are responsible for the bank reconciliation and matching the movements of the amounts transferred with the debts and credits recorded in the SIAF, and negotiating with BN the regularization of incorrect transactions.¹⁵⁵ This work is done monthly for all the other accounts held by government entities (over 15,000 public accounts) at the BN, based on the information reported by the BN and the entries of transactions and balances in the SIAF. Accounts are reconciled first on an aggregate basis, i.e., mainly balances being reviewed. When there is a discrepancy, it is taken to the level of detail (by account and by transaction). To correct those discrepancies, account holders must request a change in the relevant entries, on appropriate grounds. Bank account holders must reconcile their movements and balances for each source of financing as of December 31 of each fiscal year, and ask the BN to regularize unauthorized transactions affecting those balances.¹⁵⁶

DNTP has not recorded any significant difference between the information provided by the BN and the SIAF's records, and there are no unresolved differences with the BN that may have exceptionally occurred in the past.¹⁵⁷

¹⁵³ This indicator required working sessions with MEF's DNTP and DNCP, as well as the BN's Financial Manager.

¹⁵⁴ Every day the BN's Financial Manager sends to the DNTP by electronic means the balances and movements of the Treasury's accounts with a one-day gap (until day t-1).

¹⁵⁵ Article 57 of Treasury Directive 001-2007-EF/77.15, on Responsibilities for Bank Account Reconciliations.

¹⁵⁶ Article 79 of Treasury Directive 001-2007-EF/77.15, on Bank Reconciliation at the end of a fiscal year.

¹⁵⁷ Information obtained at work meetings with DNTP and BN.

(ii) Regularity of reconciliation, and clearance of suspense accounts¹⁵⁸ and advances

DNTP informed that, according to its practices, no suspense accounts are opened and, therefore, no reconciliation and clearance are needed. Law 28693 establishes the use of checks or cash payment only exceptionally; the general rule is to execute the expenditure through bank debits and credits, documented and operated through the SIAF. Treasury Directive 001-2007-EF/77.15 governs, among other issues, those exceptional cases where a fund can be created for cash payments. It establishes that the provisional delivery of resources (advances) is not allowed with a charge to the Fund for Cash Payments, except when expressly and individually authorized by the General Administration Director (of OGA) or his/her appointee, in which case the expenses incurred must be supported with documentation within 48 hours of its delivery.¹⁵⁹ In turn, article 68, point three of the same Directive provides for a maximum of eight calendar days to submit per diem accounts after a mission has been completed, in cases when the services are delivered around the country, and fifteen calendar days when a mission takes place abroad. If unused per diems are not refunded within the prescribed term, the form used to deliver the per diems must state the collector's authorization for the Execution Unit to make the appropriate refund through a Single Payment Spreadsheet, irrespective of the penalties applicable for the failure.

Finally, the Directive establishes a maximum of one month to deposit and enter into the SIAF the balance resulting from the settlement of the Funds for Cash Payments as of December 31 of the prior fiscal year. These terms and conditions are applicable to the refund of the balance resulting from the settlement of the Petty Cash Fund and the amounts provided to the institution's staff, which are deposited with the related source of financing account and entered in the SIAF.¹⁶⁰

Indicator	Score	Explanation
PI-22 Timeliness and regularity of accounts reconciliation	B +	Scoring Methodology M2
(i) Regularity of bank reconciliations	A	Bank reconciliation for all central government bank accounts takes place at least monthly, globally and in detail, usually within 4 weeks from the end of the month.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	B	Reconciliation and clearance of advances take place at least annually within two months of end of period. Some accounts have uncleared balances brought forward.

¹⁵⁸ In theory, suspense accounts are opened to record movements of securities, when they do not affect or modify the entity's financial statements, but are necessary to state the institution's contingent rights or responsibilities, as well as to specify reminders about the accounting used.

¹⁵⁹ Article 36 of Treasury Directive 001-2007-EF/77.15.

¹⁶⁰ Article 76 of Treasury Directive 001-2007-EF/77.15.

PI-23 Availability of information on resources received by service delivery units

This indicator establishes whether there is consolidated data and available detail on the amount of resources actually received (in currency or in kind) by each of the basic service delivery units, particularly schools and primary health care centers in the country, irrespective of their source of financing. It is also important to verify whether this data, if available, is used to follow up and ensure that public financial management systems effectively support front-line service delivery. The evaluation covers the budget years 2005, 2006 and 2007.

The budget of the Education and Health sectors in Peru is allocated to the two most general levels: to the budget of the sector lead ministry and the budget of the regional government involved with the respective public service unit, either education or health. The sector's ministry budgets resources to finance nationwide programs; these amounts are then allocated to different basic service units, while the payroll and other ordinary operating resources required for the daily operation of schools and health centers or clinics are included in the regional government's budget, either at the Regional Education Office (DRE) or Regional Health Office (DIRESA).¹⁶¹

The sector budgets are disaggregated to enable the preparation and allocation of specific budgets for the different execution units. In the case of Education, the execution units are Local Education Management Units (UGEL), which group a specific number of schools in a region and are responsible for managing the material, economic and financial resources allocated to the education institutions it administers. Since 2003, in accordance with the General Education Law (Law 28044 of July 28, 2003) and its related regulations, education units participate in the UGEL as costing units, and are represented directly in budget preparation and allocation decisions.

For the Health sector budget, the execution units are: (i) specialized institutes, (ii) referral hospitals at different categories and levels, and (iii) Health Offices (DISA), i.e., networks of primary care level facilities (basic hospitals, health centers and clinics). DISAs are responsible for managing the budget resources allocated to the facilities within the group, providing the physical resources for their proper operation, and executing directly the expenses entered in the SIAF. In effect, DISAs are the units that consolidate the requirements of primary health care facilities and prepare the appropriate budget.

- (i) Compilation and processing of information to record the resources that were actually received (in cash and kind) by most front-line service delivery units (with a focus on primary schools and primary care health clinics), in relation to the overall resources for the sector(s), irrespective of the level of government responsible for the operation and funding of those units**

Basic service delivery units (education units and primary health care centers) are not identified as individual execution units in the public budget; therefore, they do not have

¹⁶¹ Local governments may also include in their budget investment resources to improve the infrastructure and equipment of basic education and health service centers within their jurisdiction, but they do not affect the sector budgets.

a budget allocated directly for their operation. The budget is prepared and executed on an aggregate basis for a group of education units (UGEL) or a network of primary health care facilities (DISA), and budgetary information is available for this aggregate level. As far as this evaluation could assess, there were no studies, surveys or audits of the resources allocated to each basic service unit over the last three years. Therefore, it is not possible to assert that there is a follow-up by the public finance management system of front-line service delivery.¹⁶²

Indicator	Score	Explanation
PI-23 Availability of information on resources received by service delivery units	D	Scoring Methodology M1
(i) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units	D	No comprehensive data collection on resources to service delivery units in any major sector has been collected within the last three years. The budgetary record only reaches up to the Implementation Units. In general, these include a group of basic units. The distribution of these resources across basic service units managed by DISAs or UGELs is unknown.

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

This indicator evaluates the quality of reporting on budget execution during the year covered by the budget. Good quality and timely budget reports allow the executing agency and the senior levels of government to track the effectiveness and efficiency of public spending in real time.

(i) Scope of reports in terms of coverage and consistency with budget estimates

According to article 48.1 of the *General National Budget System Law* (Law 28411 of January 1, 2005), MEF must conduct a quarterly evaluation of the government's financial results, and make an aggregate analysis of the variations noted between amounts allocated and what was actually spent in relation to the current Budget Law. In practice, the law is complied with and a public sector financial evaluation is made each quarter. The budget execution reports inform about the status of accrued expenditures and the modified institutional budget (PIM), by economic and functional classification, as of the date of each evaluation. However, the same comparison cannot be made for the 16 functions that form the economic classifications of expenditures budgeted in the annual law passed by

¹⁶² The follow-up of front-line services is based on the information available in the budget for primary education or group health subprograms.

Congress (PIA). The expenditure is entered in the SIAF-SP at the PIA, PIM, calendar, committed and transferred stages and covers all the sources of financing.¹⁶³ The payment stage is administered by DNTP, using a specific information technology system. The recording is mandatory for the source of ordinary resources, and mandatory for the remaining sources of financing only after the second half of 2007, so that the data are only partial for sources other than ordinary resources.

(ii) Timeliness in issuing reports

As established in article 48.2 of the law, the evaluation must be made within thirty calendar days following the end of each quarter; however, for the fourth quarter, the evaluation is made within thirty days following end of the regularization period (March 31). None of the four quarterly evaluations for fiscal year 2007 indicate any publication date. MEF's DNP documented when those evaluations were sent through letters to the Congress and the National General Auditor's Office.¹⁶⁴ The evaluation for the first quarter was sent with a letter dated May 14, 2007; the letter for the second quarter, on August 24, 2007; the letter for the third quarter, on November 30, 2007 and the global evaluation on July 4, 2008.¹⁶⁵ Thus, only the first evaluation was sent before the sixth week following the end of the quarter being reported. The following two (second and third) were sent before the eighth weeks after the end of the quarter being reported, and the last one some six months later. In all cases the evaluation was made but the term prescribed by law was exceeded. The evaluations for the first three quarters covered the national and regional governments; the report for the fourth quarter also includes the budget evaluation of local governments, ETE and FONAFE's public enterprises and incorporates an evaluation of the public investment projects within the context of the SNIP. This additional scope accounts for the longer time spent on its preparation.

¹⁶³ (i) Sources: MEF-DNPP, Financial Evaluation for the First Quarter of the Public Sector Budget, Fiscal Year 2007; Financial Evaluation for the Second Quarter of the Public Sector Budget, Fiscal Year 2007; Financial Evaluation for the Third Quarter of the Public Sector Budget, Fiscal Year 2007; Global Financial Evaluation of the Public Sector Budget, Fiscal Year 2007, which can be obtained from the MEF's web page.

