Paraguay
Country Financial Accountability Assessment

Country Management Unit Argentina, Chile, Paraguay and Uruguay
Financial Management, Operations Support Unit
Latin America and Caribbean Region

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GOVERNMENT FISCAL YEAR
January 1 – December 31

Main Abbreviations and Acronyms

AG  Auditor General (CGR in Spanish)
AGPE Office of the Executive’s Internal Auditor (Auditor General del Poder Ejecutivo)
CAS Country Assistance Strategy
COA Court of Accounts (Tribunal des Cuentas)
CPAR Country Procurement Assessment Report
CFAA Country Financial Accountability Assessment
CGR Contraloría General de la República (Auditor General)
CSSNI National Integrity Commission
DGCDP Public Credit Office (Dirección General de Crédito y Deuda Pública)
DGJ General Tax Office (Dirección General de Impuestos)
DGT Treasury Office (Dirección General de Tesoro Público)
DMFAS UNCTAD Debt Management System
ESW Economic and Sector Work
FA Law Financial Administration Law
FSAL Financial Sector Adjustment Loan
GFS Government Financial Statistics
GOP Government of Paraguay
INTOSAI International Organization of Supreme Audit Institutions
IPS Social Security Institute
MOF Ministry of Finance
NICS International Accounting Standards (Normas Internacionales de Contabilidad)
SAI Supreme Audit Institution
SIAF Integrated Financial Management System (Sistema Integrado de Administración Financiera)
SBYS Goods and services module of SIAF (Sistema Integrado de Bienes y Servicios)
SICO Accounting module of SIAF (Sistema Integrado de Contabilidad)
SIAAGADE Spanish acronym for the UNCTAD Debt Management and Information System
SINARH Personnel module of SIAF (Sistema Integrado de Recursos Humanos)
SJPP Budget module of SIAF (Sistema Integrado de Presupuesto Público)
SITE Treasury module of SIAF (Sistema Integrado de Tesorería)
SESEFA Deputy Secretary for Financial Administration (Subsecretaría de Estado de Administración Financiera)
SESET Deputy Secretary for Taxation (Subsecretaría de Estado de Tributación)
STR Request for Transfer
SUAF Administration and Finance Sub-unit
UAF Administration and Finance Unit
WB World Bank

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EXECUTIVE SUMMARY

THE CFAA AS A KEY DEVELOPMENT TOOL

The issues addressed in this Country Financial Accountability Assessment (CFAA) lie at the very core of the Government of Paraguay’s performance and its fight against corruption. The CFAA is a primary diagnostic tool for addressing issues of governance and transparency in the public sector, and also helps address corruption because good systems, practices and accountability arrangements that are properly observed make it more difficult for venal officials to divert public resources. Curtailing corruption and improving governance are fundamental objectives for both the Government’s development strategy and the country assistance strategies of the Inter-American Development Bank (IDB) and World Bank (WB), who jointly prepared this report.

The outputs of the CFAA, which assesses the Government’s public financial management systems, practices and accountability arrangements, also address key issues in the sustainability of economic growth. Fiscal sustainability may be driven by a strong macroeconomic situation, but cannot occur without strong public financial management. The outputs of this report are also of particular importance at this time, given the need to ensure that quick disbursement funding linked to adjustment lending operations by the two participating Banks will be subject to adequate financial management arrangements.

GOVERNMENT REFORM AND THE IMMEDIATE PRIORITIES

The preparation of this report in 2002-03 took place during a period of economic and political instability that slowed the pace of public sector management reforms launched by Government in the 1990s. Nonetheless, the report recognizes that public sector budgeting and accounting have been transformed over the last six years. Government has addressed two of the most important problems identified in a 1996 WB report on the role of the state: outdated legislation governing financial administration legislation, and the lack of financial information. An integrated financial management system has now been partially implemented and is supported by legislation governing financial administration. Much credit is due the Paraguayan Government for the effective financial management controls applied to the Central Administration, which rest on a good legal framework and an effective integrated financial management system.

The new administration that took office in August 2003 has rededicated the Government’s commitment to public sector management reforms. Since that time Congress has approved laws to reform the tax and pension systems and the financial and banking sector, for which there is now broad public and political support.
Over the next few years, reform efforts will need to address the remaining weaknesses and shortcomings that continue to threaten financial accountability in Paraguay's public sector. The strategic approach to improving public financial management in Paraguay embodied in the Action Plan emerging from this CFAA requires immediate action on two fronts. The first is to move towards establishing a **proper control environment**. Independent surveys indicate that there is a perception that the public sector has not actively opposed corruption in the past. Without an adequate control environment, even the significant advances in control procedures and systems that have been made are powerless to safeguard assets against losses due to waste, abuse and mismanagement. The control environment is also adversely affected by numerous and serious exceptions in the application of the financial administration law and regulations.

The second strategic priority is a **stronger control function**, both internal and external. Establishing a system of internal control and strengthening the main external audit body (Auditor General) were the two other important problems identified in the 1996 WB report on the role of the state in Paraguay. This CFAA presents the standards, regulations, and practices recommended to implement an effective system of internal control, and the changes recommended to give the Auditor General more impact in its work

**Summary of CFAA Findings.**

The most important weaknesses and shortcomings that continue to threaten financial accountability in Paraguay are:

1. Weak control environment.
2. Numerous and serious exceptions in the application of the financial administration law and regulations.
3. Weak internal audit and control, especially in revenue collection agencies.
4. The disproportionate share of time and resources that the Auditor General devotes to ad hoc review requests.
5. Congressional introduction of budget increases without provision for corresponding financing.
6. Trade liabilities incurred by executing agencies but unrecorded if they exceed the authorized cash program.
7. Many exceptions to generally accepted accounting and auditing standards and financial statements not prepared in compliance with Government’s own regulations.

**Control Environment.** While Paraguay has made progress in the development of control procedures it is not clear that this is supported by an adequate control environment. The control environment refers to the overall attitude, awareness and actions of management
regarding the internal control system and its importance to an entity. Factors of the environment are the organizational structure, means of distributing authority and responsibilities and management’s control system including internal audit and personnel policies. The conditions in Paraguay’s public sector include serious institutional weaknesses and high levels of corruption according to independent surveys of the public’s perceptions; all this contributes to a poor control environment which affects the risk to public funds, which is considered high. President Duarte Frutos has made anti-corruption and improved public administration central to his program; steps taken in this direction include the appointment of independent ministers, declaration of wealth by all the members of the cabinet and major improvements in tax administration.

**Legal Framework.** The Financial Administration Law of 1999 and the accompanying regulation (FA Law) are well organized, clear and comprehensive but there are numerous and serious exceptions to the application of the law: budget expenditure is included by the Congress without identified the requisite financing, there are failures to comply with reporting provisions by the decentralized entities, and the evaluation of budget performance required by the law is not carried out. Use of the Integrated Financial Management System (SIAF) is mandatory for all public entities but is not widely implemented outside the Central Administration.

**Budget Execution.** The budget control system does not include commitment control, so approaching liabilities (those coming due next month and thereafter) are unknown to the central financial authorities. The lack of provision for a commitment phase is particularly serious since spending agencies are limited by law to entering accruals only up to the ceiling of the financial plan. The Treasury employs the monthly cash program as a ceiling for budget accruals to ensure that actual expenditure stays in line with revenue actually collected; these controls fail, however, in that they do not extend to contractual obligations that the spending agencies undertake beyond the cash program.

**Accounting Standards.** The accounting standards for the public sector in Paraguay are not codified; they comprise provisions in the Financial Administration Law and Regulations and occasional pronouncements of the Government Accounting Office. Paraguay does not comply with its own regulations in that not all public assets are recorded (only the assets under the use of specific agencies are recorded). Similarly, there is a significant exception to the application of international accounting standards in that the liability for post employment benefits for public servants is not recorded. A more general issue is that there is no distinction made for the standards for the general public sector and the government business enterprises.

**Decentralized Entities.** Many of the decentralized entities operate outside SIAF and the quality of their budget execution is therefore not effectively monitored by Treasury nor is there effective review by the internal and external audit functions. Although the Budget Office does control the approved budget for decentralized entities and compares execution against budget in the monthly reporting provided by these entities, the Budget Office controls only expenditures funded by Treasury releases, and not those expenditures funded from revenue generated directly by the decentralized entities. The
information from the decentralized entities is not considered reliable since the financial information of the individual entities provided to the Accountant General by March 31 following the year-end (which should be more reliable than the monthly reporting) does not reconcile with the information in the annual reports of the individual entities. This discrepancy may be attributed to the fact that many of these entities operate outside the SIAF. Similarly, the Central Administration or the Auditor General does not receive the auditors report on the annual statements.

**Internal Control.** Internal control applied in the entities generating Central Administration revenues is weak as are the accountability arrangements applied to the decentralized entities. This situation is aggravated by ineffectual work by the internal audit function which comprises primarily a priori review of transaction leaving no time and no independence to perform value added functions of measuring, evaluating and reporting on the effectiveness of the elements of the internal control system. Lastly, the independence of the Auditor General in carrying out its annual plan is affected by the disproportionate share of resources used in ad hoc reviews.

**CONCLUSIONS AND RECOMMENDATIONS**

The CFAA concludes that Paraguay's financial accountability arrangements are failing to support public expenditure outcomes and that transparency in the use of public funds is needed to encourage faith in the conduct of the government. This transparency in Paraguay could be improved with stricter compliance with generally accepted accounting standards in the financial reporting and with generally accepted auditing standards in the review of the annual financial report. Although there have been advances in systems for the Central Administration, these advances are not sufficient to compensate for the poor control environment. At the present time, the financial management risk is assessed as high. To achieve an acceptable level of risk, reforms are recommended in the areas of internal control, external audit, and the control of decentralized entities.

The highest priority CFAA recommendations are presented in a time-phased Action Plan that indicates the actions required in each area (budget, internal control, external audit) over the next few years.

Urgent attention must be given to the areas of the independent control function, control over the financial position, and to governance of the decentralized entities. Most serious are the numerous exceptions in the application of the Financial Administration Law and the need for the financial management legal framework to be supported by broader laws on civil service, ethics, anti-corruption and transparency. The failure to apply the law opens up a double standard and the gap between the regulation and actual practice undermines accountability.

The Government must undertake to achieve the basic elements of financial administration like the evaluation of results, the implementation of SIAF, reporting by decentralized entities and recording of all liabilities which are all supported in the law. Similarly,
Congress must respect the provisions for budget development, the introduction of mid-term macro budgeting guidelines would support more realistic budgets and achieving fiscal targets. The vagueness on what accounting standards are followed in Paraguay and exceptions to the law and regulations on accounting must be addressed.

The approach to control should be rethought to better support operational efficiency, taking advantage of the advances in information systems, legal framework and the staff who should be selected under a merit-based civil service. Two areas would be directly affected: the cash program and authorization of requests for transfer and the a priori review by the internal auditors. The external spending control exercised by Treasury is costly and has resulted in off-record expenditures in any case. Empowering spending units to control their own operations would support making them accountable for their decisions and actions. The participation of internal auditors in the a priori review of transactions leaves them no time and no independence to perform value-added functions of measuring, evaluating and reporting on the effectiveness of the elements of the internal control system. Lastly, regarding the control function, Paraguay has recently removed the overlap between the Auditor General and the Court of Accounts; the Auditor General also should be given greater control over the selection of work it performs. Similarly, the agency must ensure application of international auditing standards in the audit planning and field work associated with the opinion on the annual report.

GOVERNMENT RESPONSE, ACTION PLAN, AND DISSEMINATION

The Government of Paraguay is already taking significant steps to achieve an efficient and ethical public sector. In August 2003, the Ministry of Finance held an intensive workshop in collaboration with CISNI to lay out strategies to increase accountability and transparency in public management. Similarly, the Auditor General is effecting reforms with the cooperation of other Supreme Audit Institutions from countries in the region. The findings in this report were shared with representatives of the Ministry of Finance, the National Integrity Commission, the Auditor General and the Internal Auditor of the Executive in a presentation in October 2003 in Asuncion. The proposed Action Plan reflects the input received from these representatives following the presentation. The participating Banks would like this report to be disseminated broadly in Paraguay.
1. BACKGROUND

A. REPORT OBJECTIVES AND COVERAGE

1.1 In early 2002, in preparation for updating the World Bank (WB) Paraguay Country Assistance Strategy (CAS) and the Inter-American Development Bank Country Strategy (IDB), the WB and the IDB agreed on the joint production of a Country Procurement Assessment Report (CPAR) and a Country Financial Accountability Assessment (CFAA). The WB took the lead for the CPAR, and IDB assumed primary responsibility for the CFAA. The outputs of the CFAA are of particular importance at this time, given the overall fiduciary concerns with Paraguay and the need to support adjustment lending operations now under consideration by the two participating Banks.1

1.2 This report was prepared from the input of missions by the WB and IDB teams. The IDB team was headed by Ms. Lynnette Asselin and composed of Regis Cunningham, Financial Administration Consultant, Rafael Reyes, Internal and External Control Consultant. Luis Schwarz (LCOAA) participated in the early efforts of the IDB team. The later WB effort was headed by Paul Sisk and was composed of Jorge Domper, Treasury Consultant, and managed by Roberto Tarallo, Regional Financial Management Manager (LCOAA), and Jamil Sopher, Quality Assurance Advisor.

1.3 The objectives of the CFAA exercise are to (i) identify the strengths and weaknesses of financial accountability arrangements in the public sector and the risks that these may pose to the implementation of Paraguay’s development strategy; (ii) report on the state of the country’s public financial management systems and practices, and provide guidance as to the types of policy interventions as well as technical assistance and capacity building that can be used to address identified major gaps; and (iii) assess the risk to participating Bank funds in Paraguay, in particular with respect to adjustment operations.

