Report No. 31915-CO

Colombia
Country Financial Accountability Assessment

April 13, 2005

Country Management Unit Colombia, Mexico
Financial Management, Operations Support Unit
Latin America and Caribbean Region
The World Bank

Regional Operations Department 3
State and Civil Society Programs Division 3
(RE3/SC3)
Inter-American Development Bank

Document of the World Bank and the Inter-American Development Bank

CURRENCY EQUIVALENTS (April 2005)

Currency Unit = Colombian Peso
US$ 1 = $ 2,337.00
FISCAL YEAR
January 1 to December 31

ABBREVIATIONS AND ACRONYMS

BANCOLDEX	Colombian Foreign Trade Bank
COINFO	Interdepartmental Information Policies and Management Committee
CONFIS	National Fiscal Policy Council
CONPES	National Council on Economic and Social Policy
DIAN	National Department of Tax and Customs
DFID	Department for International Development British Ministry of International Development
ECOPETROL	Colombian National Petroleum Company
EOP	National Organic Budget Code
FIAL	Fiscal and Institutional Adjustment Loan
FINAGRO	The Agricultural Financial Fund
FOSIT	Integrated provincial /municipal information management system
IFAC	International Federation of Accountants
ISS	Social Security Institute
MAFP	Administrative Modernization of Public Finance Project
PAC	Month-by-Month Annual Cash Plan
PER	Public Expenditure Review
PFM	Public Financial Management
PFMM	Public Financial Management Modernization
PRAP	Public Administration Renewal Program
ROSC	Report on the Observance of Standards and Codes
SIIF	Central Government Information Management System
SINERGIA	National System for Evaluating Results of Public Sector Performance
SOE	State Owned Enterprise
SUIFP	Unified Public Financial Investment System
TELECOM	Colombian National Telephone Company

INTER-AMERICAN DEVELOPMENT BANK (IDB)

Regional Operations Department 3 Manager	Ciro De Falco
Division Chief	Xavier Comas
Co-Task Manager	Marcio Cracel

WORLD BANK (WB)

Vice-President	Pamela Cox
Country Director	Isabel Guerrero
Sector Manager	Roberto Tarallo
Co-Task Manager	Luis Schwarz

TABLE OF CONTENTS

Acknowledgements

The Colombia Country Financial Accountability Assessment (CFAA) was prepared by a joint WB and IDB team led by Luis Schwarz (WB Senior Financial Management Specialist). The CFAA team made an introductory visit to Colombia in February 2003, and conducted its main mission May 19-31, 2003. Major CFAA findings were discussed with the Government in June 2003. The mission gratefully acknowledges the contribution of Colombian counterpart officials, who are listed in Annex 1.

Members of the World Bank team included Roberto Tarallo (Regional Financial Management Manager for Latin America), Jamil Sopher (Economic and Sector Work Advisor), Daniel Boyce (Senior Financial Management Specialist), and Otto Bolanos, Mauro Brusa, Mariana Paredes, Ricardo Vásquez, and Joost Polak (Consultants). Gilma Unda (LCOAA) and Adriana Salazar from the WB Colombia country office provided administrative assistance. The IDB team was headed by Marcio Cracel (Financial Management Information Systems Specialist) and included Gonzalo Afcha (Public Debt Financial Specialist), and Fredy Betancurt and Ulises Guardiola (Consultants). Peer Reviewers were the Management Review Committee of the IDB, and at the WB, Mauricio Carrizosa (Manager, Economic Policy Sector), Mario Sanginés (Senior Public Sector Specialist, Latin America Region), and Robert Saum (Senior Financial Management Specialist, East Asia Region).

PREFACE

Colombia's economy and social structure have, however, been undermined by a 40-year insurgency. Violence, sabotage, particularly of oil pipelines, and kidnappings have resulted in a clear deterioration of the quality of life. The drop in exports caused by recession in the economies of Colombia's main commercial partners, falling oil production, and low international coffee prices have stalled economic growth. This has led to fiscal difficulties and increasingly tight budgets, while deteriorating security conditions have dissuaded private investment.