(http://www.mef.gob.pe/DNPP/Evaluacion_Ppto/EvaluacionAnualGNGRGL_2007_VE.pdf).

It should be highlighted that the above-mentioned evaluations do not indicate any publication date and the budget closing should be consistent in all its expenditure stages (especially for accrued and paid expenditures) and for all sources of financing. (ii) In accordance with section 50 of Law 28411, the budget execution data are also available in the Economic Transparency site: <http://transparencia-economica.mef.gob.pe>, which reports the execution stages of the committed, accrued and transferred expenditure, with the payment stage pending, as well as the expenditures under the initial institutional budget (PIA) law and modified institutional budget (PIM), for all the functions and programs.

¹⁶⁴ In accordance with section 50 of Law 28411, the financial evaluations must be submitted within five calendar days following the deadline for their preparation, to the National Congress' Budget and National Financial Statement Committee and the National General Auditor's Office.

¹⁶⁵ MEF, *Ministry Resolution*, Official Letters 595-2007-EF/10 and 596, of May 14, 2007; MEF, *Ministry Resolution*, Official Letters 1152-2007-EF/10 and 1153, of August 24, 2007; MEF, *Ministry Resolution*, Official Letters 595-1580-EF/10 and 1581, of November 30, 2007; MEF, *Ministry Resolution*, Official Letters 780-2008-EF/10 and 596, of July 4, 2008.

(iii) Quality of information

The evaluation of the execution of expenditures for fiscal year 2007 by DNPP was based on the data in the SIAF-SP IT systems.¹⁶⁶ There may be differences in the methodology used in the reports as compared with the documents prepared by other entities, such as BCRP (for the preparation of fiscal accounts). However, these are minor concerns relative to the accuracy of the information. In general, the reports are commendable. Therefore, the global consistency and usefulness of the evaluations would not be compromised.¹⁶⁷

The common methodology used for recording inflow operations is cash flow accounting, and for expenditure operations is accrual accounting. No differences are found at the institutional coverage level. For economic classification, some accounts are reclassified: tax accounts report gross revenue (IGV with IPM, income tax with license fee and royalties), while the budget version considers net income (IGV without IPM, income tax without license fee and royalties), as these concepts are considered in sub-national governments' budgets. Also, tax revenues are net of commissions paid to SUNAT and Banco de la Nación. SUNAT's commissions are considered in the ETE sector's revenue budget. In the tax accounts, revenues are gross and include these commissions, and then they are recorded as transfers to SUNAT and the Banco de la Nación. Other important reclassifications have been noted in the revenue and expenditure accounts.

Indicator	Score	Explanation
PI-24 Quality and timeliness of in-year budget reports	C+	Scoring Methodology M1
(i) Scope of reports in terms of coverage and compatibility with budget estimates	C	It is possible to compare the modified institutional budget (PIM) with the accrued expenditures, by functional and economic classifications. The executed expenditure corresponds to the accrual stage.
(ii) Timeliness of the issue of reports	C	Quarterly reports have been completed and submitted to Congress and the CGR within 8 weeks of the end of quarter being reported.
(iii) Quality of information	B	There are minor concerns about data quality, which are highlighted in the reports. The evaluations are very useful.

¹⁶⁶ Based on entries recorded by the entities in the SIAF-SP Budget Processes Module, the Financial Budget Information System - ETE (SIAF-ETE), the National Accounting Integration System (SICON) and the Information Technology Application for the Annual Institutional Evaluation of the Budget Year 2007.

¹⁶⁷ The IMF's resident representative shares this opinion (work session with the team). At this point it should be noted that already in 2004 the IMF indicated that the tax information fulfilled the completeness criteria of Special Data Dissemination Standards (SDDS). See IMF 2004: 24, paragraph 41.

PI-25. Quality and timeliness of annual financial statements**(i) Completeness of the financial statements**

The law establishes that the National Public Accounting Directorate (*Dirección Nacional de Contabilidad Pública*, DNCP) is responsible for preparing the National Financial Statements.¹⁶⁸ Every year, DNCP receives and processes the public sector's accounts and prepares the National Financial Statements (Cuenta General de la República). The National Financial Statements for 2007 (MEF-DNCP 2007) is a full document with detailed information on the evolution and the results of macroeconomic indicators, revenues and expenditures (with economic, administrative, functional and geographic classifications) and on financial assets and liabilities.

(ii) Timeliness of submission of the financial statements

The law establishes that DNCP must send the National Financial Statements to the National Auditor General's Office to be audited and to the Congress' Review Committee by June 30 of the year following the fiscal year.¹⁶⁹ In 2008 that deadline was met for the 2007 National Financial Statement (as well as in the previous year).¹⁷⁰

(iii) Accounting standards used

DNCP defines the national accounting standards.¹⁷¹ They are applicable to all the financial statements and relate to the IPSAS.¹⁷² They have been applied to the National Financial Statement for the years 2006 and 2007.¹⁷³

Indicator	Score	Explanation
PI-25. Quality and timeliness of annual financial statements	A	Scoring Methodology M1
(i) Completeness of the financial statements	A	The National Financial Statement is complete and includes revenues and expenditures, as well as financial assets and liabilities.
(ii) Timeliness of submission of the financial statements	A	The 2007 National Financial Statement was sent to the National Auditor General's Office on June 30, 2008 (within the term prescribed by law).
(iii) Accounting standards used	A	The accounting standards are applicable to all the statements and relate to the IPSAS.

¹⁶⁸ Public Sector Financial Management Framework Law (Law 28112 of November 16, 2003), article 42.2 c.

¹⁶⁹ General National Accounting System Law (Law 28708 of April 10, 2006), article 30.2.

¹⁷⁰ DNCP's communication confirmed by the National Auditor General's Office and the Congressional Budget and National Financial Statement Committee. The last National Financial Statements prepared (for 2007) was sent to the National Auditor General's Office on June 30, 2008.

¹⁷¹ *General National Accounting System Law* (Law 28708 of April 10, 2006), article 42.2 a.

¹⁷² *Idem*.

¹⁷³ DNCP's communication confirmed by the National Auditor General's Office.

3.6. External Scrutiny and Audit

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

The legal and regulatory framework of the external audit is comprehensive. The Political Constitution of Peru (1993) identifies the National Auditor General's Office (CGR) as a public law decentralized entity. The CGR is independent according to its charter and is the supreme body of the National Oversight System. In addition, it supervises the legality of the government's budget execution and its public debt operations, and the actions of the government institutions subject to oversight. The National Auditor General is appointed by Congress, at the proposal of the Executive Branch, for a seven-year term and can be removed by Congress for gross negligence (article 82).

The Political Constitution of Peru also establishes external audit obligations. The National Financial Statements,¹⁷⁴ accompanied by the CGR's audit report, must be sent by the President of the Republic to the Congress and must be examined by a Review Committee that has to issue a timely opinion (article 81).

The Charter of the National Oversight System and the National Auditor General's Office (Law 27785 of July 22, 2002) sets forth the regulations governing the norms, organization, powers and operation of the National Oversight System, and CGR's role as supreme body Oversight System. Resolution No. 17-2001-CG dated June 27, 2001 of the National Auditor General's Office, approved Directive 013-2001-CG/B340 "Rules for Financial Information Audit and Special Examination of Budget Information prepared for the National Financial Statements by public sector entities."

(i) Scope of audit performed (including adherence to auditing standards)

The public sector audit is conducted annually. As regards the central government, the audit covers revenues and expenditures, as well as financial assets and liabilities (debt). Approximately 75% of the central government's total expenditure is subject to annual audit (Table 3.14). Financial audits are conducted, which focus on processes and systems, such as Treasury, staff, procurement, budget, accounting, among others. Performance audits are only occasionally conducted.

¹⁷⁴ In Peru the financial statements are named *Cuenta General de la República*, including their consolidation, thus comprising all the public sector.

Table 3.14. Scope of the audits performed at central government entities and auditing standards (2007)

Items comprised	Percentage of expenditures subject to audit	Audits conducted	Auditing standards applied
- Revenue - Expenditure - Assets - Liabilities (debt)	- 74.62% *	- Financial audits focusing on systemic problems of Treasury, staff, procurement, budget, accounting.	International standards adopted by the Accounting Directorate (IPSAS)

* The national government's total expenditure execution in 2007 was PEN 39,972,435.2. The expenditure amount of the entities subject to the annual audit was PEN 29,827,371.8, which represents 74.62% (29,827,371.8 / 39,972,435.2) of the central government's total expenditure.

Source: Audit Report on the Financial Statements and Budget Information of the 2007 National Financial Statements, chapter IV, article 2, p. 95. In addition, the information has been confirmed by the CGR's Economic Sector Manager at a work session.

(ii) Timeliness of submission of audit reports to the Legislature

After having received the National Financial Statements by June 30, 175 CGR has sixty days to review it. On August 31, the National Audited Financial Statements (Audit Report) must be submitted to MEF and the Congressional Review Committee.¹⁷⁶ The Ministry of Economy and Finance sends the National Financial Statements, prepared by DNCP, accompanied by the CGR's Audit Report to the President of the Republic. It should be submitted to the full Congress by November 15 of the year following the fiscal year.¹⁷⁷ In practice, these deadlines are met and the National Financial Statements are submitted to the Legislature (with the appropriate Audit Report). For the latest fiscal year audited (2007), the National Financial Statements and the Audit Report were submitted to the Legislature on September 26, 2008,¹⁷⁸ that is, before three months had elapsed (June 30 to September 26).

(iii) Evidence of follow up on audit recommendations

Subsection "f", article 36 of Law 28708 provides: "The head of the budget implementation agency or senior authority or those who may act as such in the entities have administrative responsibilities and are obliged to implement the recommendations and remedy the CGR's observations." In turn, subsection "b", article 38 of the same law details that "failure to implement the recommendations and failure to solve them for terms of more than one fiscal year" are serious administrative faults. Institutional control offices (OCI) are also legally obliged to submit a semiannual progress report on implementing the recommendations.¹⁷⁹

¹⁷⁵ Article 30.2 of the General National Accounting System (Law 28708 of April 12, 2006) states that June 30 (of the year following the fiscal year) is the deadline for the DNCP to send the National Financial Statements to the CGR.