1.4 Coverage was limited to public sector financial management at the national level; this setting was chosen because proceeds from both Banks are disbursed into and controlled under the arrangements prevailing in the national government. In this regard, the CFAA teams worked with the offices responsible for financial management within the Ministry of Finance and the Auditor General; with two non-financial agencies, the Ministry of Public Works and the Police; and with the Association of Accountants and two NGOs with an interest in the Government’s financial management.
B. REPORT PREPARATION, ORGANIZATION, AND DISSEMINATION

1.5 The early efforts of the participating Banks were conducted separately. The first IDB field work (which included a WB participant) was carried out in Asuncion between Nov.30 and Dec. 15, 2001. A draft of the CFAA was provided to the WB for review in August 2002 and the WB carried out a follow-up mission during November 4-15, 2002, which addressed, inter alia, the fiduciary due diligence required for a proposed Financial Sector Adjustment Loan.

1.6 The combined CFAA team’s main sources of information include (a) data existing at the Ministry of Finance covering selected spending ministries as well as the organs of control; (b) existing reports and outputs of the accounting and reporting systems; (c) other reports available from Government, the participating Banks, and other international agencies, and (d) interviews with key officials of the government agencies participating in the assessment and of the professional association and NGOs. Annex 1 includes a list of the documents used in the preparation of the report, and Annex 2 is a list of persons interviewed on both missions. The IDB CFAA team also used a set of prepared questionnaires to solicit the views of the participants in the current financial management environment, their own practices and capacity, and their suggestions for improvement.

1.7 The analysis of the information collected in preparation for and during the field missions is presented in Chapter 2 of this report. The standard used for evaluating the systems and processes was whether they contribute to a transparent and accountable environment in the public sector. Chapter 3 provides the Country Risk Assessment and the conclusions.

C. COUNTRY CONTEXT

1.8 Paraguay is an inland republic, bounded on the northwest and north by Bolivia, on the east by Brazil, and on the south and southwest by Argentina. The total area of Paraguay is 406,752 sq km (157,048 sq mi). The Paraguay River divides the country into sharply contrasting regions. In the west is the Gran Chaco, or Paraguay Occidental; and in the east is Paraguay Oriental. The Gran Chaco is part of an alluvial plain that extends from Paraguay into Bolivia on the west, Argentina on the south, and Brazil on the east. Grassy plains, swamps, and scrub forests cover the area. Paraguay Oriental consists mainly of the southern extension of the Paraná plateau. This elevation, from 300 to 600 m (1,000 to 2,000 ft) high, forms a watershed that gives rise to numerous tributaries of the Paraguay and Paraná rivers. The country’s population is estimated at about 6 million in 2003. On that basis, the overall density is only 15 persons per sq km, one of the lowest in South America. Given that about 30% of the country lives within Asuncion or the surrounding area, the population is sparse around the rest of the country (especially in the Chaco). The country’s geography combined with its sparsity of population make it difficult for the Government to establish control beyond the capital district. That applies to enforcing the rule of law as well as observing consistent good governance practices.
1.9 The WB’s Initiating Memorandum for the Paraguay CAS 2002 update captures vividly the country’s poor reputation for governance and institutional weakness. It mentions Paraguay’s reputation for pervasive corruption and contraband and its consistent ranking among the ten most corrupt nations by Transparency International. While public entities do not dominate the economy, they in charge of important sectors, including electricity, telephone, water, cement and oil importation, as along with the social security (pension and health) system and the national university. These entities provide about one-third of total public sector employment, plus ample opportunity for corruption, mainly through the widespread abuse of public procurement, false billing and poor internal controls.

1.10 Corruption is not the country’s only institutional issue. The basic management systems within government are also weak or non-existent. Within the Central Administration, the personnel management system is at an embryonic stage and is only now pulling together a master roster of all civil servants. A much larger task is to embark on the professionalization of the civil service, including competitive entrance exams, career streaming, and training.

1.11 In this already difficult environment, the significant deterioration of economic, social and political conditions in Paraguay during 2002 placed the country in its worst recession since at least the early 1980s. Paraguay’s economy stagnated between 1998 and 2002, with per capita incomes falling by 15 percent in local currency terms, and from US$1810 to US$1170 as measured by the World Bank Atlas methodology. Poverty stood at 34 percent of the population in 2001 and is now likely to be higher. Much of the decline in per capita income is due to economic turmoil in the southern cone, which resulted in significant devaluations for all countries in the region. But poverty increased in Paraguay also as a result of political instability, drift in economic policies and the inefficiencies of a highly informal and corrupt system. During this period, public finances weakened significantly and, until the end of 2003, the Government has been unable to stay current with salaries, pensions and debt service. At this juncture, Paraguay requires external financing to meet its obligations, yet the country has little if any access to financing from the international private capital markets.

D. RECENT POLITICAL DEVELOPMENTS IN PARAGUAY

1.12 On August 15 of 2003 President Nicanor Duarte took office for a 5 year term. President Duarte campaigned for office on the basis of a genuine commitment for reform; so far into its term, the administration has shown determination to build a coalition of political parties to fight corruption and introduce significant economic reforms. The Government has requested active support from the international community, including the World Bank and IDB.

1.13 The political situation stabilized during 2003, especially following the election. Although the political opposition controls one house of Congress, all parties agree that the economy has reached a breaking point and that fundamental changes are needed. The President has capitalized on this situation by striking an agreement with all political parties to approve a package of core economic reforms on a priority basis. These include
1.14 On the strength of these reforms, the Administration approached multilateral and domestic creditors for support. It has already reached historic agreements with domestic bond holders to reschedule the Treasury bill stock and with the IMF on a Standby Arrangement, the first in 46 years; that Standby Arrangement was approved by the IMF Board on December 15, 2003.

E. WB COUNTRY STRATEGY

1.15 Bank operations in Paraguay have been very limited in the recent past due to poor portfolio performance stemming from high staff turnover, lack of counterpart funds and slow procurement, non-compliance with Government commitments regarding Yacyreta, and absence of meaningful state reform. Four Bank operations were completed within the period FY01-FY 02 and there are five projects now under implementation: Natural Resource Management, Education Reform, Maternal Health, Rural Water IV and Community Development Project. The total value of Bank loans supporting the four projects underway is US$ 152.3 of which US$ 65.8 million had been disbursed by June 18, 2003. The pace of implementation has been slowing; the average project implementation period of the portfolio is 6.3 years.

1.16 The Government’s development strategy aims at (i) a recovery of confidence in state institutions through a sustained fight against corruption and the modernization of public administration; (ii) sustainable growth through a change in the economic model from triangular trade and public employment towards agro-industry and export diversification; and (iii) an increase in human capital through higher investment in health and education and policies that enhance equity and increase access to these services. The World Bank’s assistance strategy is closely aligned with the Government’s development objectives. Overall, the strategy aims to restore confidence in the economy and lay the basis for sustainable growth and poverty reduction. To this end, the CAS supports (i) the fiscal and financial reforms the Administration has sent to Congress; (ii) improved governance and transparency in public administration; (iii) sustained growth, particularly in the rural areas where poverty is concentrated and deepest; and (iv) social inclusion, to improve the coverage and efficiency of basic social services to help Paraguay meet the millennium development goals. The extent of World Bank lending during the FY03-05 period will depend on the government’s perseverance in implementing its economic and governance reforms, and later in the success of those reforms.

1.17 The WB’s experience with financial management in investment operations raises issues. All four active projects in the portfolio were rated satisfactory with respect to Development Objectives. However, the Natural Resource Management Project is rated unsatisfactory for Implementation Progress because the audit reports raised evidence of accounting irregularities, and there is evidence of fraud in presentation of expenditures in the Asunción Sewerage (Modernization of the State Component).
F. IDB COUNTRY STRATEGY

1.18 Following the guidelines of the VIII Replenishment of Resources, and in accordance with the priorities expressed in the Country Document approved by the Executive Board on November 8, 2000 (GN-2118-1), IDB’s strategy for Paraguay focuses on four areas: (i) Competitiveness, in order to favor effective participation of Paraguay in the regional integration process; (ii) Modernization of the State to strengthen governance, leverage the role of the State as regulator and promoter of development, and improve its efficiency in the supply of basic social services; (iii) Development of the Rural Sector, with an integrated multisectoral approach allowing for sustainable development in rural areas and poverty reduction; and (iv) Reform of the Social Sectors to contribute to the development of human capital.

1.19 The active portfolio of loans, technical cooperation, and small projects as of September 30, 2003, amounted to US$644.3 million, made up of 24 loans totaling US$626.1 million; 23 non-reimbursable Technical Cooperation grants for US$9.9 million; 11 non-reimbursable FOMIN Technical Cooperation Grants for US$6.4 million, and 4 small projects totaling US$1.9 million. In general terms, and considering the difficult environment, the performance of the portfolio may be considered reasonably satisfactory.

1.20 In the area of public financial management, IDB has been supporting the GOP through the following operations: (i) Strengthening and Modernization of the Fiscal Administration Program (1253/OC), which has supported the strengthening of the Subsecretaries for Financial Administration and Tax Administration and the Customs Department, which has contributed to increasing revenue collection by 56 percent in October 2003 as compared to October 2002. On the expenditure side, it is hoped that the measures adopted will produce measurable results in the first quarter of 2004. The Preinvestment Program (1143/OC) is assisting the Government in defining the functions, responsibilities, and interrelationship of the government organizations involved in the planning and control of public sector management.

G. STRATEGIC FOCUS OF THE CFAA

1.21 Curtailing corruption and improving governance are fundamental objectives for the government’s development strategy, and those have been absorbed into the Country Assistance Strategies of the participating Banks. The CFAA, which assesses the government’s public financial management systems, practices and accountability arrangements, is a primary diagnostic tool for addressing issues of governance and transparency in the public sector. The CFAA also helps address corruption because good systems, practices and accountability arrangements that are properly observed makes it more difficult for venal officials to divert public resources. Therefore, the driving issue for this CFAA will be to address the country’s corruption and governance issues.

1.22 The CFAA’s primary analysis is focused on how well systems and practices work, what additional systems are needed to enhance coverage, and what sort of capacity development is needed to enable the government to implement its systems and practices
correctly. At the same time, this report will differentiate between systems and practices that are being improperly on account of faulty design, inadequate coverage or unsuitably qualified staff, and attitudinal deficiencies that result from the broad based tolerance of corruption and lawlessness that had become ingrained over time.

1.23 By improving the country's public financial management systems, practices and accountability arrangements, the government should be able to increase its collections from taxes and customs, improve the timeliness and effectiveness of financing government services delivered at remote locations, and more generally enhance the efficiency of the government. Therefore, the secondary strategic focus of this CFAA will be to contribute to the sustainable economic growth. This would be achieved indirectly, by fostering the more comprehensive coverage and improved implementation of systems and practices.
2. ANALYSIS OF PUBLIC FINANCIAL MANAGEMENT IN PARAGUAY

A. CONTROL ENVIRONMENT

2.1 The World Bank “Policy Options for the New Administration” of June 2003 provided the Government of Paraguay with a candid summary of the problems it is facing in governance. The document reports the results of a World Bank Institute Study on governance in Paraguay, in which the country is rated consistently below other countries in the region; of particular relevance to financial accountability is the low rating of Paraguay in accountability and control of corruption. The sources of the governance problems are identified in the World Bank Institute Draft Report “Diagnostic of the Behavior and Institutional Performance, Governance, and Corruption in the State of Paraguay” of November 2000; financial management factors reported to contribute to corruption included lack of public’s access to information, lack of transparency in budgeting, and the absence of a meritocracy in the public service. The IMF Article IV Staff Report of April 2003 also recognizes the governance problems in Paraguay and their link to poor economic performance. Their report points to the need to reforms in transparency and accountability.

2.2 While Paraguay has made progress in the development of control procedures it is not clear that this is supported by an adequate control environment. The control environment refers to the overall attitude, awareness and actions of management regarding the internal control system and its importance to an entity. Factors of the environment are the organizational structure, means of distributing authority and responsibilities and management’s control system including internal audit and personnel policies. Control procedures, on the other hand, are those policies and procedures in addition to the control environment which management has established to achieve the entity’s specific objectives. The control environment has an effect on the effectiveness of the specific control procedures.

2.3 To provide the proper control environment within an organization, INTOSAI has established internal control general standards for (1) reasonable assurance, (2) supportive attitude, (3) integrity and competence, (4) control objectives and (5) monitoring controls. GOP has not established standards for internal control and, in any case, no assurance is being provided by management that controls are adequate. Similarly, external surveys indicate the perception that corruption in the public sector is high; this reflects on the integrity of management. Also, the absence of internal auditing standards and the use of non-merit based recruitment and promotion in the auditing function constitute a failure in applying the substance of control environment standards. Without an adequate control environment the advances in control procedures, which has been significant, do not achieve the objectives of internal control, namely the efficient provision of products and services; the safeguarding of assets against loss due to waste, abuse and mismanagement; adherence to laws and reliable financial recording and reporting.
The conditions in Paraguay’s public sector include serious institutional weaknesses and a perception that the public sector is plagued by corruption; all this contributes to a poor control environment which affects the risk to public funds, which is considered high. It is incumbent on the GOP to examine ways to reduce this risk; improvement in financial accountability is an important step. Practices to address and improve the control environment include: the use of a Statement of Responsibility by executing agency managers, the development of regulations supporting the minimum level of controls required in the public sector, and the hiring civil servants through a competitive process.

B. LEGAL AND INSTITUTIONAL FRAMEWORK

Legal Framework

Paraguay’s public sector comprises the Central Administration, the decentralized entities and the municipalities (see Table 1). The Central Administration covers all the agencies within the executive, legislative and judicial branches as well as the Auditor General’s office. The decentralized entities represent half of the public expenditure budget and comprise both commercial entities—state-owned enterprises (utilities) and state-owned financial operations (including the Central Bank)—and non-commercial entities—the 17 departmental (regional) administrations, the social security entities and funds, the public universities, and the regulatory entities. All of these operations are governed by the national government’s Financial Administration Law (FA Law). (The municipalities are governed by the Organic Law on Municipalities and consider the national FA Law to be supplementary to this.)