The law and order situation and difficulties in communicating with remote mountainous and forested areas have led governments since the early 1980s to decentralize power by building up provincial and local government structures. Their increasing autonomy—formalized in 1991 in a new Constitution—also aimed to increase fiscal independence in provincial and municipal governments. This process has not, however, been successful, as fiscal problems have reduced transfers, and the taxing power ceded by the center has been extremely limited. Instead, it has led to a multitude of new actors of varying political degrees of power, laying claim to national revenues.

The Government that took office in August 2002 has adopted a Public Administration Renewal Program (PRAP) that includes anti-corruption and fiscal responsibility measures, which are handled by another governmental program under the auspices of the Vice-Presidency of the Republic. The program also contributes by giving priority to the actions of the Government in the area of fiscal responsibility and in the improvement of inter-governmental communications. The Government also restructured the petroleum and telecommunications parastatals and the Social Security Institute and weeded out redundant staff.

Scope and Coverage of the Report

The 1998 CFAA found that Colombia did not lack public financial management (PFM) laws or regulations, but that there were problems in the degree to which financial management activities mandated by law were actually implemented. The present study focuses on analyzing Colombia's financial management systems to identify more precisely the causes that underlie the weaknesses in applying the legal and regulatory framework. The CFAA was coordinated with the WB's Public Expenditure Review (PER) and 2003 Fiscal and Institutional Adjustment Loans (FIAL), and the International Monetary Fund's May 2003 Fiscal Transparency Report on Standards and Codes (ROSC), which cover other aspects of Colombia's fiscal management.

The major central government systems analyzed in this CFAA include the budget, treasury, accounting, public debt management, external and internal fiscal control. The study also reviewed information technology systems supporting the PFM system, and second-tier public banks and state-owned enterprises.

For each of these systems, the study analyzes the applicability and comprehensiveness of the legal framework, the degree to which operational practices comply with these laws and regulations, the transparency of processes, and the mechanisms for reporting financial results. The CFAA team also examined Colombia's decentralization program, and concluded that this will require a separate study.

EXECUTIVE SUMMARY

In recent years Colombia has made important progress in its PFM systems and improved transparency in public finance. Important initiatives include adoption of the 2002 presidential anticorruption plan, improving the administration of publicly owned banks, clarifying responsibilities for managing expenditures among different levels of government, and introducing modern accounting concepts and procedures.

These initiatives were supported by the rollout of new information systems covering the budget and local government finances, as well as the monitoring of public procurement. The Government enacted an important Fiscal Transparency and Responsibility Law in 2003, and strengthened the disciplinary code for public servants.

The Government also strengthened the laws regulating contingent liability management in 1998, and is building a systematic framework to track and manage contingent liabilities. Systems are being put in place to track counter-guarantees for sub-national governments, lawsuits, and arrears to providers, and two special funds have been established to manage specific contingencies. Despite this progress, there remain problems in managing other liabilities. The Government has run up significant arrears with providers, largely because anticipated budget allocations from Treasury have been curtailed by revenue shortfalls. In addition, the handling of pension liabilities and contingent liabilities related to lawsuits represents an important financial management weakness. These contingent liabilities are aggravated by the Government's weak capacity to defend itself in court, and a reluctance to pursue legal action against civil servants, which implies that corruption involves little risk.

The legal framework needed to flesh out constitutional mandates is not yet fully in place and is sometimes unclear, particularly in the areas of budget and fiscal control. This creates legal gaps and conflicts regarding agency responsibilities for implementing processes and procedures that result in poor implementation. Colombia has made progress in modernizing and automating its PFM and information systems, especially with regard to the implementation of central government's information management system (SIIF). This progress has been uneven, however, and the Government lacks an integrated vision of an overall PFM system. In order to remedy this shortcoming, the Inter-Governmental Policy and Information Management Committee was created. [1] These remaining gaps in the law and in implementation of SIIF, and a lack of accountability for results, have limited the quality and effectiveness of public financial management. Budget formulation is also fragmented, which prevents the budget from being used as a strategic governance tool.

These problems have made PFM responsibilities diffuse, and duplication and overlapping agency responsibilities prevent the Government from setting and achieving clear PFM goals.

[1] See Decree 3816, dated 12/31/03.