¹⁷⁶ Law 28708, article 31.2.

¹⁷⁷ Political Constitution of Peru, article 81, and Law 28708, article 32.

¹⁷⁸ Bill 02737/2008-PE.

¹⁷⁹ Directive 014-2000-/B150, G. Specific Provisions, 2. Verification and follow-up on the implementation of recommendations.

Thus, the head of an audited entity that receives an audit report from the CGR is legally obliged to inform CGR, within fifteen calendar days, of the actions taken, with details of the terms of reference and the identity of the officers responsible for implementing CGR's recommendations.¹⁸⁰ CGR makes visits to verify the follow-up on corrective actions,¹⁸¹ and inquires through official letters about the status of implementation of the recommendations.

Reforms

CGR is currently conducting a modernization and deconcentration program for the National Oversight System, supported by the IADB.¹⁸² The program includes capacity building, staff training, process improvement and regional offices strengthening. The German Technical Cooperation (GTZ), through its Governance Project, is developing the second phase of a government oversight strengthening program (2008-2010¹⁸³). UNDP is supporting the CGR with a small project (US\$ 250,000) to train regional governments (2006-2008). Finally, the European Community is preparing, in the context of the decentralization process, a project to strengthen preventive controls, which will begin in 2009.

Indicator	Score	Explanation
PI-26 Scope, nature and follow-up of external audit	B+	Scoring Methodology M1
(i) Scope of audit performed (including adherence to auditing standards)	B	The central government audit covers revenue, expenditure, financial assets and liabilities (debt). Close to 75% of the central government's total expenditure is subject to annual audit. The audits focus on systems problems.
(ii) Timeliness of submission of audit reports to legislature	A	The National Financial Statements are presented to the legislature (with an Audit Report) less than three months after having been received by the CGR (June 30 to September 26).
(iii) Evidence of follow up on audit recommendations	B	The entity's legal obligation of implementing the CGR's recommendations and follow-up controls show that there is follow-up.

PI-27 Legislative scrutiny of the annual budget law

This indicator assesses the Legislature's capacity to examine, debate, approve and control the public budget, in addition to ensuring strict compliance with the government's regulations. The assessment was made based on the budget year for fiscal year 2007.

¹⁸⁰ Directive 014-2000-/B150, Verification and follow-up on the implementation of recommendations arising from control action reports, Specific G. Provisions, 1. Actions adopted by the incumbent.

¹⁸¹ Directive 014-2000-/B150, G. Final Provisions, 2.

¹⁸² It is a loan for US\$ 12 million for a four-year reform program (2005-2009).

¹⁸³ The first phase extended from 2004 to 2007.

(i) Scope of the Legislature's scrutiny

Article 77 of the Political Constitution of Peru (1993) establishes that “the government’s economic and financial administration is ruled by the Budget approved every year by Congress” and Article 78 reads that the Public Budget Bill is accompanied by a Fiscal Balance Bill and an Indebtedness Bill for the year under consideration. The General National Budget Law (Law 28411 of January 1, 2005) also defines the documentation supporting the budget that must be submitted to Congress, including the Multiannual Macroeconomic Framework (MMM), which contains the economic forecasts and the fiscal targets supporting the proposed budget.¹⁸⁴

The scrutiny of the Budget Bill by Congress is based on the bills sent by the Executive Branch, including the related recitals and supplementary information, as well as the appearance of Executive Branch authorities at the Congress plenary. The review by Congress starts on the basis of considering the MMM and then focuses on the justification of the revenues and expenditures presented, as well as on the medium-term fiscal policies and priority expenditures (three years).¹⁸⁵ This review is mainly qualitative, and is performed in public hearings with economic or sector authorities. The format used to present the Budget to Congress does not allow for an adequate review of the policies and priorities. Therefore, for the 2007 Budget, Congress took the initiative of asking the Executive Branch to introduce a Results-based Budget exercise to provide a better view of the policy priorities and to measure their progress against the proposed goals and indicators.

(ii) Extent to which the legislature's procedures are well-established and respected

Article 80 of the Political Constitution establishes that the Minister of Economy and Finance must support the revenue budget, while the other ministers must support the expenditure budget for their sectors before the Congress plenary. The President of the Supreme Court, the National Prosecutor and the President of the National Elections Jury also explain the budgets for their institutions. Furthermore, the Congress Regulations establish that 48 hours after having received the Budget Bill, the President of the Congress should call a special plenary meeting to allow the Minister of Economy and Finance to present its justification. Once the debate is finished, the Budget Bill draft is sent to the Official Gazette for publication and forwarded to the Budget and National Financial Statements Committee (CPCG) for analysis at a public session. The processes for scrutiny by the Legislature are duly regulated, are relatively comprehensive and have been regularly followed as established in the Constitution and Law 28411.

¹⁸⁴ Law 27958, Fiscal Responsibility and Transparency Law, that amended Law 27245, establishes that the budget must also be accompanied by an evaluation of the fiscal policy.

¹⁸⁵ The fiscal framework analysis is macroeconomic only, with no sector forecasts established in the budget documentation.

(iii) Adequacy of time for the legislature to provide a response to budget proposals both regarding the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates early in the budget preparation cycle (time allowed in practice for all stages combined)

The President must send to Congress the Public Sector Budget Law before August 30 of each year.¹⁸⁶ Congress has ninety calendar days from August 30 to review, amend and approve the Bill, and return it not later than November 30 of each year to the Executive Branch for enactment.¹⁸⁷ If this deadline is not met, the Budget Bill draft sent to Congress by the President of the Republic becomes effective and is approved by legislative decree.

At the National Congress, the CPCG has until November 15 of each year to express an opinion on the Budget Bill,¹⁸⁸ which serves as a basis for the discussion and subsequent vote at the plenary meeting.¹⁸⁹ The Budget Bill, with or without amendments, is approved with the affirmative vote of half plus one of the Congressional members present at the session.

(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature

Article 80 of the Political Constitution provides that “[...] supplementary credits, authorizations and transfers of items should be sent to Congress as in the case of the Budget Law [...]” Articles 38 to 41 of Law 28411 further establish the limitations and procedures to amend the budget for the current year, classified into: (i) changes at the institutional level (increase in general budget and transfers of items across sectors); and (ii) changes at a functional programmatic level, which include annulments (reduction) and authorizations (increases) of items within an institution’s budgetary ceiling. The latter are within the powers of the head of the institution that is modifying the budget, provided they are reported to DNPP, and the restrictions defined for these cases are respected. The changes must also be published in the Official Gazette.

The approval of the Budget Bill in 2007¹⁹⁰ and the addition of supplementary credits to that law¹⁹¹ have fully complied with the regulations mentioned above. However, during 2007 as in other years, several urgency decrees were approved to make budget changes; some of those

¹⁸⁶ Political Constitution of Peru, article 78.

¹⁸⁷ Political Constitution of Peru, article 80.

¹⁸⁸ National Congress Regulations.

¹⁸⁹ Although this performance evaluation does not go into details as to the quality of the scrutiny and mainly refers to the fulfillment of regulations and terms for this scrutiny, it should be highlighted that there are the limitations in human and financial resources in Congress to carry out this work more effectively and in further detail, especially at the CPCG, which recurrently demands more support for this purpose.

¹⁹⁰ Law 28927 of December 11, 2006.

¹⁹¹ Law 28979 of February 16, 2007 and Law 29035 of June 10, 2007.

related to the transfer of resources to deal with natural disaster situations, particularly the earthquake of August 15, 2007 that affected southern Peru. Urgency decrees are recognized in the Political Constitution and are enforceable as laws. They are enacted by the President of the Republic to address economic and financial issues of national interest that require immediate decisions and must be accounted for before Congress.¹⁹² Congress may amend or abrogate those decrees.

Reforms

Congress has recently signed a Letter of Agreement with the World Bank¹⁹³ to receive nonrefundable technical assistance to develop a computerized information management system. This new system will be connected to the SIAF and be capable of providing information on Budget programming and execution in a more efficient fashion. In addition, this technical assistance seeks to improve the capacity of the National Congress to analyze, monitor and evaluate the main targets of the Public Budget. Likewise, it is expected that a monitoring and evaluation system will be implemented to follow up the results-based budget.

Indicator	Score	Explanation
PI-27 Legislative scrutiny of the annual budget law	B +	Scoring Methodology M1
(i) Scope of the legislature's scrutiny	A	The legislature's review covers fiscal policies, medium term fiscal framework and medium term priorities as well as details of expenditure and revenue.
(ii) Extent to which the legislature's procedures are well-established and respected	A	The legislature's procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures.
(iii) Adequacy of time for the legislature to provide a response to budget proposals	A	The legislature has over two months to review the budget proposals.
(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature	B	Clear rules exist for in-year budget amendments by the executive. They are usually respected, although they allow for broad administrative reallocations (within the budget limits).

*PI-28 Legislative scrutiny of external audit reports*¹⁹⁴

This indicator evaluates the performance of Peru's National Congress in scrutinizing the National Financial Statements (CG), audited by the National Auditor General's Office (CGR). The performance is measured by the timing of the examination of the CG, the scope of the arrangements to review its conclusions and the implementation and follow up of its recommendations.

¹⁹² Political Constitution of Peru, article 118, point 19.

¹⁹³ Signed on June 3, 2008 for IDF Grant No. TF091818.

¹⁹⁴ The preparation of this indicator required work sessions with the Congress' Budget and National Financial Statement Committee, the CGR and the MEF's DNCP.