<table>
<thead>
<tr>
<th>Level of Government</th>
<th>Public Sector Expenditure (2001 actual, millions of PYG, US$=7,000 PYG)</th>
<th>% of Total Public Sector Exp.</th>
<th>Budget Approved by Congress</th>
<th>Annual Report</th>
<th>Budget Execution and Accounting</th>
<th>External Audit</th>
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<tbody>
<tr>
<td>A. Central Administration</td>
<td>5,191,548</td>
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<td>Yes</td>
<td>Central IFMS (SIAF)</td>
<td>Yes/CGR</td>
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<td>B. Decentralized Entities</td>
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<td>C. Municipalities</td>
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<td>100.00%</td>
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2.6 The Financial Administration Law of 1999 and the accompanying regulation (FA Law) are well organized, clear and comprehensive. This current legal framework for financial management covers budgeting, accounting, reporting, treasury and control; it assigns the supervision of the financial administration to the Under-Secretary for Financial Administration within the Ministry of Finance and makes the use of the integrated financial management system (SIAF) mandatory in the public sector. Internal audit is assigned to institutional auditors in the respective agencies with the coordination and supervision of these assigned to the Office of the Executive’s Internal Auditor (AGPE). Under Law 1525 and the constitution, external control is assigned to the Auditor General (CGR). Both the AGPE in the Executive and the CGR have their own organic law.

2.7 There are numerous and serious exceptions to the application of the law, however. The FA Law is clear in limiting accruals to the cash program set monthly by Treasury for each Administrative and Finance Unit, but in practice the agencies incur trade liabilities as a matter of course and hope the cash program, which is advised late in the month, will cover these expenditures. The requirement to present consolidated financial statements for the public sector is not complied with, since the annual report presents the Central Administration and the decentralized entities separately so that only the aggregates are known. The evaluation of budget performance required by the law is not carried out. Use of SIAF is mandatory for all public entities but is not widely implemented outside the Central Administration.

2.8 Similarly, the municipalities are required to send their annual financial reports to the Auditor General (CGR) but only a fraction comply with this requirement. Although the CGR has the responsibility to carry out operational and performance audits, its annual program is significantly affected by the requests for special reviews relating to allegations of malfeasance. Similarly, the CGR is charged with controlling the truthfulness of compilation of financial and economic statistics but has no program to address this requirement. The CGR is also responsible for evaluating the quality of internal and external audits carried out in the public sector, when in fact it is not informed of this work and performs no supervision in this regard. The civil service law on the public service calls for competition based on merit for hiring and promotion, but this law is generally disregarded, and as a rule not applied at all in the case of ministries and agencies internal audit positions, in the AGPE or positions with the CGR. It follows from the numerous exceptions cited in the application of the law that, while the legal framework for financial management is comprehensive, the full application of the law has yet to be realized.

2.9 On anti-corruption, there is a national commission on integrity, CISNI, which brings together representatives from the Government, political parties, control entities, the courts, and civil society. The objective of the commission is the modernization and reform of the state, under the National Integrity Plan, and has focused on reform in state procurement, customs service and the judiciary. There is also a Network of Citizen Controllerships, which should bring citizen participation into the management of public funds. One control mechanism on malfeasance in Paraguay is the requirement that public servants must make declarations of wealth; unfortunately there are no sanctions applied for failure to do so. There is no anti-corruption law, outside of the requirement for sworn statements of wealth for public servants, although Paraguay has signed and ratified the Inter-American Anti-Corruption Convention and has prepared an evaluation on progress on its implementation (see Annex 3). Therefore, although a new procurement law was passed in 2003, the financial management legal framework is not supported by broader laws on
civil service, ethics, anti-corruption, or transparency. The incomplete state of the legal framework on anti-corruption undermines the advances which are being made in the financial management framework.

C. FISCAL RECORD

2.10 The government does not work under any medium-term expenditure framework, nor are there any regulatory guidelines setting budget parameters, other than provision for earmarking education and judicial branch expenditures. Such parameters would be useful guideposts in keeping the budget to realistic targets. The record on executing the budget has not been good. In 2001, for example, the initial budget was increased during the course of the year by more than 10 percent, but execution came to 10 percent less than the original budget, or 80 percent of the modified budget. The increases were made principally in public investment (these rose by 40 percent) but the extent of public investment actually came to 46 percent of the modified budget. This distortion in the capital investment budget, along with the overestimation of tax revenue (which averages only 80 percent of the budgeted figure), undermines the transparency of the budget document and effectively shifts the authority in resource use to the cash program, which determines what priorities will actually be funded.

D. BUDGET DEVELOPMENT

2.11 Article 5 of the 1999 FA Law provides that the budget cover all public entities, except municipalities. All Treasury resources, internal and external credits, institutional credits and grants go into the budget. There are no significant off-budget items. A number of ministries have approved reserved funds within the budget which are not subject to the prior approval of the cash program, nor are they detailed in the reporting, but these reserved items come to less than 1 percent of total budgeted expenditures. Donor funds are included in the budget by application of the principal of universality of the budget (Article 6 of the 1999 Law) and are specifically mentioned in the budget structure (Article 12). The Central Administration budget comprises significant intergovernmental transfers but since the execution of transfers appears in the decentralized entities report, the eventual use of the funds is subject to the same budget law and regulations. There are no significant transfers to NGOs. Although the budget is comprehensive in coverage, there is no information in the budget on tax expenditures, which would be of great use in disclosing the impact of tax exemptions.

2.12 The structure of the Paraguay budget does indicate resources assigned by organizational unit. The units covered by the national Government budget include all the Central Administration and decentralized entities. The latter comprise commercial and non-market entities as well as entities from the financial and non-financial sectors. This structure does not coincide with the IMF's Government Financial Statistics, which defines general government as all government units and all non-market non-profit organizations that are controlled and mainly financed by Government, but reconciliation is possible since the information is available by entity.

2.13 The budget structure meets current standards for modern budgeting and is well suited to support monitoring and reporting by institution, activity, function and object of expenditure. Budget regulation provides for income to be classified as either current or capital, by source and
institution. Expenses are classified by institution, by capital and recurrent, by program and function and object of expenditure. There are clear rules proscribing financing of current items with borrowing. The law calls for program budgeting around results but this approach is just beginning to be put into practice. In the preparation of the budget for 2003, a number of agencies are building their budgets on an activities basis and are providing targets with monitoring indicators.

2.14 Budget control for personnel cost and debt service is applied at the most detailed level recognized in the budget classification, while the rest of the expense types are controlled only at the group level. Hundreds of budget changes are processed. Most worrisome, however, are the many increases added throughout the year, amounting to 10 percent of total budget expenditure. This practice of inflating the estimates effectively displaces activities in the original approved budget, since funding falls at least 10 percent short of the approved budget and 20 percent short of the modified budget. The shortfall in revenue from the estimate has ramifications beyond the size of the deficit; expenditures are cut proportionately since (i) Article 21 of the FA Law provides that the budget must be executed under a financing plan that requires expenditures to be limited to available funds, and (ii) Article 33 introduces cash planning, which permits Treasury to keep accrued and cash expenditures within the limits of revenue actually collected.

2.15 Congress controls the budget, both in its development and in the changes. The Executive may veto Congressional budget modifications and increases, but these changes are usually accepted, even when they are not supported by a plan for financing. A review of the draft FY2002 budget proposal by the Budget Office showed that the modifications introduced by the Congress increased the fiscal deficit from 1.4 percent of GDP to 2 percent in the budget as finally approved. There is practically no participation outside of the Executive in the preparation of the budget proposal.

2.16 The budget composition, which is mostly salaries, transfers and debt service, leaves little room for input from the spending agencies outside of capital investment, which makes it the line most sensitive to funding shortfalls. The expenditures corresponding to personnel expenses, social security pensions and debt service constituted 79 percent of the budget for the year 2001; a trend that was maintained in the year 2002, where the execution of the budget was even more rigid, with personnel services of 49 percent, social security pensions of 13 percent and debt service on the order of 14 percent.

2.17 The noted failures in compliance with the Financial Administration law in budget development and execution (not recording trade payable relating to budget expenditures beyond the approved cash program and Congress approving increases beyond the identified sources of income) arise from the same source - there is no hard commitment to a fiscal target. The temptation to concede to spending pressure can be limited or removed from the Congress and the Executive through the introduction of mid-term expenditure targets which may impose limits on the possible budget totals and the guidelines for the net deficits; these macro-budgeting guidelines could focus on aggregate expenditure or the balance between total revenue and total expenditure and therefore support fiscal sustainability.
E. Budget Execution and Monitoring

2.18 Budget control for the Central Administration, which is made possible through a centralized integrated financial management information system (SIAF), is the responsibility of each spending unit. However, the budget system does not include commitment control, so approaching liabilities (those coming due next month and thereafter) are unknown to the central financial authorities. Approved changes are entered by the Budget Office but processing of the transactions is entirely under the spending agencies. Execution of the budget is carried out on the basis of financial, general and institutional plans, and in accordance with the technical standards established in the rules. The financial plans serve as a frame of reference for funds programming and the allocation of cash quotas. The budget's execution phase does not include a commitment phase, that is, the budget law and practice recognize only the budget assignment to a specific undertaking followed by the obligation or accrual. The lack of provision for a commitment phase is particularly serious since spending agencies are limited by law to entering accruals only up to the ceiling of the financial plan.

F. Cash Program

2.19 The 1999 FA law provides for the approved budgets to be converted to a financial plan which assigns expenditure over the 12 month period and becomes the basis for the monthly cash programs. The Treasury consolidates all receipts from taxes, which are collected by the Tax or Customs Departments either directly or by commercial banks, along with all borrowing. Disbursements, on the other hand, are decentralized to the agencies through the use of transfers for specific payments. Given the history of revenue shortfalls, the Treasury employs the monthly cash program as a ceiling for budget accruals to ensure that actual expenditure stays in line with revenue actually collected. The cash program may be in direct proportion to the approved calendarized financial plan total for each month, but in any case the details are decided by the Economic Council of Ministers. The cash program distinguishes allocation by line item so as to ensure that the non-discretionary expenditures will be fully funded. Payments, which are made by the spending department, depend on releases of funds from Treasury under the Request for Transfer (STR) procedure whereby the spending agencies request release of funds for specific payees. As such, the cash program set by Treasury effectively controls the Treasury-financed accruals that are booked by the spending agencies.

2.20 However, the ceiling for accruals does not guarantee that the commitments are paid, since payments depend on specific releases of funds by Treasury, which is a separate procedure. The criteria for approving the STRs are in the hands of Treasury and they are not transparent, beyond the general knowledge that priority is given to salaries. If the Treasury does not approve the STR, the expenditures, to the extent that they are covered by the cash program, appear as accounts payable. The control over expenditures through the cash program is supported by an a priori review by the internal auditors in the spending agencies.

2.21 Treasury’s controls fail, however, in that they do not extend to contractual obligations that the spending agencies undertake beyond the cash program. In practice, the spending agencies cannot record expenditures until the cash program is entered in the SIAF, and since this is only approved late in the month, the units incur expenses during the month, take delivery of goods and services, and hope that they will be covered by the cash program. Where the expenses
incurred exceed the cash program, the excess is simply not recorded as accrued. This practice has resulted in a volume of unrecorded (and unpaid) budget expenditures which is not quantified and undermines the measuring and reporting of the budget execution and financial position.

2.22 Arrears on trade payables are growing; a portion of this are the trade payables “floating debt” where the obligations recorded exceed the agreed terms which results from granting accrual quotas (cash program) beyond the capacity to paid. But there are also the expenditures incurred beyond the cash program; these unrecorded expenses are not quantified in the records but cover a significant percentage of non-salary and non-debt expenditures. While they are not quantified, it is known that the government is facing law suits for their payment and that administrative penalties are being applied to financial officials for taking on commitments beyond the accrual quota.

2.23 The cash programming is extended to special purpose funds (investment operations special accounts) and to direct revenue of executing agencies of the Central Administration. It is not clear what is achieved by the former since these funds are already controlled by the project budget and the available balance in the special account. As for the latter, flexibility and control over these funds by the agencies would encourage them to generate more direct revenue.

2.24 The effects of the mismatch between the liabilities assumed by the spending agencies and the cash made available by Treasury include: (a) increased unit costs of inputs since suppliers include the financing costs in their prices; (b) budget staff incur unauthorized expenditures and the whole application the regulations is then put into question; (c) unproductive time is spent in controlling the cash program in addition to the actual expenditure; (d) the budget process is reduced to one of processing operational expenses rather than as a means of planning the means of achieving the government’s plans; and, (e) the variance of the approved expenditure to the approved budget undermines the transparency of the budget process since Congress approves one budget and another is implemented.
Box 1: External to Internal Spending Control in Budgeting

External to Internal Spending Control in Budgeting

Budgets systems can have external or internal spending control. External control implies that the operations are carried out by an executing agency while the funds are entrusted to a separate (central) authority and that control is exercised a priori over inputs. This is clearly the case of Paraguay where Treasury uses the monthly cash program and the STRs to release specific disbursements.

External spending controls are appropriate where operations are modest, executing agencies staff are not trained in administration or there are no accounting systems or rules. This approach is aimed at ensuring that use is in line with authorizations for specific items and only inputs are of concern; there is no monitoring of outputs. When operations are as large as they are in the Paraguay national government the transaction cost of applying external spending controls is high and ,in any case, the spending units learn to work around the controls by incurring liabilities which are not reported. A double standard has arisen in Paraguay where on one hand the cash program is a ceiling for what is recorded while on the other hand spending units take on trade liabilities that are not recorded. This double standard undermines the legal framework governing the use of public funds and blurs the line between proper and improper uses.