At all levels of government there is also a tendency to concentrate on the formal legal aspects of PFM—as is customary in Colombian public administration—rather than substance. Agencies, thus, exploit weaknesses and gaps in the legal framework to avoid administrative procedures and protect their spending capacities. Beginning with the 1996 Organic Budget Code, they have sought legislation earmarking budget allocations for particular uses, which has led to great rigidity in the allocation of public resources.

While transparency and civil involvement in government have been improved by the introduction of an e-government system, the quality of information about public finances remains highly uneven, which limits transparency and makes financial reporting by the different agencies challenging.

The strengths and weaknesses of the major PFM sub-systems are set out below.

Budget

Colombia began reforming its budget processes in 1989, and the 1991 Constitution established a comprehensive legal framework that has been fleshed out in the 1996 Organic Budget Code and subsequent laws and regulations. The Constitution sets the schedule for the yearly budget process, and assigns responsibilities for formulating and implementing the budget. Budget reform has decentralized spending authority and oversight from the Finance Ministry to ministries and public enterprises. In the early 1990s Colombia further decentralized expenditure authority to its 32 departments (provinces) and more than 1,000 municipalities. It eliminated ex-ante audits and replaced them by internal control systems and mechanisms supervised by internal comptroller offices in each jurisdiction. While decentralization of taxing and spending power has made government more responsive, it has also increased the number of stakeholders competing for resources, which consequently has increased political pressures on the budget process.

Broad loopholes in the legal framework, however, have allowed public agencies to seek legislation, earmarking their annual budget amounts to the point that 96 percent of each year's budget is now pre-allocated. This has made the budget extremely rigid, and left the Government almost no flexibility in allocating public resources. This budgetary rigidity severely limits the Government's planning flexibility, and makes it extremely difficult to undertake new programs or capital investments.[2] The Constitution also splits budgetary responsibility, giving the Finance Ministry responsibility for the operating budget and assigning the investment budget to the National Planning Department, undercutting the Finance Ministry's ability to produce a comprehensive budget.[3] The resulting budget proposals often far outstrip available resources.

---

[2] The rigidities imposed by budget earmarking also severely limit the Government's financial management performance

[3] Two other bodies—the National Council on Economic and Social Policy (CONPES) and the National Fiscal Council (CONFIS)—are involved in budget preparation. They add little to the process, however, and their role should be limited to planning and basic policy decisions.

Continuing revenue shortfalls and the constraints imposed by earmarking have led agencies to try to beat the system by committing funds beyond their programmed budget allocations, so that the center has to carry over financing into the following year's budget. Those carryovers create a continuing buildup of claims against future budgets that further reduces what little budgetary flexibility the Government has after earmarking. They also foster a culture in which agencies use political artifices and legal loopholes to avoid budget limitations.

Balancing budget obligations and revenue flows requires constant adjustments to the yearly budget acts passed by Congress. This reduces transparency and accountability. As existing cash flows determine what gets spent—and when—normal budgets become nearly meaningless.

The budget process does not include monitoring and evaluation to track how the use of public resources responds to fiscal, economic, and political objectives, or to evaluate the performance of those responsible for implementing it. While the Planning Department is building a Unified Public Financial Investment System (SUIFP) to evaluate and monitor investment projects, it is not yet operational, and requires an institutional structure to ensure that that the recurrent expenditure needs of projects are factored into the budget. Budget economic classifications and procedures also do not follow international standards, but the Government plans to adopt the International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants.

Recommendations. In December 2003, while developing one of the crosscutting strategies of the Public Administration Renewal Program (PRAP), the Government submitted legislation to Congress to reform the Organic Budget Code, which regulates budget planning, formulation, approval, and implementation. This bill, scheduled for congressional debate in July 2004, would improve medium-term fiscal sustainability and expenditure efficiency by mandating a medium-term expenditure framework, reducing budget rigidities, increasing Ministry of Finance control over budgetary aggregates, and limiting additions to the budget passed by Congress. The revised budget code should also integrate current and capital expenditures for each budget implementation unit.