The Political Constitution of Peru (1993) establishes that the President has an obligation to forward the CG to Congress, accompanied by CGR's audit report, before November 15 of the year following that of the budget execution.¹⁹⁵ One of the powers of Congress is to approve the CG after following internal processes and before a fixed deadline.¹⁹⁶ Prior to this approval process, according to the General National Accounting System Law,¹⁹⁷ the National Public Accounting Directorate (DNCP) is charged with forwarding the CG to the CGR for its audit, and to a review committee (Budget and National Financial Statements Committee) of the National Congress by the deadline of June 30 of the year following the one for which the accounts are being reported.¹⁹⁸ Then, CGR audits the CG and submits its Audit Report to MEF and the Congressional Budget and National Financial Statements Committee before the August 31 deadline.¹⁹⁹ The review committee must then issue its report within ninety calendar days of the presentation of CGR's Audit Report,²⁰⁰ and then the full Congress will have thirty days to express its opinion on the annual audited National Financial Statements.²⁰¹

The Charter of the National Oversight System and National Auditor General's Office establishes the regulations that govern the scope, organization, powers and operation of the National Oversight System, and the CGR as lead agency of this system.²⁰² These regulations also define CGR's powers, among them, "to submit every year to the National Congress the Evaluation Report on the National Financial Statements, for whose preparation the National Auditor General's Office will issue the appropriate resolutions."²⁰³ Thus, CGR issues resolutions that organize the work to be done. The most relevant one is Resolution No. 117-2001-CG dated June 27, 2001, which approves Directive 013-2001-CG/B340 "Rules for Financial Information Auditing and Special Examination of Budget Information prepared for the National Financial Statements by public sector entities."

(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years)

The CG is examined and assessed by the review committee within ninety days of its reception. The full Congress must express an opinion on the review committee's report within thirty calendar days; if no opinion is expressed by the deadline, the review committee's report is provided to the Executive Branch to enact a legislative decree approving the CG. The 2004 CG was approved in March 2006 by law. The 2005 CG was not approved and, therefore,

¹⁹⁵ Political Constitution of Peru, article 81.

¹⁹⁶ Political Constitution of Peru, article 102.

¹⁹⁷ Law 28708 of April 10, 2006.

¹⁹⁸ Law 28708, section 30, point 2.

¹⁹⁹ Law 28708, section 31, point 2.

²⁰⁰ Law 28708, section 33, point 1.

²⁰¹ Law 28708, section 34, point 2.

²⁰² Law 27785 of July 22, 2002.

²⁰³ Law 27785, article 22.

it was filed in March 2007.²⁰⁴ Finally, in February 2008 the Executive Branch approved the 2006 CG through a legislative decree, disregarding the review committee's report because Congress had adjourned during the time when the plenary was required to express an opinion. In practice, Congress uses its entire legal review period to do its work, which means that if the deadline had been complied with, the duly audited 2007 CG should have been received by November 15, 2008 and a review committee's report with a bill of approval should have been provided by February 13, 2009. Since then, Congress would have had time until March 15, 2009 to express an opinion and approve the related law. As Congress did not enact the law within the specified term, the CG was approved by the Executive Branch through a legislative decree.

(ii) Extent of hearings on key findings undertaken by the Legislature

CPCG sets up a subcommittee to examine the CG. This subcommittee operates based on the information provided by MEF and CGR, and holds working sessions with specialized units of audited entities, asking specific questions and, exceptionally, inviting Executive Branch members to formal hearings. When the case warrants a more specific action (justified complaints with high visibility signs of potential criminal offenses), the plenary may refer it to the Congressional Oversight Committee and request an investigation. In the recent past the subcommittee has not held any public hearings with MEF to discuss the findings of the audited CG or with the heads of the entities that have made observations on the audit report, although in the past it did so on occasion.

(iii) Issuance of recommended actions by the Legislature and implementation by the Executive

The current laws do not specify the actions that should be taken in connection with the review committee's recommendations on the CG. Only on rare occasions (i.e., signs of high visibility offenses) may these recommendations give rise to a referral of the audit report to the Congressional Oversight Committee for consideration. Congress is also empowered to establish special committees to analyze these issues. The review subcommittee's reports (opinions) address a lot of information and are quite comprehensive to the extent they analyze each of the significant issues of the CG and they also make recommendations and detailed comments. However, the review subcommittee itself acknowledges that its follow-up by the Congressional plenary is limited, or simply nonexistent, and Congress does not make good use of the analysis and reports it prepares. Unfortunately, Congress lacks the institutional capacity to follow up on the recommendations. There is thus no way of evidencing that any Congressional recommendations are implemented.

²⁰⁴ The Congressional Budget and National Financial Statement Committee has tended not to approve the in years when there is a change of administration (July 2006 was the most recent one).

Reforms

The Budget and National Financial Statements Committee has developed a constitutional reform initiative to change the deadline for these review processes because they are considered to allow too much time. The new deadline proposed for delivery of the national audited financial statements is September 15 of each year, i.e., two months less than the current deadline. This would make it possible to have a reviewed and eventually approved CG before the end of November, in time to be used as an input to consider for the following budget.

Indicator	Score	Explanation
PI-28 Legislative scrutiny of external audit reports	C+	Scoring Methodology M1
(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years)	B	CPCG usually completes its scrutiny and issues an opinion on the audit reports within 6 months from receipt of the reports. However, Congress does not generally approve the CG within its deadline and it has to be approved by the Executive Branch.
(ii) Extent of hearings on key findings undertaken by the legislature	C	In-depth hearings on key findings take place occasionally. They cover only a few audited entities, and sometimes may only include Ministry of Finance officials.
(iii) Issuance of recommended actions by the legislature and implementation by the executive	C	Actions are recommended, but are rarely acted upon by the Executive. Congress has no capacity to follow up on such recommendations.

3.7. Donor Practices

D-1 Predictability of direct budget support

This indicator measures the annual differences between the budget support received as compared with what was originally forecast by international financial agencies and the donors. Budget support consists of all the financial aid provided directly to the Public Treasury, either as a loan or grant. When received by the Public Treasury, the funds will be used in accordance with the procedures applied for all other general revenues. The analysis of this indicator covers the years 2005, 2006 and 2007. The data used for the evaluation were provided by the multilateral and bilateral agencies mentioned in the analysis, as well as by the Peruvian International Cooperation Agency (APCI). Table 3.15 summarizes the information received.

During the period 2005-2007, the World Bank (WB) provided three Development Policy Loans to Peru. These loans, which provide budgetary support for specific agreed development policies²⁰⁵, include: the third Programmatic Decentralization and Competitiveness Loan for

²⁰⁵ Development Policy Loan (DPL).

US\$150 million in 2005; the first Fiscal Management and Competitiveness Loan for US\$200 million in 2006; and the Results and Accountability Loan²⁰⁶ for US\$150 million in 2007.

Of these three loans, only the first one was disbursed as scheduled. The second was only disbursed in 2007, with a delay of almost two months; and, the third did not become effective within the year scheduled. The delays in disbursements were the result of decisions by the Peruvian government related to its borrowing strategy. In practice, the WB commits a disbursement when the government requests funds and remits the funds immediately after loan is effective (after the Loan Agreement has been ratified by the PCM). If the government changes its mind as to the ratification date (effective date), the loan disbursement is delayed as occurred in this case. Thus, the delays in disbursing these loans during the three years under review are not attributable to the World Bank, but rather to government decisions.

Similarly, disbursements related to IADB funded budgetary support were also partially delayed. IADB's budgetary support funding for 2005 was disbursed as scheduled: disbursements of US\$150 million and US\$200 million, were disbursed as anticipated during the first and fourth quarters of that year. However, a US\$300 million disbursement, scheduled for the fourth quarter of 2006 and a US\$350 million disbursement scheduled for 2007 were both delayed.

From 2005 to 2007, the German Financial Cooperation, through the Kreditanstalt für Wiederaufbau (KfW), had scheduled budget support funding for Peru. The operations were designed as co-funding with the World Bank's DPLs for 2005 and 2006. In 2005 and 2006 KfW's scheduled disbursements took place as expected, but in 2007 they were delayed and reduced as compared to the amounts originally offered by Germany. These changes were made for the same reasons that the Peruvian government delayed and reduced the corresponding World Bank disbursements –i.e., decisions related to changes in the Peruvian government's borrowing strategy.

Belgium provided budget support to finance the Integral Health System (SIS). The funds scheduled in 2005 and 2006, for Euros 3 million (approximately US\$4.3 million) annually were reportedly disbursed without delays.

From 2005 to 2007, France provided humanitarian aid and assistance through Debt Swaps for Sustainable Development. The counterpart of this assistance was US\$7.6 million in 2005; it decreased to US\$4 million in 2006 and US\$2.08 million in 2007.

²⁰⁶ Results and Accountability Program (REACT).

The Office of the Ombudsman uses a basket of funds financed by Canada, Sweden, Spain and Switzerland to develop its Strategic Plan. Belgium does not participate in this basket, but assists the Office of the Ombudsman by depositing its contribution in a special account. Those funds for the Ombudsman's Office were disbursed to the Public Treasury as planned. In 2006, this financing amounted to US\$1.21 million; in 2007, the amounts increased to US\$2.15 million. These were approximately the amounts planned; small differences arose on account of exchange rate variations in the currency basket.

(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six months prior to the government submitting its budget proposals to the legislature (or equivalent approving body)

In general, the actual budget support of all the agencies during the period under consideration (2005-2007) does not show variations as compared to that scheduled. As to the WB, the IADB and KfW, the variation noted in 2006 and 2007 was not due to delays caused by these institutions, but rather to the Peruvian government's decisions.

(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)

In general, the quarterly aggregate estimates are respected and the agencies' disbursements are made on time in the course of the fiscal year. The delays in the WB, IDB and KfW disbursements were not attributable to these institutions but to decisions by the Peruvian government.

Indicator	Score	Explanation
D-1 Predictability of Direct Budget Support	A	Scoring Methodology M1
(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six months prior to the government submitting its budget proposals to the legislature (or equivalent approving body)	A	The effective budget support from all the agencies during the period under consideration (2005-2007) shows significant deviations as compared to what was scheduled. However, the variations were not caused by the donors, but by a reduction of actual demand by the Peruvian government.
(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)	A	The quarterly aggregate estimates are respected, and the disbursements of the agencies other than the WB, IDB and KfW were made on time in the course of the fiscal year.