Internal spending control, however, gives the executing agencies the responsibility to ensure the legality and propriety of the uses. It is their responsibility to have the staff and procedures in place to ensure compliance with government wide financial legislation and regulation on budget uses. The inputs are controlled but are not subject to external a priori authorizations and allow the executing agencies decisions over which payments to effect. Internal spending control is an important step toward concentration on outputs over inputs which is sought through the initiative of the program budgeting and performance measures introduced in the 2002 budget law in Paraguay.

The type of budget spending control employed affects operational efficiency in that different forms provide different incentives to management; the more controls are delegated to spending units the lower the transaction costs and the greater flexibility there is for management to use resources to improve operational efficiency.

The move away from the external spending control to more delegated accountability must, however, be supported by clear and strictly applied rules. In Paraguay, the rules, in the form of the financial administration framework, are in place, what is missing is the strict application or adherence to the law. Exceptions arise, for example, in the limited implementation of SIAF, late reporting of decentralized entities and incurrence of trade payables which are not recorded against budget. Similarly, the lack of progress in the prosecution of cases of malfeasance charges arising from the findings of the Auditor General undermines the application of the rules.

Once the rules are accepted and respected, control can pass to the spending units where good use of the funds and the ends of the spending will be kept in mind more than mere processing. This prepares management of the executing agencies for greater discretion in the use of funds and measurement against results.
G. ACCOUNTING AND ACCOUNTING STANDARDS

2.25 The FA law (Law 1535/99) calls for the establishment of an integrated financial management system in all government organizations (except municipalities) which is based on centralized standard setting and decentralized operations and comprises systems for budgeting, public investment, treasury, public credit, accounting and control. This integrated system is regulated by the executive branch and coordinated by the Ministry of Finance which administers each of the component systems. Further, it provides the requirements of the accounting system and calls for an accrual basis with a uniform set of accounting standards and chart of accounts and states that it should be integrated with budget recording, treasury and public debt. It specifically states that generally accepted accounting standards should be applied and references to the resource reporting makes it clear that the full accrual basis is required by the law.

2.26 The regulation to the FA Law (Decree 8127/00) clearly empowers the Ministry of Finance to regulate financial administration in the public sector. It goes on to mandate the recording of debt and physical assets and assigns this responsibility to the Ministry of Finance. The regulation on the accounting system defines the conceptual framework for the public accounting system, its provisions support full accrual basis of accounting and stipulates that this basis applies to the whole public sector. The regulation spells out the reporting requirements of the agencies to the National Accounting Office and the reporting requirements of the Executive to Congress.

2.27 On the external reporting, the regulation calls for a consolidated balance sheet and income statement for the public sector, statement of source and application of funds, statement of budget execution, the balance sheet and income statement of the Treasury, and a statement on public debt. It also calls for a statement of public savings, investment and financing which is a source and application of funds statement for the non-financial public sector organized around the requirements of the national accounts in that it separates government net savings, public investment and isolates the deficit (or surplus) and delineates how this is financed.

2.28 The accounting standards for the public sector in Paraguay, however, are not codified; they comprise provisions in the Financial Administration Law and Regulations and occasional pronouncements of the Government Accounting Office. This office states that there is an aim to apply the international accounting standards set by IFAC and adopted by the Association of Accountants of Paraguay for the public sector. Given the differences between the private and public needs and operations, this policy is not appropriate or entirely enforceable. In any case, Paraguay does not comply with its own regulations in that not all public assets are recorded (only the assets under the use of specific agencies are recorded). Similarly, there is a significant exception to the application of international accounting standards in that the liability for post employment benefits for public servants is not recorded. A more general issue is that there is no distinction made for the standards for the general public sector and the government business enterprises.

2.29 The published annual financial statements, posted on the government’s web site, are comprehensive in content and coverage; they comprise all the statements required under the standards for the Presentation of Financial Statements and all national entities, state enterprises
and municipalities are included. The financial information of these, however, is presented in an aggregated basis separately in 3 groupings: 1) those entities of the central administration, 2) the decentralized entities, which comprise state enterprises, fiduciary funds (social security) and national government agencies and 3) lastly, the municipalities. Neither the presentation of aggregated figures nor this grouping is supported by any generally accepted accounting standards. Related to its interest in business enterprises, the central administration’s balance sheet and results do not reflect the government’s investment in controlled entities.

2.30 Disclosure of financial position and results lies at the heart of transparency of public administration; the use of generally accepted accounting standards facilitates understanding and faith in disclosures. There is vagueness on what standards are followed in Paraguay and in any case, there are significant exceptions to the law and regulations on accounting for use and position of public funds. If the public sector financial statements are to merit confidence then an unequivocal statement should be made on the standards to be followed and a firm commitment made to implement these standards.

**Asset Management**

2.31 In each Administration and Finance Unit (UAF) within the government agencies, there is a department responsible for maintaining public assets records where detailed fixed asset records are kept, supported by an annual inventory of fixed assets, and reported to the Accountant General. These detailed records on fixed assets are not integrated into the accounting system (SICO). To its great credit, the Accountant General discloses the difference between the accounting balances and the balances generated by the detailed fixed assets records. The differences between the accounting balances of fixed assets and the detailed records is approximately 50 percent of the accounting balance in the case of the Central Administration and 90 percent in the case of the decentralized entities. Inventory items present a similar situation, although they are not reported in the annual report. The significance of this weakness is that capital goods and inventory may be effectively charged to the budget but not available for use by the Government and their use or disappearance is not booked as an expense in the financial statements. The balance for physical assets reported in the annual report is not supported by detailed asset records that have been verified against a physical inventory.

**H. Revenue Issues**

2.32 Treasury does not set ceilings for the monthly cash program until the revenue figures are known for the month. This does ensure that the deficit limits are not exceeded but creates other problems with budget execution, since no expense can be recorded until the cash programs are entered in the SIAF by Treasury.
Box 2: Generally Accepted Accounting Standards for Consolidated Reporting in the Public Sector

**Box 2**

**Generally Accepted Accounting Standards for Consolidated Reporting in the Public Sector**

IFAC International Public Sector Accounting Standard

Those controlling entities (governments) using full accrual accounting should present consolidated financial statements; financial position and results of all controlled entities, including state enterprises and trust funds, should be aggregated then the balances and transactions between entities as well as unrealized gains be eliminated. Investment in unconsolidated entities should be accounted for as investments.

**Government Accounting Standards Board (USA)**

Comprehensive annual financial statements are called for on an accrual basis and includes government wide statements and separate statements of each type of government fund; in the whole government statements, the financial position and results of the primary government entity are presented separately from the aggregate of government businesses but trust funds are not included at all. Transfers included in the revenue and expenses of this statement are eliminated in the face of the financial statements to determine the change in assets of the government.

2.33 Information on Treasury resources originates in the Tax Under-Secretariat in the Ministry of Finance. The controls in this agency were not evaluated however concerns arises because the Ministry of Finance's Internal Audit does not plan regular reviews of the revenue side of operations in the collection agencies. Issues of control over tax revenue surfaced recently with the absconding of tax receipts, made possible because of the poor oversight of collection operations. This case highlights the danger where is no systematic coverage planned by the AGPE or the CGR of the revenue side of public sector operation. It seems revenue is reviewed only in response to a request from the Executive or the Congress.

2.34 On revenue management, urgent action is needed to improve the internal control applied in the entities generating Central Administration revenues.

**I. EXTERNAL FISCAL REPORTING AND TRANSPARENCY**

2.35 The reporting on budget execution is timely and is used to set cash programs and ensure that expenditures do not exceed receipts; the format and classification of the report is the same as that of the approved budget. There is no evidence, however, that any decisions are taken on the basis of the physical advance reporting associated with the program report. This arises because program budgeting and reporting are only getting underway in 2003 and because the demands on revenue to cover the salary, debt services and entitlement portions of the budget leave little discretion over what is left of the budget.

2.36 The financial administration regulation calls for the presentation of monthly financial statements to the Ministry of Finance by the 15th of the following month, and a more complete set by the 10th of February following year-end close. In practice, the reporting may not be quite up to this standard, but it is timely enough for the purposes of both the Central Administration
and the decentralized entities; the consolidation of the Central Administration accounts and for the decentralized entities for 2003 are posted to the webpage of the Ministry of Finance. Similarly, the budget law and all financial administration legislation is posted to the Ministry of Finance website.

2.37 Many of the decentralized entities operate outside SIAF and the quality of their budget execution is therefore not effectively monitored by Treasury nor is there effective review by the internal and external audit functions. Although the Budget Office does control the approved budget for decentralized entities and compares execution against budget in the monthly reporting provided by these entities, the Budget Office controls only expenditures funded by Treasury releases, and not those expenditures funded from revenue generated directly by the decentralized entities.

2.38 The information from the decentralized entities is not considered reliable since the financial information of the individual entities provided to the Accountant General by March 31 following the year-end (which should be more reliable than the monthly reporting) does not reconcile with the information in the annual reports of the individual entities. This discrepancy may be attributed to the fact that many of these entities operate outside the SIAF. Similarly, the Central Administration or the Auditor General does not receive the auditors report on the annual statements.

2.39 The requirements for format and content of the financial reports is in line with those of the most advanced in practice for the public sector since it calls for a full accrual basis and covers the general government sector, state enterprises and municipalities. However, compliance with the requirements is weak in that decentralized entities do not report on time for inclusion in the annual report. Since the financial position and the results depend on both centralized and decentralized entities, the oversight and transparency of the national government is undermined by this omission. The public resources involved are enormous and are equally the responsibility of the elected officials both for efficiency in use as well as protecting from misuse. The GOP must take up the issue the compliance and accountability of the state enterprises if they are to fulfill their fiduciary responsibilities and provide transparent management of the whole non-financial public sector.

J. INTERNAL AND EXTERNAL AUDIT FUNCTIONS

2.40 Up to late 2003 four agencies were involved in the control function in Paraguay and all limited themselves to providing assurance on compliance and the reliability of government reporting. The internal audit function is assigned to the Institutional Internal Auditors with the Office of the Executive’s Internal Auditor (AGPE) also involved in internal audit; external audit is now assigned exclusively to the Auditor General (known as CGR in Paraguay) since the Court of Accounts, an agency in the judicial branch of government, was removed from ex post review in 2003.

2.41 Under the FA Law the primary role of the Institutional Internal Auditor in the state agencies is to review procurement and effect control of requests for budget uses; consequently, the principal activity of the internal auditors is the review of the documentary support for expenditures. Ongoing and a priori review of documentary support and budget availability for
budget expenditures by the internal audit departments provide effective assurance to the agencies on the legality of the expenditures. However, little time is left for ensuring the application of controls in general which is the role of internal audit under the generally accepted standards of internal control. At the same time, this participation in the a priori review creates a conflict of interest for carrying out the financial audit for the certification of the entities' annual financial reports which are provided by the internal auditors to the Auditor General and are used as the basis for his own opinion on the Annual Report.

2.42 The work of the internal audit staff is not governed by a manual of procedures and staff in internal audit positions in the Central Administration and the Decentralized Entities have generally not been selected according on the basis of merit through a competitive basis.

2.43 The law provides for the work of the internal auditors, who are staff of the individual ministries, to be supervised by the AGPE, which is a separate agency reporting to the President, but this office has few resources to allocate for this supervision. The AGPE is generally uninformed about the activities of the internal auditors, does not know their plans, does not have any influence on their recruitment, and thus is not in a position to provide any supervision or guidance to them. The FA Law assigns the AGPE two main functions: to conduct its own audits of the agencies and organizations reporting to the Executive Branch; and to regulate and supervise the operation of the internal institutional audits. The Office started its activities in 2001 and the regulation for its operation has been issued, in accordance with the requirement in the FA Law. The budget for 2003 was set at less than $50,000 to pay for a staff of eight who are responsible for supervising the work of more than 70 internal audit departments throughout the Government (20 central administration entities and 54 decentralized ones) and for carrying out special reviews at the request of the President. It is evident that the AGPE cannot carry out its responsibilities with its current budget. Furthermore, it does not work on an annual plan designed to support its overall responsibilities but is primarily involved in ad hoc reviews arising from instructions of the President.

2.44 The modern concept of control recognizes that it is management’s responsibility and that internal audit role in the internal control structure is to review the application and the adequacy of the controls. The participation of internal auditor in the a priori review of transaction leaves them no time and no independence to perform value added functions of measuring, evaluating and reporting on the effectiveness of the elements of the internal control system. Work is not carried out under any audit standards and as such does not generate the confidence expected from the audit investment. The GOP must reexamine the role and responsibilities of the Institutional Internal Auditors as well as the effectiveness of the work. Similarly, the whole function of the AGPE must be properly funded or discontinued since the current approach does not contribute to stated objectives.

External Audit

2.45 The Constitution and the FA Law clearly assign the financial control function to the Auditor General (CGR) and provide for its financial and administrative independence. The CGR and the Deputy CGR are appointed by the House of Representatives, by an absolute majority of its members, from among three candidates for each position proposed by an absolute majority in the Senate.
2.46 All public sector entities come under the purview of the CGR—financial and non-financial, national and sub-national, including state enterprises. The CGR’s duties include the control and investigation of all of the state’s assets and operations. It must also provide a report to Congress and an opinion on the President’s Annual Report. In practice and under Article 12 of the Auditor General Act, Law 276, the CGR is obligated to conduct special investigation in response to every allegation forwarded by the legislative chambers, the executive, or the sub-national governments.

2.47 Although the CGR’s responsibilities are to examine the accounts and the reporting by government entities control over priorities is affected by the requests for special ad hoc investigations which absorb a disproportionate share of the time of the professional audit staff undermining any overall annual plan. The selection of much of the work by the CGR is determined by the requests from outside by the CGR and as such is not subject to an objective analysis of the risk factors. The result of the high investment in the ad hoc reviews impinges on the independence of the auditor; therefore the scope of the CGR is broad in law but highly limited in practice.

2.48 Most reports from the CGR deal with the findings on special reviews, which arise from allegations of malfeasance. These reports (100 per year) often result in basis for charges. Between January and October 2002, 43 reports with charges were sent to the Attorney General. No report on the results of these processes is available although it is generally considered that none of the cases were processed. There is a procedure for follow-up of recommendations regarding administrative actions but no systematic reporting is prepared on these cases. The impact as a deterrent to corruption which the Auditor General could have is undermined by this record on prosecution.

2.49 The Auditor General is required by law (under the Constitution and the FA Law) to report to the Congress on the President’s Annual Report. The CGR’s report on the annual financial report (2001) is limited to the budget statement and contains serious qualifications. The CGR issued in June, 2002 a resolution calling for the application of generally accepted auditing standards; however, the auditor’s opinion arises principally from work on the final balances carried out in the offices of the Auditor General, where staff compare statements received by the Auditor General from the agencies to the aggregated information included in the President’s Report (and to the certification of the internal auditors, when this is presented, which is not often). The Auditor General, in arriving at a position on the Annual Report, does not take into account the results of the external audit of autonomous entities and state enterprises.

2.50 Initiatives under the Program of Institutional Strengthening of the CGR financed by the Inter-American Development Bank are underway in the CGR to address the situation described above. Specifically, a training program and preparation of audit manuals is being carried out with the cooperation of the Contraloria of Colombia; a plan for information technology was developed with the help of the Contraloria of Chile and most significantly, the procedures related to the review of the Annual Report to Congress are being reviewed with the assistance of the Contraloria of Peru. Furthermore, in 2002 the CGR issued a code of ethics.

2.51 The work of the Auditor General is affected by the disproportionate demand for special reviews the work of the institution would benefit from more control and determination over what
reviews it pursues. Similarly, it is crucial that the agency implement the improvements in procedures followed in the audit planning and field work associated with the opinion on the annual report. Improvements in this area are being sought with the cooperation of the Contraloria of Peru on the work on the review of the annual report.
Box 3: Auditor General's Role in Combating Corruption

Box 3

Auditor General's Role in Combating Corruption

A prime concern of the current government of Paraguay is combating corruption in the public sector. Accountability (holding officials responsible for their decisions and actions, or lack of decisions and actions) is a constraint on corruption (Corruption = Monopoly Power + Discretion – Accountability (Klitgaard,1996). Accountability may be weak as a result of poorly defined ethical standards for the public service, weak administration and financial systems or ineffective independent oversight (watch dog) agencies. In Paraguay the role of the independent review (watch dog) of public financial operations is assigned to the Auditor General (CGR) as the Supreme Audit Institution (SAI). Strategies and undertakings to date and ongoing include participation of the CGR in the National Integrity Plan through its membership in CISNI and the special reviews in response to allegations by Congress of malfeasance in the governmental agencies. The report on progress under the Interamerican Anti-corruption Convention (Annex 3) recommends strengthening the control agencies.

International trends light the way for improving the contribution of auditors in the fight against corruption; key elements are: SAIs should stay free of interference through appropriate audit mandate; they should pay good salaries and recruit qualified staff; publish audit reports after work is done and not wait for annual report; issue clear and understandable audit reports; employ quality assurance; engage the media to educate the public on their role and the importance of their finding; document the audit methodology and commit to on-going investment in auditor training (Pillars of Integrity: the Importance of Supreme Audit Institutions in Curbing Corruption (Dye and Stapenhurst)).

In a paper by Vinod Sahgal of the Office of the Auditor General of Canada “Strengthening Legislative Audit Institutions: A Catalyst to Enhance Governance and Combat Corruption” he explains that the public doesn’t trust government to act in their interest so the Supreme Audit Institutions, like the CGR in Paraguay, are in a unique position to combat certain aspects of corruption given their mandate as independent review, their access to information and their trained and motivated staff. Modernizing of accountability means emphasizing “ethics in the public service”. SAIs should move their scope from compliance and performance auditing to promoting ethics.

The SAI is fundamental in any government’s plan to fight corruption since its responsibilities include: ensuring that the executive complies with the will of the legislature as expressed in the budget appropriations, promoting ethical behavior, and preventing corruption through development of sound internal control and reporting procedures designed to prevent incidents of corruption and increase the likelihood of its detection. Steps that the CGR could take to improve its contribution to combat corruption would include:

1. clarify role of the CGR on corruption: objectives have to go beyond examining for compliance
2. CGR has to actively pursue policies that promote good ethical behavior in the public service (push for ethics law, set a good example)
3. CGR could strengthen their reporting and communications strategies to improve impact of their work in area of ethics. (CGR could use media to publish cases of unethical behavior which are not dealt with by authorities – like the results of the malfeasance cases which are not processed)
Box 4: Guatemala Financial Management Reform

As Paraguay moves forward with its priorities to improve governance and accountability of public institutions, reduce corruption and improve the efficiency of public administration, the case of Guatemala’s financial reform offers a useful guide.

Emerging from three decades of civil war, Guatemala had a desperate need not only to improve service delivery, but to restore confidence in the integrity and efficiency of the public sector. It was impossible to track expenditures for essential services, or to ensure efficient execution of appropriated funds because of the maze of antiquated arrangements which governed budget allocations and execution. Not surprisingly, stakeholders in the peace process distrusted and had little confidence in the information available to them, and the private sector was reluctant to commit additional revenues to what was widely perceived as an inefficient and unaccountable public sector.

Guatemala undertook a reform in the 1990s to improve service delivery in this post-conflict context by promoting more transparent, efficient, and effective public sector financial operations. The reform involved the modernization of the government’s budgeting, accounting, cash management, procurement, and auditing sub-systems, with ongoing reforms in debt management and public investment sub-systems.

The results have been remarkable, and Guatemala now represents the cutting edge in financial management in the Latin America Region. Among the achievements:

- Widespread reduction in prices paid for supplies; modernized procurement and payment systems substantially cut the time and procedural steps (and thus premiums built into prices to reflect inflation and/or bribes by suppliers to speed payments).
- Arrears to suppliers have been eliminated. Before, the so-called “floating debt” used to linger up to three months into the next fiscal year preventing the “opening” of the new budget.
- Once payments are authorized by line agencies, they are made by the Finance Ministry through the banking system on average within 72 hours (compared to payment delays averaging from 15 days and 6 months before).
- Electronic funds transfers have increased from near zero in 1996 to 50 percent of public sector payments in 1998 and are expected to cover all payments by mid-1999. This reduces the time and transaction costs, discretionarily in payment priorities, and lost/stolen checks.
- The number of government bank accounts has been reduced from 1,300 in 1996 to 600 in 1998, with the aim of keeping one Single Account by 2000.
- The number of budget line items was reduced from 7920 to 887 during 1997-1999, permitting a greater focus on programs while providing executing agencies increased flexibility to adjust their budgets without requiring time consuming prior approval from the Finance Ministry.
- The unique relational database provides immediate and detailed information on all recorded financial transactions, individually or aggregated in a variety of ways (by supplier, authorizing official, region, product, budget classification or program, time period, cost levels, etc.) thus providing an audit trail as well as relevant and timely budget execution information for managers at various levels.

| Box 4
Guatemala Financial Management Reform |
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3. CONCLUSIONS, RISKS AND RECOMMENDATIONS/ACTION PLAN

A. CONCLUSIONS

3.1 Previous reports on the role of the government in Paraguay identified the need for reforms both deep and broad, including those for public sector financial management. A 1996 WB report described public sector management in Paraguay as chaotic. The report recommended a program of financial management reform comprising: (a) the development of an Integrated Financial Management System, (b) the strengthening of the Auditor General and (c) the implementation of a system of internal control. Government launched major public sector reforms during the 1990s that addressed two of the most important problems identified in the 1996 WB report: outdated legislation governing financial administration legislation, and the lack of financial information. As a result, public sector budgeting and accounting have been transformed over the last six years. An integrated financial management system has now been partially implemented and is supported by legislation governing financial administration. Much credit is due the Paraguayan Government for the effective financial management controls applied to the Central Administration, which rest on a good legal framework and an effective integrated financial management system.

The most important weaknesses and shortcomings that affect financial accountability in Paraguay are:

1. Weak control environment.

2. Numerous and serious exceptions in the application of the financial administration law and regulations.

3. Weak internal audit and control, especially in revenue collection agencies.

4. The disproportionate share of time and resources that the Auditor General devotes to ad hoc review requests.

5. Congressional introduction of budget increases without provision for corresponding financing.

6. Trade liabilities incurred by executing agencies but unrecorded if they exceed the authorized cash program.
7. Exceptions to generally accepted accounting and auditing standards and financial statements not prepared in full compliance with Government’s own regulations.

3.2 These issues arise in part from the need to extend and improve formal controls (i.e. introduce commitment control, extend the central integrated financial management system to decentralized entities, improve accounting standards, train auditors and fuller application of international auditing standards), and in part from a deficient control environment that allows violation of the law to go unsanctioned and does not provide the positive incentives through an ethics and anti-corruption law for transparent public financial management.

3.3 The CFAA concludes, therefore, that Paraguay’s financial accountability’s arrangements are failing to support public expenditure outcomes in that, on one hand, fiscal discipline is undermined by unrealistic budgets, unrecorded trade payables and limited control over decentralized entities and, on the other hand, the heavy investment in a priori centralized spending controls do not provide the incentives to public managers to improve operational efficiency. Furthermore, transparency in the use of public funds is needed to encourage faith in the conduct of the government. This transparency in Paraguay could be improved with stricter compliance with generally accepted accounting standards in the financial reporting and with generally accepted auditing standards in the review of the annual report.

B. RISKS

3.4 The susceptibility of funds to be used for unauthorized purposes is known as the inherent risk and is influenced by the control environment. The control environment documented in this report is one where:

- failure to adhere to the financial administration law is unsanctioned and even the findings of the CGR supporting charges of malfeasance do not generally result in any action;

- the Civil Service Law is unenforceable and there is no code of ethics or anti-corruption legislation;

- the Paraguayan Government’s report on advance under the Interamerican Anticorruption Convention highlights the need to:
  - prepare and enact an ethics code following the regulation of the civil service code
  - harmonize the legal and institutional framework on the civil service
  - prepare and enact a new law on the declaration of wealth by civil servants
  - strengthen and rationalize the control entities

3.5 Given the prevalence of corrupt practices, reported by the control entities and independent surveys (Paraguay’s public sector corruption risk rating by Transparency International is among the most corrupt), and the lapses in the application of the financial
administration law, it can only be concluded that the attitude toward control is weak and that the inherent risk is high.

3.6 The control risk, on the other hand, is the probability that unauthorized uses go undetected. Control risk is assessed from an examination of the accounting system and a review of how the accounting system is applied. Paraguay’s financial administration framework and the systems for budgeting and accounting have greatly advanced since 1996 and now apply many of the best practices of modern public expenditure management, however:

- The Central Systems do not provide commitment control, payroll is not subject to review against data bases of personnel, generally staffing in not professional;
- The core system and procedures in place in the Central Administration have not been extended to the decentralized entities, which manage about half of public expenditure;
- The review of the application of these systems by the internal and external audit entities reveal there is no planned coverage extending from any risk analysis, work is not done to acceptable auditing standards and there is no systematic coverage of the Decentralized Entities.

3.7 Given these weaknesses, the control risk must be considered high.

3.8 This assessment concludes that the financial management risk is high and that although there have been advances in systems for the Central Administration, these advances are not sufficient to compensate for the poor control environment. To achieve an acceptable level of risk, reforms must be effected in the areas of internal control, external audit, and control of decentralized entities.

C. RECOMMENDATIONS / ACTION PLAN

3.9 The Paraguay World Bank Country Assistance Strategy identifies the need to improve basic cross-cutting administrative systems, including financial management systems. The Government of Paraguay is undertaking significant steps to achieve an efficient and ethical public sector. In August, 2003 the Ministry of Finance held a workshop in collaboration with the National Integrity Commission, CISNI, where goals for accountability and transparency in public management were agreed. The Auditor General (CGR) is also effecting reforms with the cooperation of other Supreme Audit Institutions from countries in the region and carrying out reforms under a Technical Assistance program financed by the IDB. These initiatives are beginning to address the findings in this report. Additionally, the Ministry of Finance is pushing for reforms in the management of public finances and intends to make the Ministry of Finance a model for the rest of the public sector – a Ministry of Excellence. The strategy for this reform is in the making; it also would address the risks raised in this report and should consider the recommendations made herein.
Strategic Approach

3.10 Many of the observations in this report deal with formal controls and systems that would address some specific shortcoming. However, the effectiveness of these systems and the accountability of Government depends on the control environment in which these operate, including the application of the law. The actions proposed in the Action Plan concentrate on this vital foundation. Related to this base is the control function, both internal and external. The Executive and line management need assurance that the financial management systems and procedures are indeed adequate and are indeed being applied; this assurance can only come from an effective internal audit function; that is, work carried out under a plan to address risks, by qualified staff. Similarly, those outside of the executive branch want assurance that Government’s financial reports are reliable; this assurance should be provided by an independent Supreme Audit Institution, based on work done to acceptable audit standards.

3.11 As such, the GOP must first address the issue of the control environment. This issue has two parts. The first regards attitude and culture. The conditions in Paraguay’s public sector include serious institutional weaknesses and a perception that there is a culture in the public sector not opposed to corruption. Independent surveys indicate an attitude that was tolerant of corruption. This reflects on the integrity of management and contributes to a poor control environment (the overall attitude, awareness and actions of management regarding the internal control system). Without an adequate control environment the advances in control procedures, which has been significant, do not achieve the objectives of internal control, namely the efficient provision of products and services; the safeguarding of assets against loss due to waste, abuse and mismanagement; adherence to laws and reliable financial recording and reporting.