Table 3.15. Budget support (2005-2007)
(In millions of US Dollars)

	Disbursement committed												Disbursement committed												Disbursements											
	2005						2006						2006						2007						2007											
	1Q	2Q	3Q	4Q	Total		1Q	2Q	3Q	4Q	Total		1Q	2Q	3Q	4Q	Total		1Q	2Q	3Q	4Q	Total		1Q	2Q	3Q	4Q	Total							
WB	--	--	--	150	150		--	--	--	200	200		--	--	--	--	--		--	150	--	--	150		--	--	--	--	--		--	--	--	200	200	
IDB	150	--	--	200	350		--	--	--	300	300		--	--	--	300	300		--	--	--	--	--		--	--	--	--	--		--	--	--	350	350	
GTZ	2.5	2.5	2.5	2.5	10		2.2	2.2	2.2	2.2	9.0		2.2	2.2	2.2	2.2	9.0		2.2	2.2	2.2	2.2	2.2		2.9	2.9	2.9	2.9	11.6		2.9	2.9	2.9	2.9	11.6	
KfW	3.9	1.6	3.9	6.9	16.5		2.2	2.2	2.5	2.7	9.6		2.2	2.2	2.5	2.7	9.6		1.8	2.0	1.0	1.3	6.3		1.8	2.0	1.0	1.3	6.3		1.8	2.0	1.0	1.3	6.3	
Belgium	--	--	--	4.3	4.3		--	--	--	4.3	4.3		--	--	--	4.3	4.3		--	--	--	--	--		--	--	--	--	--		--	--	--	--	--	
France	--	--	--	7.6	7.6		--	--	--	4.0	4.0		--	--	--	4.0	4.0		--	--	--	--	--		--	--	--	2.0	2.0		--	--	--	2.0	2.0	
Basket	--	--	--	--	--		--	--	--	1.2	1.2		--	--	--	1.2	1.2		--	--	--	--	--		--	--	--	2.1	2.1		--	--	--	2.1	2.1	
Total	156.4	4.1	6.4	371.6	539		4.4	4.4	4.7	514	528		4.4	4.4	4.7	514	528		4.7	4.4	3.9	3.14	328		4.7	155	3.9	358	522		4.7	155	204	358	572	

Source: information provided directly by the agencies in response to a questionnaire prepared by the team.

D-2 Financial information provided by donors for budgeting and reporting on project and program aid

The purpose of this indicator is to evaluate the completeness and timeliness of budget estimates provided by donors for project support. It also establishes the frequency and coverage of reporting by donors on actual donor resource flows for project support. The information used for this evaluation has been provided directly by each donor (and agency), which filled in a detailed questionnaire prepared by the consulting team. Additional information was provided by APCI.

The fiscal years of some agencies and donors are different from the Peruvian government's: the World Bank's fiscal year begins on July 1 and ends on June 30 of the following year; the fiscal year of the Canadian International Development Agency (CIDA) begins on April 1 each year and ends on March 31 of the following year; and, the fiscal year of the United States Agency for International Development (USAID)'s begins on October 1 and ends on September 30. The budget estimates and the information on the disbursements provided by these agencies are based on their fiscal years.

The largest international cooperation agencies such as the WB and the IADB, rely on an Annual Operational Plan (POA), managed by the task manager interacting with a Peruvian government counterpart, which sets out estimated disbursements for each project. This is also true for KfW and GTZ (Germany). These estimates are prepared at the beginning of the year and are generally reviewed (portfolio review) each quarter (or, at a minimum, twice a year). In general, the POA does not follow the government's budget classification.

Other cooperation agencies such as those of France, CIDA, SIDA (Swedish International Development Cooperation Agency) and USAID provide information on disbursements at the beginning of the year (in general to the APCI). The European Community does not present this kind of information on a consistent basis. However, in 2003 it created, jointly with the APCI, a database which has been updated twice to date.²⁰⁷ The Spanish Agency for International Cooperation and Development (AECID),²⁰⁸ KfW and GTZ (German Technical Cooperation) all provide information at the beginning of each quarter. This information is sometimes provided at the beginning of a project and covers its entire life (Belgium, Finland). Except for AECID and KfW, the donors' information is not consistent with the government's budget classification.

²⁰⁷ Integrated matrix of international cooperation projects (www.apci.gob.pe/MIPCI).

²⁰⁸ AECID and the Peruvian government have a mixed management tool: the Peruvian civil association called Fondo de Cooperación Hispano-Peruano (Spanish-Peruvian Cooperation Fund), which allows it to properly manage the flows of allowances and disbursements of all the grants of the Spanish Peruvian Cooperation Program, thereby ensuring sufficient disbursement of funds for execution of programs and accountability requirements (AECID's communication).

In general, disbursement authorization processes carried out for large projects funded by loans (WB, IDB), together with estimated disbursement schedules, have been previously reviewed by the MEF. Thus, the government is aware of estimated and actual disbursements, even if it does not receive regular formal reports consistent with government budget classifications.

The other agencies do not prepare quarterly reports on the actual disbursements; however, they do communicate that information every year to their headquarters and to the APCI (except for AECID and the KfW); the European Community relies on the APCI to communicate with EU headquarters.

Table 3.16 presents a summary of the financial information provided by the donors for projects and programs.

(i) Completeness and timeliness of budget estimates by donors for project support

Most agencies (development banks and bilateral agencies) provide complete budget estimates for disbursement of project aid for the government's next fiscal year. In general, they do not use the government's budget classification.

(ii) Frequency and coverage of reporting by donors on actual donor flows for project support

Although, in general, the agencies do not provide quarterly reports on disbursements, these are known by the MEF for major projects funded by the development banks. The APCI also receives information from bilateral (and multilateral) agencies on all the donations. Thus, it may be considered that at least 50% of all the budget estimates for projects with foreign financing are covered by this type of information.

Indicator	Score	Explanation
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	C	Scoring Methodology M1
(i) Completeness and timeliness of budget estimates by donors for project support	C	Most agencies provide estimates for disbursements, although the format is not consistent with the government's budget classification.
(ii) Frequency and coverage of reporting by donors on actual donor flows for project support	C	Information is available on actual disbursements for at least 50% of all project estimates.

Table 3.16. Financial information provided by donors for projects and programs

	EC	WB	IDB	CIDA	France	AECID	ASDI	Germany KfW/GTZ	USAID	Belgium	Finland	SECO
1. The agency provides complete budget estimates for disbursements of project aid	No	YES	YES	YES	YES	YES	YES	YES/YES	YES	No	No	No
2. Disbursements of project aid are made at stages consistent with the government's budget calendar	n.a	YES	YES	YES	YES	YES	No	YES/YES	No	n.a	n.a	No
3. Disbursements of project aid are made with a breakdown consistent with the government's budget classification	No	No	No	No	No	YES	No	YES/No	No	n.a	n.a	No
4. The agency provides reports within one month of end of quarter on all the disbursements made	No	No	No	No	YES	YES	No	YES/No	No	No	No	No
5. Reports have a breakdown consistent with the government's budget classification	n.a	n.a	n.a	n.a	n.a	YES	n.a	YES/n.a	No	n.a	n.a	n.a

Source: information provided directly by the agencies in response to a questionnaire prepared by the team.

D-3 Proportion of aid that is managed using national procedures²⁰⁹

The purpose of this indicator is to establish the overall share of aid funds (foreign loans and donations) to the central government managed in accordance with national procedures in four areas: procurement, payments and accounting, audit and reporting. The information used in the evaluation has been provided by each donor, which completed a detailed questionnaire prepared by the consulting team. The APCI and the International Monetary Fund (IMF) provided additional information. Actual data on disbursements by agency (and aggregates) have been used for the years 2005 and 2006, since information on more actual nonrefundable aid was not available at the time of evaluating this indicator.²¹⁰

In general, funds from international agencies and donors used for budget support are channeled to the Peruvian government using national procedures. These agencies were included in Table 3.15. Table 3.17 presents the information that has been used to establish the overall share of aid funds to central government that are managed under national procedures. As noted, approximately 40% (42.7% and 39.7% in 2005 and 2006, respectively) of these funds are estimated to have used national procedures in 2005 and 2006.

(i) Overall proportion of aid funds to central government that are managed through national procedures

Approximately 40% of the actual aid funds for the Peruvian central government have been managed under national procedures.

Indicator	Score	Explanation
D-3 Proportion of aid that is managed by use of national procedures	D	Scoring Methodology M1
(i) Overall proportion of aid funds to central government that are managed under national procedures	D	Less than 50% of aid funds to central government are managed using national procedures.

²⁰⁹ To deal with this indicator, fiscal years 2005 and 2006 have been considered. As of the evaluation date, the complete data executed for 2007 were not available.

²¹⁰ October 2008.

**Table 3.17. Share of aid funds managed under national procedures
(In millions of US Dollars and as a percentage of total aid funds)**

Agencies and type of program	National procedures					Use of national systems (%)	Disbursements			Disbursements % *
	Procurement	Payments/ Accounting	Audit	Report submission			2005	2006	2005	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
WB**	–	YES	YES	YES	YES	YES	150	–	11.9%	–
WB (projects)	No	YES	YES	No	No	No	–	–	–	–
IDB***	YES	YES	YES	YES	YES	YES	350	300	23.8%	35.7%
IDB (projects)	No	No	No	YES (partial)	YES (partial)	No	–	–	–	–
GTZ***	YES	YES	YES	YES	YES	YES	10	9	0.8%	1.07%
GTZ (projects)	No	No	YES	No	No	No	–	–	–	–
KfW	YES	YES	YES	YES	YES	YES	16.5	9.6	1.3%	1.14%
Belgium	YES	YES	YES	YES	YES	YES	4.3	4.3	0.34%	0.5%
France****	YES	YES	YES	YES	YES	YES	7.6	4.0	0.6%	0.47%
USAID*****	YES	YES	YES	YES	YES	YES	–	4.9	–	0.6%
Basket funds	YES	YES	YES	YES	According to Manual of Procedures	YES	–	1.2	–	0.14%
TOTAL	–	–	–	–	–	–	538.4	333.0	42.7%	39.7%

* Percentage of actual disbursement of the agency on actual total disbursements of foreign aid to Peru (loans and donations).