3.12 The second part of providing the proper control environment would require Government to concentrate on achieving the application of the financial management law. From the numerous exceptions in the application of the financial administration law, it is clear that while the legal framework is comprehensive, the full application of the law has yet to be realized. Application of the law would be encouraged by new laws on ethics in the public sector, anti-corruption, and transparency, making officials responsible for omissions that affect their fiduciary responsibilities.

3.13 Practices to address and improve the control environment would include the use of a Statement of Responsibility by executing agency managers, the development of regulations supporting the minimum level of controls required in the public sector, and hiring through a competitive process. The GOP has not established standards for internal control neither is any assurance being provided by management that controls are adequate. Recruitment in line with the spirit of the Civil Service Law is also crucial.

3.14 Secondly, the approach to control within the ministries should be rethought to better support operational efficiency, taking advantage of the advances in information systems, the legal framework and the staff who should be selected under a merit based civil service. As the quality of systems advances and the level of financial management staff improves, it is appropriate to give this line staff full responsibility for the use of funds under their control. Every ministry now has an internal audit function whose work is overseen by the General Auditor of the Executive (AGPE), although these units report to their parent ministries. The participation of
internal auditors in the a priori review of transactions leaves them no time and no independence to perform value-added functions of measuring, evaluating, and reporting on the effectiveness of the elements of the internal control system.

3.15 Thirdly, the external control function, can be greatly strengthened. Paraguay invests a great deal of its operating budget in the control function, which is spread over internal and external audit in three organizations: the institutional internal auditors, the AGPE, and the CGR. Some rationalization of this efforts is underway, so it is time for these entities to work to better standards in order to achieve their objectives. The work of the CGR would have more impact if it had more control over what reviews it pursued. Similarly, the agency must implement the improvements in procedures followed in the audit planning and field work associated with the opinion on the annual financial statements.

Action Plan

3.16 Given the view that the systems and procedures need support of an improved environment, the CFAA recommends that the GOP follow the strategic approach outlined above, which targets improved support for transparency and accountability in three broad areas: Control Environment, including the application of the Financial Management Law; Internal Audit, and External Review Function. The roadmap for the strategy and the sequence for its most critical activities are presented in the rest of this chapter.

3.17 The individual activities are also included in a time-phased matrix at the end of the chapter; the matrix item number is referenced for each strategic activity discussed here. The matrix contains all priority activities over the next few years in the areas of budget, internal control, and external control.

3.18 In addition to strategically critical activities covered in this discussion, the matrix also includes some significant steps for improvement in the systems and procedures, since these arise from findings in the analysis. It also presents follow-on activities for 2006 that depend on the successful achievement of the strategic actions for 2004-05.

Control Environment

3.19 The following initiatives, complementing actions already underway, are needed to provide an environment where the formal rules for public financial management are clear and generally observed; where sanctions for failure to observe the rules are invariably applied and the attitude of the public servant is to comply with the letter and the spirit of the rules.

3.20 In the short term (2005), as rector for public finances the Ministry of Finance must undertake the establishment of a minimum level of internal controls in all public sector entities. This may be accomplished by determining and then imposing internal control standards for application in the entire public sector. (See matrix item 7-c) These minimum internal control standards would provide central authorities and operating management with a guide to how to achieve control over their operations and a measure against which they may be evaluated in determining their compliance with the control framework. This objective would involve assigning resources and responsibility to first survey the detail of the controls which is most
appropriate; developing the controls with the regulatory support; and then carrying out their implementation.

3.21 Similarly in the immediate term (2004), the Ministry must undertake to apply sanctions provided in the law for omission to comply with the financial administration law (Article 107, Financial Administration Regulation-decree 8127; see matrix item 7-a). The entire fiduciary framework for public funds rests on compliance with its own rules and regulations. The Ministry would enlist the support of the legislature and the civil society in announcing its commitment to apply the law to any and all and make a public commitment to this effect.

3.22 At the same time and in support of this, the Ministry would advise the decentralized entities of their duty to report on their financial operations and propose their plan to extend SIAF to all of these entities (see matrix item 6-b). In particular, the Ministry would make use of the integrated accounting (SICO) system obligatory for the revenue collection agencies and stipulate in the related procedures that the revenue collection agencies must record all income at the time of collection (see matrix item 4-b). The Ministry would similarly move to consistently apply generally accepted accounting principles through the preparation of an accounting manual to support the application of generally accepted accounting principles for the public sector (see matrix item 5-b).

3.23 In the medium term, to ensure that compliance with financial management legislation on budget development the Ministry would move to develop fiscal responsibility legislation setting limits on total spending and deficits to ensure alignment of annual budget with long-term fiscal sustainability. Draft legislation should be prepared in 2004 (see matrix item 2-a).

3.24 To address the persistent perception that corruption is tolerated in Paraguay, in the short term, the Auditor General would include in its 2004 work plan, steps to review statements of Declaration of Wealth by public officials, in line with provisions in the political constitution and the organic law of the Auditor General (see matrix item 7-b).

3.25 In the short term, since the financial administration law is not supported by legislation on ethics and anticorruption, the Ministry of Finance would lead an initiative to develop both ethics and anti-corruption provisions for inclusion in the civil service law (see matrix 8-a).

3.26 Steps to address the lack of enforcement of the civil service law are of equal importance in clarifying the incentives for public servants. The development of a law which can be enforced extends beyond the Ministry of Finance to the entire Executive and the Legislature. The first step would be a diagnostic by the Ministry of Finance to determine the route to follow to introduce amendments to civil service bill to overcome constitutional objections to current law. On the basis of the study, the GOP would initiate work with the legislature to prepare the draft bill or amendments (see matrix item 7-d).

Role of Internal Audit

3.27 Management of all public sector entities, beginning with the Ministry of Finance, should be supported by a professional internal audit; this provides the assurance to management that their control system is adequate and is being applied. Fundamental issues to address are the rationalization and effectiveness of the control function as well as the quality control of the work
of internal audit. The Plan recommends first building capacity in the internal audit function, then directing their work to value-added areas of review of adequacy and application of the controls, and ensuring coordination across the executive. These steps would allow internal audit to assure management on the level of control that is effectively being applied.

3.28 In the immediate term, the Ministry of Finance in conjunction with the AGPE would issue an internal auditing manual for application in the public sector. The manual would establish the auditing standards as well as the request profile for staffing of internal audit positions (see matrix item 9-a).

3.29 Over the next two years, the GOP would design (2004) and carry out (2005) an ongoing professional development program for internal audit staff that would go beyond diagnostic at the current level of knowledge and lead to full mastery in modern audit techniques (see matrix items 9-a, 9-e). Having established this basis, internal audit would move on to contributing to monitoring and evaluations as part of their review mandate. In order to assess the justification of internal auditors' frequent participation in the a priori review of transactions, the role and responsibilities of the Institutional Internal Auditors and the effectiveness of their work would be examined. The goal would be to determine the value added by their participation in the a priori review, as compared to performing the value-added functions of measuring, evaluating and reporting on the effectiveness of the elements of the internal control system (see matrix item 10-a).

**Independent Control Function**

3.30 A central tenet of transparency is the independent review function. In order to fulfill its mandate the external auditor needs effective independence and technical capacity to carry out its work to the highest professional standards. Measures are recommended to address both the independence and the capacity of the audit.

3.31 The following high priority steps are needed to support on-going initiatives in the CGR to reap the full benefit of a strong independent review function which affords the legislature, civil society and other stakeholders the assurance that financial reports of the Executive are reliable.

3.32 To restore CGR's effectiveness independence, which is affected by the obligation to pursue all requests for investigation from the legislative or executive, immediate modifications must be effected in the legislation that would protect a share of the CGR work plan so they can carry out independent reviews identified from their own risk analysis (see matrix item 11-a).

3.33 At the same time, the work carried out to support the audit opinion on the annual report needs to adhere to international standards of auditing. This is addressed at present by an ongoing technical assistance project expected to culminate in a program for ongoing professional development of the financial audit staff. A peer review of the work related to the review of the annual report is needed immediately to support this objective. The peer review would include an analysis of the staffing profiles and recruiting practices of the CGR (see matrix items 12-a through 12-c).
Government Review and Report Dissemination

3.34 The findings in this report were shared with representatives of the Ministry of Finance, the National Integrity Commission, the Controller General and the Internal Auditor of the Executive in a presentation in October 2003 in Asuncion. The matrix and proposed Action Plan reflects the input received from these representatives following the presentation. The response to the final draft report and the Action Plan was positive and is reflected in an Aide Memorie presented in Annex 5 to this report.
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<th>ISSUE</th>
<th>ACTIONS AND PROGRESS BENCHMARKS</th>
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<td>Implementation arrangements</td>
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<td>1. Effective implementation of the Government’s strengthened growth and poverty reduction strategy depends in good part on its commitment to enhance public financial management.</td>
<td>a. Sign inter-institutional memorandum of understanding (MOU) to implement CFAA Action Plan and set up implementation working group.</td>
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<td>Budget Development</td>
<td>a. Prepare draft legislation on fiscal responsibility as guidelines for the development of multi year budgets.</td>
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<td>2. Financial administration legislation should be supported by fiscal responsibility legislation to set limits on total spending and deficits which ensure alignment of annual budget with long-term fiscal sustainability.</td>
<td>b. Calculate recurrent cost implications of Public Investment Program.</td>
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<td>c. Prepare long-term projections of fiscal revenues and expenditures.</td>
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<td>d. Complement budget document with explanations of underlying macro-economic framework and methodology used for revenue forecasting.</td>
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<td>Budget and Financial Control</td>
<td>e. Relate specific outputs to budgeted costs in sector development plans, to serve as basis for ex-ante feasibility and ex-post execution.</td>
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<td>3. Recording of accrued expenditures is limited to the amount of the approved cash</td>
<td>f. Prepare multi-year fiscal budget under a Medium Term Expenditure Framework.</td>
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<td>a. Modify instructions to executing agencies to allow full recording of accrued expenditures.</td>
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<td>b. Establish in budget subsystem (SIPP) the recording of commitment phase of the budget uses.</td>
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<td>4. Controls over physical assets are manual and incomplete. Support for other expenditures should be enhanced.</td>
<td>a. Undertake to apply the current Asset Management Manual (Decree 20132). b. Complete the development of the asset management system (SABYS) and the interface with the Accounting Sub system (SICO) to support physical asset control.</td>
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<td>5. Generally accepted accounting principles are not consistently applied in the complying of the public sector accounts.</td>
<td>a. Establish with the Committee on Public Accounts (Comisión Bicameral) the accounting basis to be followed in the public sector. b. Prepare and issue an accounting manual to support the application of generally accepted accounting principles for the public sector.</td>
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<td>6. The consolidated financial statements do not fully reflect the results and financial situation of the decentralized entities.</td>
<td>a. Apply sanctions to authorities in the agencies for failure to report in line with financial administration legislation. b. Expand the coverage of SIAF to the decentralized entities. Cover all noncommercial autonomous and decentralized entities of the Executive.</td>
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<td>Incentives</td>
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<td>7. Inconsistent application of the financial administration legal framework and the perception that corruption exists in the public sector contribute to a poor control environment.</td>
<td>a. Undertake to apply sanctions provided in the law for omission to comply with the financial administration law (Article 107, Financial Administration Regulation (decree 8127).</td>
<td>c. Establish internal control standards for application in the entire public sector</td>
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<td>d. Propose amendments to civil service bill to overcome constitutional objections to current law.</td>
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<td>8. The financial administration law is not supported by legislation on ethics and anti-corruption.</td>
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<td>a. Both ethics and anti-corruption should be taken up in the revision of the civil service law.</td>
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<td>Internal Control</td>
<td>a. Issue an internal auditing manual for application in the public sector which will ensure that work is done to an acceptable standard. The manual would establish the profile for staffing of internal audit positions.</td>
<td>c. Make use of integrated financial management system (SIAF) obligatory for revenue collection agencies and stipulate in related procedures that revenue collection agencies must record all income at the time of collection.</td>
</tr>
<tr>
<td>ISSUE</td>
<td>ACTIONS AND PROGRESS BENCHMARKS</td>
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<td></td>
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<td>b. Design Training Program for Internal Audit staff.</td>
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<tr>
<td>10. The participation of internal auditor in the a priori review of transaction leaves them no time and no independence to perform value-added functions of measuring, evaluating and reporting on the effectiveness of the elements of the internal control system.</td>
<td>a. Examine the role and responsibilities of the Institutional Internal Auditors as well as the effectiveness of the work to determine the value added on their participation in the a priori review. b. Conduct analysis of the skills vis-à-vis the new role for internal audit and accounting staff. c. Design training program to address skills gap.</td>
<td>d. Effect plan to upgrade human and technological resources for accounting and internal audit departments. e. Examine the function of the OGA with a view to optimize investment in internal audit function.</td>
</tr>
<tr>
<td><strong>External Audit</strong></td>
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<tr>
<td>11. CGR’s independence is affected by the obligation to pursue all requests for investigation from the legislative or executive.</td>
<td>a. Effect modifications in legislation to protect a share of CGR’s work plan to respond to independent review determined from their own risk analysis.</td>
<td>b. Issue annual plan in terms of outputs for Compliance, Financial and performance audits.</td>
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**CGR**
## ACTION MATRIX FOR IMPROVING PUBLIC FINANCIAL MANAGEMENT

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>ACTIONS AND PROGRESS BENCHMARKS</th>
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<tbody>
<tr>
<td>12. In relation to the work carried out to support the opinion on the annual report, the CGR must continue with the improvements in the application of international standards of auditing.</td>
<td>a. Contract a peer review of work related to review of annual report.</td>
</tr>
<tr>
<td></td>
<td>b. Conduct analysis of staffing profiles and recruiting practices vis a vis strategic plan.</td>
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<tr>
<td></td>
<td>c. Develop training program for specialists and management of CGR staff in forensic auditing and value-for-money auditing.</td>
</tr>
<tr>
<td>1 The World Bank is preparing a Financial Sector Adjustment Loan and it is the WB’s policy that the fiduciary support for the adjustment instrument generally should be assessed.</td>
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</tr>
<tr>
<td>3 Elaborado por María Gonzalez de Asis, del Instituto del Banco Mundial</td>
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</tr>
<tr>
<td>4 Financial Administration Law of 1999 (Law 1535/99), with regulation in Decree 8127/00.</td>
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</tr>
<tr>
<td>5 Revenue losses which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit The Congressional Budget and Impoundment Control Act.</td>
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</tr>
<tr>
<td>6 The information from the Decentralized Entities for any given month of reporting may not be up to date of the reported month and the information contained is often estimated.</td>
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</tr>
<tr>
<td>7 In 2002 the combined balance of public enterprises fell from a surplus of .3% of GDP to a deficit of .3% of GDP ( IMF Country Report No 03/94)</td>
<td></td>
</tr>
<tr>
<td>8 Role of the State, World Bank Report No. 15044-PA, April 26, 1996.</td>
<td></td>
</tr>
</tbody>
</table>
ANNEX 1: REFERENCES


Convencion Interamericana Contra la Corrupcion, Desafíos para la Republica del Paraguay. Informe de Paraguay de la Primera Ronda de Evaluación (agosto, 1993)
## ANNEX 2: LIST OF PERSONS INTERVIEWED

### Mission December 3-15, 2001

<table>
<thead>
<tr>
<th>NAME</th>
<th>POSITION</th>
<th>INSTITUTION</th>
</tr>
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<tbody>
<tr>
<td>Acosta, Dr. Manuel</td>
<td>Director</td>
<td>Retirement and Pensions</td>
</tr>
<tr>
<td>Airaldi, Octavio Augusto</td>
<td>Director</td>
<td>Environment Office, CGR</td>
</tr>
<tr>
<td>Arce Obregón, Prof. Carlos</td>
<td>Account Lawyer</td>
<td>Public Ministry</td>
</tr>
<tr>
<td>Avalos Mariño, Dr. Jorge</td>
<td>Director, Legal Questions</td>
<td>CGR</td>
</tr>
<tr>
<td>Ayala, Lic. Aurielia</td>
<td>Director</td>
<td>Accounting Office</td>
</tr>
<tr>
<td>Borda, Dionisio</td>
<td>Academic Director</td>
<td>CADEP</td>
</tr>
<tr>
<td>Buttner Limprich, José E</td>
<td>National Director</td>
<td>Investment Program, MoF</td>
</tr>
<tr>
<td>Céspedes, Dr. Guillermo</td>
<td>Auditor General of the Executive</td>
<td>Office of the Auditor General of the Executive</td>
</tr>
<tr>
<td>Coronel Britez, Ing. Dario</td>
<td>Vice-Minister</td>
<td>Ministry of Public Works</td>
</tr>
<tr>
<td>Estigarribia, Dr. Mario</td>
<td>Deputy Con. General</td>
<td>CGR</td>
</tr>
<tr>
<td>Ezequiel, Dr. Alvaro</td>
<td>Technical Director SIAF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Fariás Queiroz, Jose Maria</td>
<td>Director</td>
<td>Court of Accounts</td>
</tr>
<tr>
<td>Fiore, Ibis</td>
<td>Member</td>
<td>Court of Accounts</td>
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<tr>
<td>Galeano, Lic. Valentin</td>
<td>Secretary</td>
<td>Colegio de Contadores</td>
</tr>
<tr>
<td>Galindo, Dr. Francisco</td>
<td>Controller General</td>
<td>CGR</td>
</tr>
<tr>
<td>Gómez Ayala, Elvidio</td>
<td>Director</td>
<td>Public Credit Office</td>
</tr>
<tr>
<td>Livieres, Lorenzo</td>
<td>Executive Directo</td>
<td>CEPPRO</td>
</tr>
<tr>
<td>Maciel, Dr. Ruben</td>
<td>Vice Director</td>
<td>Treasury Office</td>
</tr>
<tr>
<td>Martinez, Lic. Carment</td>
<td>Director</td>
<td>Information Technology &amp; Communications</td>
</tr>
<tr>
<td>Morales Paoli, Dr. Ruben</td>
<td>President</td>
<td>Colegio de Contadores</td>
</tr>
<tr>
<td>Ojeda, Juna Carlos</td>
<td>Admin. Coordinator</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Ramirez Peña, Dr. Blanca</td>
<td>President</td>
<td>Court of Accounts</td>
</tr>
<tr>
<td>Rojas, Dra. Flora</td>
<td>Director</td>
<td>Budget Office</td>
</tr>
<tr>
<td>Schneider, Dra. Casilda</td>
<td>Director</td>
<td>Treasury Office</td>
</tr>
<tr>
<td>Yejaros, Dr. Amelio</td>
<td>Director</td>
<td>Standards and Procedures</td>
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### Mission November 4-15, 2002

<table>
<thead>
<tr>
<th>NAME</th>
<th>POSITION</th>
<th>ENTITY</th>
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<tbody>
<tr>
<td>Agüero, María Teresa</td>
<td>Chief, Accounting Consolidation</td>
<td>Accounting Office</td>
</tr>
<tr>
<td>Alarcón, Manuel</td>
<td>Director, Economic Policy</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Alvarez, Dr. Juan Angel</td>
<td>Director</td>
<td>Public Credit Office</td>
</tr>
<tr>
<td>Ayala, Lic. Aurelia V.</td>
<td>Director</td>
<td>Accounting Office</td>
</tr>
<tr>
<td>Buttner, José</td>
<td>Deputy Secretary for Economy</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Céspedes, Dr. Guillermo</td>
<td>Auditor General of the Executive</td>
<td>Office of the Auditor General of the Executive</td>
</tr>
<tr>
<td>Di Lorio, Pablo</td>
<td>External Auditor</td>
<td>Central Bank</td>
</tr>
<tr>
<td>Duarte, Alejandro</td>
<td>Manager</td>
<td>Budget Office</td>
</tr>
<tr>
<td>Martinez, Lic. Carmen</td>
<td>Director</td>
<td>IT &amp; Communications</td>
</tr>
<tr>
<td>Nelson Cardozo, Lic Félix</td>
<td>Director</td>
<td>Treasury</td>
</tr>
<tr>
<td>Ogura, Francisco,</td>
<td>Director, Debt Policy</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Palacios, Dr. Expido</td>
<td>Deputy Secretary of Finance</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Peralto, Sergio</td>
<td>Modernization Project Coord.</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Rojas, Dra. Flora</td>
<td>Director</td>
<td>Budget Office</td>
</tr>
<tr>
<td>Torres, José</td>
<td>Chief</td>
<td>Standards and Procedures</td>
</tr>
<tr>
<td>Yejaros, Dr. Amelio</td>
<td>Director</td>
<td>Standards and Procedures</td>
</tr>
<tr>
<td>Estigarribia, Dr. Mario</td>
<td>Deputy Controller General</td>
<td>Office of the Controller General</td>
</tr>
<tr>
<td>Bonnin, Cesar</td>
<td>Director of Planning and Reports</td>
<td>Office of the Controller General</td>
</tr>
</tbody>
</table>
ANNEX 3: ANTI CORRUPTION WORK UNDERWAY IN PARAGUAY

National Integrity Plan

A national response to corruption was the establishment in the year 2000 of the National Integrity Plan (PNI), with WB and IDB support. The PNI aims to provide the Government with modern means of technology to combat corruption; and to facilitate the participation of civil society in the fight against corruption. Implementation of the PNI is the responsibility of the Counsel to Promote the National Integrity System (CISNI), which is made up of representatives of all branches of government and of civil society. The PNI focuses on three government functions: (a) the Customs Service; (b) the Judiciary; and (c) public procurement.

Underpinning the National Integrity Plan is the Inter-American Anticorruption Convention, which Paraguay signed and ratified in 1996. In 2002 an inter-institutional technical committee of the government (CITAIC), under the coordination of the CISNI, carried-out an analysis on the progress in compliance with the provisions of the Convention. The conclusions and recommendations of the report arising from the analysis noted that the government should, among other things:

- prepare and enact an ethics code following the regulation of the civil service code
- harmonize the legal and institutional framework on the civil service
- prepare and enact a new law on the declaration of wealth by civil servants
- strengthen and rationalize the control entities

Within the context of the National Integrity Plan, CISNI signed an agreement with the Ministry of Finance to pursue the objectives set out in the Plan. As a first step 3 workshops were organized in September, 2003 to define the elements of an ethical and efficient administration and results were developed on Transparency, Accountability, Control and indicators. The report on the results is available in CISNI and will guide the Ministry in progressing toward greater accountability and transparency.

Centro Paraguayo Para La Promocion De La Libertad Economica Y De La Justicia Social (CEPPRO) (Paraguayan Center for the Promotion of Economic Freedom and Social Justice)

CEPPRO is a non-profit, non-governmental organization that was established in 1989. It has the support of the Konrad Adenauer Foundation, from Germany (KAF) and of the Agency for International Development of the U.S. Government (USAID). Its membership – the majority of which are Paraguayan, are active in industry, commerce, professionals, trade unionists and politicians belonging to various parties. CEPPRO declare themselves to be autonomous and independent, open to the community, inter-disciplinary and multisectorial.

CEPPRO was set up, among other purposes, with the aim of disseminating reciprocal knowledge on economic freedom and social justice for the benefit of all citizens in the republic, in a democratic system. Its activities include: conducting studies on the experience of other countries with similar economic and social systems, designing advocacy mechanisms leading to the
practical application of just principles in the global socio-economic policies of Paraguay, and
developing curricula and training for teachers with the aim of facilitating the incorporation of
civic and financial education in the country’s schools. As a medium and long-term objective,
they intend to “create awareness” in the population regarding their right to the good management
of the Government’s resources.

**Centro De Análisis Y Difusión De Economía Paraguaya (CADEP)(Center For The Analysis
And Dissemination Of Economics In Paraguay)**

CADEP is a non-governmental organization established in June 1990 that is dedicated to
research, studies, training and publications in various areas of the economy of Paraguay and the
region, including public finance. It aims at developing a critical mass of professionals in the
central and local governments trained in the interpretation and dissemination of information.

In the area of transparency and financial information, CADEP runs two training activities that
are of interest: (i) a program for the strengthening of municipal governments that consists in
designing and implementing citizen participation methods in the development of the municipal
budget, and in controlling its execution. CADEP organizes the so-called “public budget
hearings” where, on the initiative of the municipal executive, neighborhood committees,
educational, cultural, sporting, business and workers’ union associations of the municipality are
invited to participate. The municipal executive informs the citizens on the financial status of the
municipalities and on priority projects for the zone; they listen to the requests and proposals of
participating citizens and undertake to advocate for these requests and include them in the
municipal budget proposal as well as to submit a report on the decisions made. The program has
the sponsorship of *Organization Paraguayan de Cooperation Intermunicipal (Opaci)*
(Paraguayan Organization Of Inter-Municipal Cooperation) and of USAID; and (ii) a
postgraduate program that is run jointly with the Catholic University for a Masters in Public
Policy and Management. A high percentage of public officials take part in the programs,
including those from the Ministry of Finance.

**International support**

International organizations sponsor a series of activities in Paraguay, including the financing of
training and research, promotion and defense of rights.

The KAF places a special emphasis on the mass media, in the understanding that the mass
communications media are an essential structural element of a democratic community. Within its
Communications Media and Democracy program, the foundation cooperates in the area of
organizing conferences, seminars, research and publications on the role of the media in a
democracy and the promotion of public education through CEPPRO and CADEP.

The Inter-American Convention against Corruption recommends mechanisms for the protection
of public officials who have acted as “whistle blowers” in cases of corruption, so that they will
not be subject to persecution at work. Paraguay was among the first signatories and was the first
to ratify it. Unfortunately little has been done to implement it and many countries have yet to
ratify it. The first task is to incorporate its recommendations into law and effectively apply its
principles.

The Inter-American Association for the Right to Information and Communication (AIDIC)
organizes national and international conferences on the subject of public access to public
financial information.
ANNEX 4: COMPONENTS OF PARAGUAY’S PUBLIC FINANCIAL MANAGEMENT

This annex documents key components of Paraguay’s public financial management systems.

Legal and Institutional Framework

The Financial Administration Law of 1999 and the accompanying regulation (FA Law) constitute the legal framework for financial management and cover budgeting, accounting, reporting, treasury and control; it assigns the supervision of the financial administration to the Under-Secretary for Financial Administration within the Ministry of Finance and makes the use of the integrated financial management system (SIAF) mandatory in the public sector. It is based on the principle of normative centralization and operational decentralization. Paraguay’s SIAF is comprised of the following six systems, supported by the specific information technology applications that are indicated in each case: Budget (SIPP), Investment, Treasury (SITE), Public Debt and Credit (SIGADE), Accounting (SICO), and Control. Computerized applications for purchase of goods and services (SIBYS) and human resources (SINARH) are being developed, although they are not yet integrated into SIAF or fully operational. The Information Technology and Communications Office is responsible for the design and development of the SIAF information system for the entire central administration. In addition to Law 1535/99, the main legal instruments that regulate public financial management are: Regulatory Decree 8127/00 and the technical resolutions issued by Deputy Secretary for Financial Management. The Ministry of Finance issues standards and guidelines for the preparation of the budget through decrees.¹

The Constitution sets out that the Executive should prepare and present the budget while the Congress will review and approve both the proposal and the reports on its execution. Details regarding the roles of the Executive and the Congress regarding budget modifications and reporting processes on reporting are set out in the 1999 law, which assigns the administration of public finance to the Ministry of Finance (MOF). The MOF in turn assigns to the agencies which receive the funds, responsibility for the management of funds advanced. As such, the respective roles of the executive and the legislative branches in financial management are clear in the law.