** They amount to 1.2609 billion United States dollars and 839.1 million United States dollars in 2005 and 2006, respectively (team's calculations based on APCI and IMF data (2008: 35, table 11).

*** Budget support (in DPL there is no supervised procurement, refer to D-1).

**** Budget support, refer to D-1.

***** Humanitarian aid and debt swap.

***** Nonrefundable technical cooperation for government institutions.

Source: information provided directly by the agencies in response to a questionnaire prepared by the team.

Section 4. Public Sector Reform Process

The Public Sector Reform Process

The inception of the public sector reform currently being implemented in Peru can be found in the Law on the Framework for State Management Modernization (Law No. 27659 of January 29, 2002). The overall aim of that law is “to build a democratic, decentralized State, concerned with serving citizens.” To accomplish that purpose, this law proposed the following priority actions:

- a) Deepening social development efforts by enhancing the population’s access to public services,
- b) Agreeing with political parties and civil society on a shared vision of development through strategic, sustainable multi-year plans,
- c) Promoting decentralization to regional and local governments through a progressive transfer of competencies and resources,
- d) Generating greater efficiency in the use of public resources,
- e) Developing increased respect for a public service career, and
- f) Institutionalizing result-based evaluation of financial management, public and period accountability, as well as transparency of government actions.

Enforcing this law, albeit gradually, has posed difficulties; however, it has created space for a dialogue and subsequent broad political agreement through the so called National Accord. As a result, a set of long-term policies has been proposed to support the democratic transition, foster the institutionalization of a culture of dialogue, and encourage the building of consensus to manage any potential discrepancies. Among the main policies agreed under the Accord are: a deeper political, economic and administrative decentralization; the promotion of ethics and transparency in government actions; and fiscal sustainability, compatible with a progressive reduction of the burden of public debt.

The current administration (in office since mid 2006) has maintained its commitment to these reforms and indicated an interest in pursuing more specific efforts to modernize and reform public financial management and its instruments. The Presidency of the Council of Ministers and the Ministry of Economy and Finance have implemented a series of reforms in public financial management systems, which were developed with the support of several international

cooperation agencies, including the International Monetary Fund, the World Bank, the Inter-American Development Bank and the German Cooperation Agencies (KfW and GTZ). These reforms aim to enhance the focus, efficiency, control and transparency in the use of public resources.

During the first quarter of 2008, pursuant to the special powers granted by the National Congress, the Peruvian Executive issued a number of legislative decrees intended to improve the country's competitiveness in the context of the implementation and enforcement of the Trade Promotion Agreement agreed between Peru and the United States of America (FTA Peru-U.S.). Those decrees include various rules designed to improve the operation of the government, including restructuring the government procurement systems.

4.1. Description of the Key Reforms

The following paragraphs describe the main public financial management reforms and those currently being implemented or enhanced:

Modernization of Financial Management

- Implementation of the Single Treasury Account (CUT);
- Application of budget classifiers, in accordance with the 2001 IMF Manual, and to match each of the accounts on the Chart of Accounts;
- Gradual implementation of result-based programming and introduction of corresponding monitoring and evaluation processes;
- Enhancement and extension of the SIAF, particularly to enable capturing budgetary and financial data from local governments, which already enabled coverage of the 1,834 municipalities existing in 2008; there is a program in place for a comprehensive system modernization of the SIAF, including a new platform;
- Strengthening the National Budget and Financial Statements Congressional Committee, to enable improved performance of its oversight role;
- Inclusion of the payment stage in SIAF-SP reports for all sources of budget financing.

Modernizing and Strengthening the Tax System

- Establishment of a legal framework to regulate the evaluation of tax exemptions now and in the future, together with a program for the progressive elimination of the tax releases currently in force;
- Definition of an advance recovery system for the VAT called in Peru General Sales Tax (IGV), to lower the financial burden related to large-scale investments;
- Development of projects to help enhance the tax base of the income tax;

- Development of projects aimed at streamlining registration requirements to obtain a taxpayer identification number and make tax payments;
- Enactment of a General Customs Law, together with new regulations to enable Peru to adjust to the provisions of the country's trade agreements;
- The creation of a Foreign Trade One-stop Window (VUCE);
- Development of programs to facilitate electronic tax reporting and payment, as part of a broader strategy to expand the tax base;
- Develop tax simplification schemes for application to small and medium enterprises, together with related free accounting software.

Transparency and Public Access

- Development of basic conditions for the introduction of electronic governance instruments;
- Enactment of a new State Procurement Law;
- Establishment of a Government Procurement Center –Peru Compras– to deal with corporate procurement at the level of the national government;
- Approval of standardized procurement procedures through the Product Database;
- Development of citizen service modules.

Management of Human Resources

- Creation of the National Civil Service Authority (SERVIR), as the agency responsible for modernizing civil service management and careers in the administration;
- Creation of a Government Managers Corp to attract qualified professionals, using measures such as competitive compensation vis-a-vis the private sector;
- Implementation of a module for the management of human resources in the public sector, within a single data base that uses centralized controls over payroll;²¹¹
- Improvement of working conditions for civil servants hired through non personnel services.

Decentralization

- Development of a decentralization and regionalization plan to complete and harmonize the regulations related to the decentralization process;
- Development and implementation of an inter-governmental information system, and establishment of a technical service center for regional and local governments;

²¹¹ Considering that the SIAF has a payment module, the idea is to improve that module so that it can perform a more integral human resource management function.

- Development of administrative and management systems for the transfer of competencies to regional governments;
- Implementation of a training and technical assistance system for municipal governments;
- Programs for regional and local governments to undertake an institutional modernization process aimed at improving the quality of the public service through restructuring, administrative simplification, result-driven performance, improvement in expenditure quality and democratization.

4.2. Institutional Factors Supporting the Planning and Implementation of Reforms

The implementation of major economic reforms in Peru during the last decades, coupled with an exceptionally favorable international economic situation that allowed for high levels of growth for the past ten years, have given rise to a focus within the public sector on the need to support past efforts with further institutional reforms, to ensure the continuity of growth, facilitate its expansion and better distribute its benefits. In this regard, the state reform and modernization process seems to enjoy a broad political support, both among the government and opposition parties as well as civil society organizations. The National Accord is a manifestation of the broad political will for good governance; and the same can be said to the leadership exercised by the PCM and the increasing participation of sub-national governments in decision making related to decentralization and poverty reduction policies.

However, this political will to modernize the state has not yet produced a strategy with consistent priorities and consensus on the sequence of interventions. This might be due to the complexity of the ambitious scope of reforms, which requires a long-term consensus across different levels of government.

The lack of a strategy can be mainly observed in the lack of coordinated actions. Different levels of government are unaware of initiatives implemented by the public administration, substantial technical and financial resources are being used ineffectively, and interaction across the various levels of government has been scarce. These results in duplication of efforts and dispersion of resources related to the reform process.

International cooperation initiatives in Peru could support the introduction of the needed strategy and the development of an institutional architecture capable of fostering the needed coordinated activities. A greater effort to harmonize the interventions related to state reform and modernization would provide support to the government to enable further progress of this reform.

This PEFA assessment only covers a portion of the wide array of reforms being undertaken in Peru; therefore, it can only be used to address the effectiveness of reforms of public financial management undertaken. In that context, this assessment confirms that the country now has an adequate framework for public financial management, responsible implementation of public financial management systems and processes, and hence a good basis to continue making progress on other reforms.

Annexes

Annex 1. Detailed calculations PI-1, PI-2 & PI-3

Table A1-1. Primary expenditures budgeted and executed in millions of PEN (2005)

Sectors	Year 2005		Difference	Absolute	Percentage
	PIA	Paid			
1. PRESIDENCY OF THE COUNCIL OF MINISTERS (01)	390.21	729.44	339.24	339.24	86.9%
2. JUDICIARY (04)	642.08	672.60	30.53	30.53	4.8%
3. JUSTICE (06)	204.69	243.60	38.91	38.91	19.0%
4. DOMESTIC (07)	3,199.56	3,387.86	188.30	188.30	5.9%
5. FOREIGN AFFAIRS (08)	388.53	437.78	49.26	49.26	12.7%
6. ECONOMY & FINANCE (09)	4,053.57	3,359.53	-694.04	694.04	17.1%
7. EDUCATION (10)	3,491.05	3,033.97	-457.09	457.09	13.1%
8. HEALTH (11)	2,316.22	2,179.61	-136.61	136.61	5.9%
9. WORK AND JOB PROMOTION (12)	214.62	266.11	51.49	51.49	24.0%
10. AGRICULTURE (13)	478.96	548.52	69.56	69.56	14.5%
11. ENERGY & MINING (16)	167.08	381.73	214.65	214.65	128.5%
12. NATIONAL AUDITOR GENERAL'S OFFICE (19)	151.70	148.62	-3.08	3.08	2.0%
13. PUBLIC MINISTRY (22)	280.99	306.90	25.91	25.91	9.2%
14. DEFENSE (26)	3,575.08	3,716.13	141.05	141.05	3.9%
15. CONGRESS (28)	288.80	278.98	-9.82	9.82	3.4%
16. FOREIGN TRADE & TOURISM (35)	148.21	150.69	2.48	2.48	1.7%
17. TRANSPORTS & COMMUNICATIONS (36)	830.39	888.43	58.04	58.04	7.0%
18. HOUSING, CONSTRUCTION & SANITATION (37)	199.28	227.09	27.81	27.81	14.0%
19. PRODUCTION (38)	111.35	116.80	5.45	5.45	4.9%
20. WOMEN & SOCIAL DEVELOPMENT (39)	998.81	1,016.73	17.92	17.92	1.8%
21. Others (20,21,24,31,32,33)*	152.60	267.50	114.90	114.90	75.3%
Total primary expenditures	22,283.79	22,358.64	74.85	74.85	0.3%
Variance in the expenditure composition	22,283.79	22,358.64		2,676.15	12.0%

* This Group includes six of the autonomous constitutional agencies with the lowest budgets: Office of the Ombudsman (20), National Judicial Council (21), Constitutional Tribunal (24), National Elections Court (31), National Office of Election Processes (32), National Identification and Civil Registry (33).

Sources: SIAF, Treasury, Budget.

Table A1-2. Primary expenditures budgeted and executed in millions of PEN (2006)

Sectors	Year 2006					
	PIA	Paid	Difference	Absolute	Percentage	
1. PRESIDENCY OF THE COUNCIL OF MINISTERS (01)	687.07	568.54	-118.53	118.53	17.3%	
2. JUDICIARY (04)	725.60	780.58	54.98	54.98	7.6%	
3. JUSTICE (06)	207.38	313.16	105.78	105.78	51.0%	
4. DOMESTIC (07)	3,324.17	3,674.02	349.86	349.86	10.5%	
5. FOREIGN AFFAIRS (08)	400.40	466.88	66.48	66.48	16.6%	
6. ECONOMY & FINANCE (09)	4,398.43	4,944.71	546.28	546.28	12.4%	
7. EDUCATION (10)	3,702.13	3,264.12	-438.01	438.01	11.8%	
8. HEALTH (11)	2,398.28	2,406.43	8.15	8.15	0.3%	
9. WORK AND JOB PROMOTION (12)	215.15	225.59	10.44	10.44	4.9%	
10. AGRICULTURE (13)	533.18	818.31	285.14	285.14	53.5%	
11. ENERGY & MINING (16)	287.11	220.75	-66.36	66.36	23.1%	
12. NATIONAL AUDITOR GENERAL'S OFFICE (19)	159.59	154.42	-5.17	5.17	3.2%	
13. PUBLIC MINISTRY (22)	296.21	343.64	47.43	47.43	16.0%	
14. DEFENSE (26)	3,643.54	3,914.01	270.47	270.47	7.4%	
15. CONGRESS (28)	313.99	288.88	-25.11	25.11	8.0%	
16. FOREIGN TRADE & TOURISM (35)	155.86	150.66	-5.19	5.19	3.3%	
17. TRANSPORTS & COMMUNICATIONS (36)	1,037.77	1,260.06	222.29	222.29	21.4%	
18. HOUSING, CONSTRUCTION & SANITATION (37)	228.86	425.31	196.45	196.45	85.8%	
19. PRODUCTION (38)	116.73	118.10	1.37	1.37	1.2%	
20. WOMEN & SOCIAL DEVELOPMENT (39)	981.10	1,037.21	56.11	56.11	5.7%	
21. Others (20,21,24,31,32,33)*	509.80	585.70	75.90	75.90	14.9%	
Total primary expenditures	24,322.34	25,961.08	1,638.75	1,638.75	6.7%	
Variance in the expenditure composition	24,322.34	25,961.08		2,955.52	12.2%	

* This Group includes six of the autonomous constitutional agencies with the lowest budgets: Office of the Ombudsman (20), National Judicial Council (21), Constitutional Tribunal (24), National Elections Court (31), National Office of Election Processes (32), National Identification and Civil Registry (33).

Source: SIAF, Treasury, Budget.

Table A1-3. Primary expenditures budgeted and executed in millions of PEN (2007)

Sectors	Year 2007					
	PIA	Paid	Difference	Absolute	Percentage	
1. PRESIDENCY OF THE COUNCIL OF MINISTERS (01)	860.20	1,154.43	294.23	294.23	34.2%	
2. JUDICIARY (04)	834.78	849.45	14.66	14.66	1.8%	
3. JUSTICE (06)	240.28	242.94	2.65	2.65	1.1%	
4. DOMESTIC (07)	3,710.01	3,952.11	242.10	242.10	6.5%	
5. FOREIGN AFFAIRS (08)	464.40	472.10	7.70	7.70	1.7%	
6. ECONOMY & FINANCE (09)	5,522.19	3,098.62	-2,423.57	2,423.57	43.9%	
7. EDUCATION (10)	4,307.18	3,803.44	-503.74	503.74	11.7%	
8. HEALTH (11)	2,618.21	2,636.13	17.92	17.92	0.7%	
9. WORK AND JOB PROMOTION (12)	228.48	268.14	39.67	39.67	17.4%	
10. AGRICULTURE (13)	854.61	802.23	-52.39	52.39	6.1%	
11. ENERGY & MINING (16)	458.07	549.63	91.55	91.55	20.0%	
12. NATIONAL AUDITOR GENERAL'S OFFICE (19)	164.20	161.53	-2.68	2.68	1.6%	
13. PUBLIC MINISTRY (22)	381.53	386.06	4.54	4.54	1.2%	
14. DEFENSE (26)	3,847.41	3,875.21	27.80	27.80	0.7%	
15. CONGRESS (28)	289.01	278.31	-10.70	10.70	3.7%	
16. FOREIGN TRADE & TOURISM (35)	170.13	146.11	-24.02	24.02	14.1%	
17. TRANSPORTS & COMMUNICATIONS (36)	1,551.31	1,609.24	57.94	57.94	3.7%	
18. HOUSING, CONSTRUCTION & SANITATION (37)	843.36	587.88	-255.47	255.47	30.3%	
19. PRODUCTION (38)	149.44	161.39	11.95	11.95	8.0%	
20. WOMEN & SOCIAL DEVELOPMENT (39)	858.04	938.37	80.33	80.33	9.4%	
21. Others (20,21,24,31,32,33)*	206.90	236.40	29.50	29.50	14.3%	
Total primary expenditures	28,559.75	26,209.72	-2,350.04	2,350.04	8.2%	
Variance in the expenditure composition	28,559.75	26,209.72		4,195.10	14.7%	

* This Group includes six of the autonomous constitutional agencies with the lowest budgets: Office of the Ombudsman (20), National Judicial Council (21), Constitutional Tribunal (24), National Elections Court (31), National Office of Election Processes (32), National Identification and Civil Registry (33).

Fuentes: SIAF, Treasury, Budget.

Table A1-4. Deviations in the budget execution of global expenditure and its composition in percentage of originally budgeted expenditure

Year	PI-1		PI-2
	Global deviation of primary expenditure net of external financing (a)	Variance in primary expenditure composition, net of external financing (b)	Degree in which the composition variance exceeds the global expenditure deviation (b)-(a)
2005	0.3%	12.0%	11.7%
2006	6.7%	12.2%	5.4%
2007	8.2%	14.7%	6.5%

Sources: Tables A1.1, A1.2 & A1.3.

Table A1-5. Revenues budgeted and executed in millions of PEN (2005-2007)

	PIA			Executed		
	2005	2006	2007	2005	2006	2007
	(1)	(2)	(3)	(4)	(5)	(6)
I. TAX REVENUE	33,493	36,617	45,806	35,588	45,486	52,487
1. Income tax	10,003	10,850	17,914	11,188	18,414	22,847
a. Payments on account	9,056	9,350	14,814	9,149	15,131	18,850
b. Regularization	947	1,500	3,100	2,038	3,283	3,997
2. Import tax	2,798	3,541	2,037	3,143	2,847	2,204
3. General Sales tax (VAT)	17,383	19,524	23,573	18,302	21,517	25,255
a. Domestic	10,520	10,988	12,991	10,587	11,982	13,586
b. Imports	6,863	8,536	10,583	7,715	9,536	11,669
4. Excise taxes	5,124	4,390	3,910	4,066	4,042	4,281
a. Others	1,380	2,820	2,200	2,607	2,399	2,426
b. Fuels	3,744	1,570	1,710	1,459	1,643	1,865
5. Other tax revenues	1,743	2,744	3,330	2,979	3,370	3,882
6. Refunds	-3,558	-4,431	-4,958	-4,090	-4,704	-5,991
II. NON TAX REVENUES	4,883	5,232	6,244	5,458	7,229	8,626
III. TOTAL (I + II)	38,376	41,850	52,050	41,046	52,715	61,113
EXECUTION IMPLEMENTATION	--	--	--	106.95%	125.96%	117.41%

Sources: MEF, PIA 2005: Reviewed 2005-2007 MMM, PIA 2006: Reviewed 2006-2008 MMM, PIA 2007: Reviewed 2007-2009 MMM, Executed 2005: Reviewed 2007-2009 MMM, Executed 2006: Reviewed 2008-2010 MMM, Executed 2007: Reviewed 2009-2011MMM.