Management of state resources is assigned by law to the Under-Secretary for Financial Administration reporting to the Minister of Finance². The Under-Secretary is responsible for applying legal rules relating to the National General Budget, the Public Treasury, and the Government's income and fixed assets; managing public credit and debt; accounting and information systems; and developing and implementing consistent standards and procedures for the management of government resources. It is also charged with managing the system of pensions, allowances and retirement of public sector staff that is not governed by special laws. Within the Under-Secretariat, the law provides that there will be Directors for Public Credit, Treasury, Budget, Accounting, Standards and Procedures, Pensions and Information Services. All these positions are established and staffed by qualified personnel. Each government agency or organization is considered an accounting unit, with the budget execution and accounting

¹ In the case of the 2002 Budget, Decree 13,088 dated 15.5.01 was adopted.
² Section 73 of Financial Management Law No. 1535/99.
decentralized. These agencies are responsible for applying the measures established in the financial administration regulations for the management of resources, through their Administration and Finance Units and Sub-Units, respectively called UAFs and SUAFs. The UAFs are specifically responsible for the appropriate management of human, financial and material resources in their respective entities. Responsibility for financial management, therefore, is clearly laid out in the law.

Payroll

For the Central Administration and other entities that use SIAF, payroll is subject to rigorous control against personnel databases and approved positions in the annual budget annex. Salaries represent 43 percent of expenditures in 2001 for the Central Administration; these payments receive the highest priority in the fund release by Treasury. Payroll for the Central Administration, unlike other services and goods, is paid by Treasury via their instructions directly to the private banks which have won concessions to effect payroll payments and debt servicing.

The process for paying salaries begins with a request from the spending agencies for payment of a specific payroll which is processed in the ad hoc payroll systems of each agency. Once authorization is given, the payroll is entered in the personnel system (SINARH), which checks it against the approved personnel positions listed in an annex to the annual budget. Any increase in the number of posts in the public service must be approved by law. The second check is against the centralized SINARH database of public servants, where the personnel detail for every civil service post under the responsibility of each agency is maintained.

The controls over payroll processing are strong; the controls exercised over the actual work performed by the personnel was not reviewed and only such a deeper review would reveal how effectively the agencies or central authorities deter and detect padding of payroll with workers who do not perform any work or are absent from their post.

Budget Reporting

The budget, Treasury and accounting information for the Central Administration is consistent and reliably recorded and reported. Budget uses (expenditures) in the Central Administration, and in some of the Decentralized Entities, are processed through the SIAF system which integrates budget, accounting and cash program. The system provides adequate checks on the inputs and integrates budget and accounting with the controls on use applied by Treasury for release of funds. Although the final use of the funds to the suppliers is not controlled by Treasury, since the payments are decentralized to each UAF within the spending agencies, the approval of funds release to suppliers is recorded in the SIAF and used in the generation of checks.

All the entities of the Central Administration process their accounting through SICO, the SIAF accounting module which integrates budget and cash program control with accounting. The accounting codes for revenues and expenses are the same as those used for the budget, so there is complete compatibility. Accounting and budgeting are kept on an accrual basis and in line with
international accounting standards. Reliability of budget execution in SIAF is ensured by the intervention of Treasury, with its control over the release of funds which is tied into the SIAF.

**Debt Management and Contingent Liabilities**

All public debt is controlled through the UNCTAD Debt Management System (DMFAS) system operating under the Director of Public Credit and reported in the Annual Report (except for municipal debt). For integration with financial reporting, the balances from the DMFAS are converted from the loan currency to USD and then to Guaranis at the exchange rate of the reporting date. Adjustments are made to this listing in the accounting records; at year-end, these adjustments are supported by a full circularization (correspondence with the Creditors requesting confirmation of the balances). Debt service schedules are drawn from this system and used to prepare three schedules per month for debt servicing which are attached to requests for funds and forwarded to Treasury where payments are expedited. The Central Bank has equal access to the DMFAS.

Guarantees on state-owned enterprise and agency debt are not recorded or reported in the budget. Government employee pension liabilities are not quantified or accounted for. Given the fiscal situation and the limited financing available to the State, it is paramount that full and accurate projections be made on future flows and the present liabilities, including contingent liabilities. In the case of the guarantees it would be easy and extremely helpful to present the entire set of guarantees in the consolidation of the budget.

**Public Access to Information on Public Financial Management**

Article 28 of the Constitution emphasizes “the right of individuals to receive truthful, responsible and fair information” and provides that “public sources of information shall be free to all.” The Chamber of Deputies passed a draft law on “administrative transparency and free access to information,” where rules are established for access to public documents, the limits to the access, the no-cost policy for access, the procedure and, above all, the sanctions in case of arbitrary refusal on the part of an official.

The main sources of financial information are the Government’s documents, consisting of the internal reports of each entity, the consolidated budget, and other reports primarily designed for internal use. Where the information is available, it is found in printed form at the individual departments, in a format that is primarily intended for official use. There is no government library, or an annual bibliography of the documents published, nor more general documents on finances intended for the public. On the Internet there is information from the Ministry of Finance, the Central Bank of Paraguay and the ministries, to promote investments in Paraguay by the business world.

The newspapers and the mass media are the most accessible source for the majority of individuals, but the coverage of information is limited to the matters in the news, normally in the nature of claims of abuses of public resources.

A growing concern with corruption resulted in the establishment in 2000 of the *Plan National de Integridad*, PNI. The PNI sets out a strategy of providing the Government with modern means of technology to combat corruption; and facilitating the participation of civil society in the fight
against corruption. Implementation of the PNI is the responsibility of the *Consejo Impulsor del Sistema Nacional de Integridad*, CISNI (Counsel to Promote the National Integrity System) with IADB support. CISNI members include representatives from government, political parties and civil society. Finally, there is significant interest by both non-governmental organizations and international organizations in researching, analyzing and publishing financial information. These organizations (CEPRO, CADEP, KAF and the OAS) are described in Annex 3.
ANNEX 5: GOVERNMENT RESPONSE TO THE FINAL DRAFT

AIDE MEMOIRE

Asunción, 25th August 2004

I. THE MISSION

A World Bank mission visited Paraguay on August 24th and 25th 2004, to discuss the Country Financial Accountability Assessment (CFAA) with the authorities of the Republic of Paraguay. The CFAA team consisted of the following members: Paul Sisk (Sr. Financial Management Specialist and Team Leader) and consultants Jamil Sopher (Financial Management Specialist) and Marcelo Barg (Public Sector Specialist).

In Asunción, the mission held meetings with Miguel Gómez (Vice-minister of Financial Management), Francisco Javier Galindo (Controller General of Paraguay), Mario Estigarribia (Sub-Controller General of Paraguay), Alberto Cabrera Villalba (Auditor General of the Executive Power), Juan Ángel Alvarez (Director of Public Credit), Nelson Cardozo (Director of the Treasury), Manuel Acosta (Director of Budget), Teresa de Agüero (Director of Accountancy), Adriana Hug de Belmont (Office of the Controller General of Paraguay), Sergio Yegros (Internal Audits of the Ministry of Economy) and Julio Devaca (Office of the Auditor General of the Executive Power).

The members of the mission gratefully acknowledge the cooperation and hospitality received from the authorities of the Government and the Office of the Controller General of Paraguay.

II. MISSION OBJECTIVES

The objective of the mission was to discuss the findings and recommendations of the Draft Financial Accountability Assessment attached to this Aide Memoire, with the aim of adding the comments of the Government to the final report.

III. MINISTRY OF ECONOMY (MH)

The authorities of the Ministry expressed their overall agreement with the contents of the CFAA.

The following paragraphs describe the advances and the current situation of the Action Plan suggested in the Matrix (and attached to this AM).

a) Fiscal Accountability Law: The Government considers that it is fundamental to first move forward with the enforcement of the Financial Management Law 1535, which has many essential elements referred to Fiscal Accountability. Nevertheless, in the future the possibility to move forward with a Fiscal Accountability Law in 2005 would be considered.
b) Multi-annual Budget: multiannual financial projections are foreseen for the 2005 Budget Law Project. Technical assistance will be hired with funds from the IADB (PROFOMAF) to move forward with the implementation of a multi-annual budget.
c) Recording accrued expenses: as foreseen in the new guidelines and regulations, the cash plan will coincide with accruals.
d) SIAF commitment module: consulting work for the development of a commitment module in SIP and SICO is being executed in the framework of PROFOMAF.
e) Physical Assets Controls: consulting services will be hired in the framework of PROFOMAF to move forward with the inventory module (to progress in the preparation of SABYS), as well as with a review of the Goods and Services Law.
f) Systematic use of generally accepted accounting principles: in the course of 2003 the Accounts Manual was updated and work is being done to implement a single Code of Accounts.
g) Consolidation of Financial Statements: The Regulatory Decree for the Budget Law includes instruments that improve compliance with financial statement reporting by decentralized entities. In the first semester of 2004 these entities presented showed better compliance.
h) Effective compliance with sanctions foreseen in the Financial Management Law: the Government considers that the current law foresees frameworks that typify crimes well and therefore, that it will not be necessary to move forward with the approval of complementary or specific laws. Instead, it will be necessary to ensure effective compliance with sanctions.
i) Extending SIAF to revenue collection agencies: The extension of SIAF to these agencies is under study to determine the full needs for implementation. The execution of the extension will be carried out through PROFOMAF.
j) Ex-ante review: (i) the regulatory decree of the 2004 Budget law does not include mandatory a priori reviews, (ii) the decree regulating AGPE, internal audits do not require ex-ante controls.
k) Internal Audit norms and procedures: an auditing standards and procedures manual is being prepared. A systematic Training Plan has not been developed yet for the AGPE but in the short term experts will be hired in the framework of PROFOMAF.

IV. OFFICE OF THE CONTROLLER GENERAL OF PARAGUAY (CGR)

The resident representative of the Bank in Paraguay, Peter Hansen, attended our meeting with the Controller General of the country.

As in the case of the Ministry of Economy, there was overall acceptance of the draft CFAA. There was agreement with the points included in the Action Plan proposed in the Matrix (which is part of the attached Assessment).

Nevertheless, there are a number of observations on the part of Controller General authorities that are summarized in the following points:

a) It was suggested that it should be added that besides its role as External Auditor, the Controller General is the Supreme Audit Institution.
b) There is need to add to the observation on corruption tolerance included in the Assessment and that this is based on the perception measures of behavior of low level public servants, and to explicitly mention the advances that have been observed in combating corruption.

c) To underline the fact that the CGR is progressing in the use of international audit standards.

d) To mention that in many cases the Controller General is unable refuse to perform the audits requested by the Parliament, the Executive Power or other sources (in many cases there are peremptory timeframes to initiate investigations).

e) It was mentioned that the CGR is carrying out a process to modify its internal statutes as part of a Modernization initiative.

f) To highlight that the functions of the CGR are performed in approximately 830 Institutions, that the staff of Auditors is of approximately 240 professionals and that its budget has not increased since 1997. In this case, a comparative analysis could be carried out to look into institutional deficits and strengths.

The Mission shares the observations made and includes them in the Final Assessment, in agreement with the CGR.

V. OFFICE OF THE AUDITOR GENERAL OF THE EXECUTIVE POWER

The Auditor General agrees with the observations made in the Assessment since its findings coincide with their own diagnosis performed between November 2003 and March 2004.

Concerning the advances and the current situation of the Action Plan proposed by the Matrix (which is included in the attached Assessment) the following is observed:

a) Audit Manual: manuals are being prepared with the support of the Technical Assistance of the IADB. There is a grant proposal from this entity to complete and assist in the process of preparation of the manuals.

b) Training Program: a 18-month Pilot Plan has been prepared. This plan contemplates training for 5 Ministries and 5 decentralized entities. It is foreseen that training processes will be completed with an IADB grant that is in its approval phase.

c) Job profiles: decree 1249 establishes the minimum requirements for professionals responsible for internal audits. It is foreseen that there will be continuous progress in this area in the future.

d) A priori control: the position of the Auditor is not to insist on a priori reviews, based on recommendations and their non-mandatory nature established by Decree 1249.

VI. CONCLUSIONS

The mission would like to highlight the progress observed since the beginning of the preparation of this study. The efforts of the government areas related to Financial Management and of the CGR have been commendable.

It is also very important to mention the high level of agreement and consensus with the findings and suggestions that arise from the assessment, as well as with the Action Plan resulting from it.
Other points to stress are those quoted by Vice-minister Gómez in the opening meeting of the mission, where among other points he mentioned: (i) A record in revenue collection in the month of July, (ii) a fiscal surplus after more than 10 years (in the said month), (iii) improved budget execution, (iv) a perception of greater transparency, particularly in the transfers process, (v) The presentation by the Ministry of Economy of A Public Accountability Report. He continued to explain that these and other achievements make for a more stable macroeconomic scenario, which has yet to produce a more direct repercussion in the citizens but that nevertheless indicates that the country is on the right path.

The attached matrix on Public Financial Management Measures represents the Action Plan that has been defined in this area. This matrix is basis for tracking the Financial Management improvement goals established by the Country Assistance Strategy (CAS) of the World Bank. By achieving these goals, the country will be able to comply with what has been established in the CAS.

VII. NEXT STEPS

A final review of the Assessment is foreseen to take place in the next days and the delivery of the document is scheduled for the end of September.

Asunción, 25 de agosto de 2004

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