Annex 2. Detailed scores

A. PUBLIC FINANCIAL MANAGEMENT OUT-TURNS: Budget credibility					
Indicator/method	Score	D (i)	D (ii)	D (iii)	D (iv)
PI-1 (M1)	B	B	–	–	–
PI-2 (M1)	C	C	–	–	–
PI-3 (M1)	A	A	–	–	–
PI-4 (M1)	C+	A	C	–	–
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency					
PI-5 (M1)	B	B	–	–	–
PI-6 (M1)	A	A	–	–	–
PI-7 (M1)	A	A	A	–	–
PI-8 (M2)	A	A	A	A	–
PI-9 (M1)	B+	A	B	–	–
PI-10 (M1)	A	A	–	–	–
C. BUDGET CYCLE					
C (i) Policy-Based Budgeting					
PI-11 (M2)	A	B	A	A	–
PI-12 (M2)	B	C	A	C	B
C (ii) Predictability and Control in Budget Execution					
PI-13 (M2)	B+	A	A	C	–
PI-14 (M2)	A	B	A	A	–
PI-15 (M1)	D+	D	A	A	–
PI-16 (M1)	B+	A	B	B	–
PI-17 (M2)	B+	A	C	A	–
PI-18 (M1)	B+	A	A	A	B
PI-19 (M2)	B+	C	A	A	–
PI-20 (M1)	B+	A	B	A	–
PI-21 (M1)	C+	A	C	C	–
C (iii) Accounting, Recording and Reporting					
PI-22 (M2)	B+	A	B	–	–
PI-23 (M1)	D	D	–	–	–
PI-24 (M1)	C+	C	C	B	–
PI-25 (M1)	A	A	A	A	–
C (iv) External Scrutiny and Audit					
PI-26 (M1)	B+	B	A	B	–
PI-27 (M1)	B+	A	A	A	B
PI-28 (M1)	C+	B	C	C	–
D. DONOR PRACTICES					
D-1 (M1)	A	A	A	–	–
D-2 (M1)	C	C	C	–	–
D-3 (M1)	D	D	–	–	–

Annex 3. Summary of performance indicators with sources

A. PUBLIC FINANCIAL MANAGEMENT OUT-TURNS: Budget credibility		Score	Sources
PI-1	Aggregate expenditure out-turn compared to original approved budget	B	Annex I
PI-2	Budget expenditure out-turn compared to approved budget	C	Annex I
PI-3	Aggregate revenue out-turn compared to original budget	A	Annex I
PI-4	Stock and monitoring of expenditure payment arrears	C+	DNPP, DNTP, DNCP, DNEP
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency			
PI-5	Classification of the budget	B	Law 28411, Recitals document, 2009 budget bill, Supreme Decree 068-2008-EF May 25, 2008
PI-6	Comprehensiveness of information included in budget documentation	A	Law 28411, www.mef.gob.pe – MEF – Economic Transparency Portal (friendly consultation), MMM 2209-2011
PI-7	Extent of government operations included in budget reports	A	Law 27958, Law 27056, Law 28006, Law 26702, Section I
PI-8	Transparency of inter-governmental fiscal relations	A	Public Sector Budget for Fiscal Year 2007, DNPP, MEF, www.mef.gob.pe – MEF - Economic Transparency Portal
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	B+	Law 27086, Law 28563, Law 28928, Law 28927
PI-10	Public access to key fiscal information	A	Law 27806 www.cpn.mef.gov.pe www.contraloria.gob.pe/pace_old www.consucode.gov.pe.
C. BUDGET CYCLE			
C (i) Policy-Based Budgeting			
PI-11	Orderliness and participation in the annual budget process	A	Peru Political Constitution (1993), Law 284111, Directive 006-2007/76.01, MEF, DNPP, Law 28652, Law 28927, Law 29142
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	B	Law 28411, Law 27245, Law 27293, Law 27958, MMM 2006-2008, 2007-2009, 2009-2010, DGMP
C (ii) Predictability and Control in Budget Execution			
PI-13	Transparency of taxpayer obligations and liabilities	B+	Supreme Decree 135-99-EF August 19, 1999; Law 27444, Law 28008, Supreme Decree 129-2004-F; Supreme Decree 017-2007-EF February 18, 2007, www.sunat.gob.pe Lima Chamber of Commerce, World Bank
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	A	Same sources as for PI-13
PI-15	Effectiveness in collection of tax payments	D+	SUNAT, DNTP
PI-16	Predictability in the availability of funds for commitment of expenditures	B+	DNPP, DNTP, Banco de la Nación, sector MDAs (MINEDU, MINSAs), Law 28112, Law 28411, Law 28979, Law 29035
PI-17	Recording and management of cash balances, debt and guarantees	B+	www.mef.gob.pe/DNEP/estadistica_cp.php DNEP, Banco de la Nación, Law 28112, Law 28693
PI-18	Effectiveness of payroll controls	B+	MEF, MINEDU, MINSAs OGAs
PI-19	Competition, value for money and controls in procurement	B+	CONSUCODE, IDB, World Bank www.consucode.gob.pe, www.seace.gob.pe
PI-20	Effectiveness of internal controls for non-salary expenditure	B+	DNPP, DNCP, SIAF, DNTP, OCI, OGA MEF, MINEDU, MINSAs, CGR, Law 27785, Law 28411
PI-21	Effectiveness of internal audit	C+	OCI & OGA of MEF, OGPP of MINSAs, CGR

(continues)

Anexo 3 (continuation)

	C (iii) Accounting, Recording and Reporting	Score	Sources
PI-22	Timeliness and regularity of accounts reconciliation	B+	DNTP, DNCP, Banco de la Nación, Law 28193, Directive 001-2007 EF 77/15
PI-23	Information on resources received by service delivery units	D	DNPP, MINEDU, MINSA
PI-24	Quality and timeliness of in-year budget reports	C+	MEF-DNPP, First Quarter Financial Evaluation of Public Sector Budget, Fiscal Year 2007; Second Quarter Financial Evaluation of Public Sector Budget, Fiscal Year 2007; Third Quarter Financial Evaluation of Public Sector Budget, Fiscal Year 2007, available at: http://www.mef.gob.pe/DNPP/Evaluacion_Ppto/EvaluacionAnualGNGRGL_2007_VF.pdf .
PI-25	Quality and timeliness of annual financial statements	A	DNPP, DNCP, CGR, Law 28708 National Financial Statement (2007)
	C (iv) External Scrutiny and Audit		
PI-26	Scope, nature and follow-up of external audit	B+	CGR, National Financial Statement (2007), Audit Report, Law 28708
PI-27	Legislative scrutiny of the annual budget law	B+	CPP (1993), Law 28411, Law 28927, Law 28979, Law 29035, Congress
PI-28	Legislative scrutiny of external audit reports	C+	CPP (1993), Law 28708, CGR
D. DONOR PRACTICES			
D-1	Predictability of direct budget support	A	Various development agencies (donors, banks and others), APCI, IMF
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	C	Various development agencies (donors, banks and others), APCI, IMF
D-3	Proportion of aid that is managed by use of national procedures	D	Various development agencies (donors, banks and others), APCI, IMF

Annex 4. Effects of Public Finance Management Performance²¹²

Table A4.1 Links across the six Dimensions of an Open and Orderly PFM System and the Three Levels of Budgetary Out-turns

	Aggregate fiscal discipline	Strategic allocation of resources	Efficient service delivery
1. Budget credibility	The budget credibility in Peru facilitates the implementation of budget surplus generation policies and the lack of arrears in payments. In general, there is a good budgetary forecast of revenue and aggregate expenses.	The budget credibility allows for an appropriate funding of priority expenditures. There are no cuts of expenditure ceilings because revenues are sufficient (in excess of forecasted levels).	Non-salary recurrent expenditures are not particularly affected by budget adjustments and this does not reduce the efficiency of resources used at the service delivery level.
2. Comprehensive-ness and transparency	Activities follow appropriate budget processes and are subject to scrutiny and control. Therefore, the fiscal risk is reduced. The existing transparency makes it possible to obtain information regarding government performance in maintaining fiscal discipline and managing fiscal risks.	The lack of extra-budgetary funds contributes to the efficiency of strategic planning against government priorities. The existing transparency makes it possible to obtain information on the use of resources in line with government publicized priorities and, therefore, the possibility that Congress, civil society and media may establish the extent to which the government is implementing its policy priorities.	The adherence to the universality principle helps to prevent the waste of resources detrimental to service supply. Specifically, the lack of transparency limits the availability of information on the resources available for service delivery units. This weakens the capacity of local communities to exercise any scrutiny on the resources allocated and used at the service delivery units.
3. Policy-based budgeting	The Cabinet's proper involvement in the budget process supports the achievement of fiscal targets in the final budget negotiations. An acceptable integration of medium-term implications of fiscal decisions in the annual budget process can help prevent the implementation of unsustainable programs.	The participation by line ministries and Cabinet supports the allocation of the global resource package in line with government priorities and reduces the likelihood of ad-hoc decisions. The existence of a medium-term perspective favors resource allocation decisions.	The budget process is adequate and allows for debate on efficiency in the use of resources. In particular, it allows for an orderly review of existing policies and new policy initiatives. The existence of a satisfactory multi-year perspective contributes to an adequate planning of recurrent costs of investment decisions.

(continues)

²¹² Table A4.1 does not indicate the existence of a mechanical link between weaknesses/strengths of the public finance management system and achievements at the three levels of budgetary out-turns, but encourages some reflection on the effects of these weaknesses/strengths and their significance for the country.

Cuadro A4.1. (continuation)

	Disciplina fiscal agregada	Asignación estratégica de recursos	Eficiente prestación de servicios
4. Predictability and control in budget execution	Orderliness in execution, as well as an adequate synchronization of cash inflows, liquidity and outflows, contribute to a good fiscal management, e.g. avoiding unnecessary interest charges or supplier surcharges. The orderly execution of the budget facilitates the introduction of in-year adjustments. Adequate oversight systems help avoid expenditures in excess of budget that reduce the surplus, increase debt levels or generate arrears.	The current budget execution limits unscheduled reallocations. Also, (in general) current oversight systems help to avoid unauthorized expenditures and fraudulent payments.	Predictability in resource flows promotes the ability of service delivery units to plan and use those resources in a timely and efficient manner. It also fosters an environment in which controls are usually observed. The observance of competitive bidding practices for the procurement of goods and services benefits the existing programs by reducing procurement costs of goods or leading to the supply goods of adequate quality. Adequate controls of payrolls, procurement and expenditure processes help prevent corrupt practices, resource leakages and patronage.
5. Accounting, recording and reporting	Timely and adequate information on revenue forecasting and collection, existing liquidity levels and existing flows increase the government's capacity to determine and control budget totals	The lack of complete information on the cost of programs and the use of resources partially limit the ability to allocate resources to public priorities. Regular information on budget execution enables monitoring on the use of resources.	An adequate level of information and records increases the availability of evidence required for effective audit and oversight of the use of funds, besides helping prevent corrupt procurement practices and the use of resources in an unintended manner.
6. Effective scrutiny and audit	Full scrutiny of government macro-fiscal policy and its implementation contributes to increasing the pressure on government to consider long-term fiscal sustainability issues and to respect its targets.	Full scrutiny contributes to increasing the pressure on government to allocate and execute the budget in line with its stated policies.	An adequate audit leads to the performance to detailed review and verification of the accounting and use of funds.

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