While these changes would strengthen PFM, budget code revisions do not yet include provisions to centralize all budget formulation, management, and assessment functions in the Finance Ministry's National Budget Directorate. The system would be vastly improved if the Planning Department concentrated on drawing up capital investment plans, setting priorities, and tracking projects, leaving the process of project budgeting to the Budget Directorate. While this budget formulation unification process in a single entity would still require negotiations —which would also usually draw in executing agencies—the Finance Ministry's broader view across the budget spectrum would make the tradeoffs imposed by resource limitations much more transparent. The Government's goal should be a budget that enables clear identification of the results public entities are committed to achieve—and the resources assigned to achieve them—and that assigns clear accountability for results.

To this end, it should move forward with its adoption of international budget economic classifications and procedures and should establish a medium-term framework to coordinate expenditures and anticipated revenues. To carry out its investment evaluation, programming, and tracking effectively, the Planning Department should make its SUIFP information system operational as quickly as possible and provide the system with the trained staff it will need.

Treasury

Colombia's Constitution and Organic Budget Code assign management of public resources to the Finance Ministry's Public Debt and Treasury Directorate. The legal framework calls for the establishment of a single treasury account to handle all government payments. The single treasury account has not yet been fully implemented, since transfers and payments are made from this account by the government entities, which initiate payments to the end suppliers or beneficiaries. This mechanism is maintained to provide each executing entity with the option of having its own account and, therefore, it is not possible to administer all payments from a single account.

The Finance Ministry's Public Debt and Treasury Directorate management of disbursements is severely hampered by revenue shortfalls that force it to ration its transfers and spread budget allocations over several years, undercutting the concept of annual budgets and making medium-term planning difficult.[4] While budgets are drawn up on an annual basis, ministries and agencies are allowed to undertake multi-year commitments that further reduce flexibility in future years. Such an approach is not necessarily incorrect, but it requires a better handling of the mechanism that allows the expected results to be reached.[5] The planned revision of the Organic Code proposes important changes that would, if approved, reduce the problems of budgetary lags and the management of future fiscal periods.

On the revenue side, taxes are now collected by several commercial and semi-public banks, which profit from extensive floats before forwarding them to the Finance Ministry's Public Debt and Treasury Directorate. These delays (14 to 18 days) create uncertainty until the pertinent information is received from the banks with regard to the level of resources available to the Government and cause significant time lags in revenue inflows.[6]

Recommendations. The single treasury account and the direct payment to suppliers should be implemented in the short term, improving the cash on hand and in banks, and increasing the transparency of the system.

---

[4] "...Expenditures based on non-realized revenue projections are programmed and, later, indebtedness and new tax reforms are used to comply with the commitments.... It is not the erroneous revenue projection that is questioned by the Comptroller, but the lack of a rule that automatically adjusts the expenditure in the same proportion in which the revenues are reduced." Source: National Comptroller's Office Report, 2003 General Budget and Treasury Account (July 2004), page 8.

[5] Law 819 of 2003 imposed restrictions on managing future fiscal years, stating that "multi-year commitments" may not be undertaken without some type of control.

[6] The DIAN (National Department of Tax and Customs) has entered into agreements with banks that allow the banks to collect the taxes. Since the operational cost of these collections cannot be covered by the Government (for lack of budgetary item), it allows the banks, in reciprocity, to keep the resources for the duration of the float.

Planned revisions to the Organic Budget Code should be used to strengthen budget programming and control by establishing a new mechanism to coordinate expenditures across a medium-term framework that takes into account financial programming goals and anticipated resource availabilities. Colombia will not, however, be able to use its budget as an effective planning tool until it liberates its ministries and agencies of the burden of forward over-commitments they have built up.

To prevent these carryovers, budget code reform should also forbid agencies from contracting forward commitments, except under contracts explicitly approved by the central government within a multi-year budget framework, apart from the provisions of Law 819. The Ministry's Public Debt and Treasury Directorate should also set—and enforce—rules forbidding agencies from entering into contracts, unless it has certified that adequate resources are available.

The role banks play in Colombia's tax collection system should be revised so that the Ministry's Public Dept and Treasury Directorate pays a set fee for tax collection services and gains immediate access to these funds and information on each bank's collections.

Managing the budget regime under the revised Organic Budget Code will require much greater coordination between the Ministry's Public Debt and Treasury, and Budget Directorates to align budget allocations with anticipated revenues.

Public Trust Agencies

Colombia uses the mechanism of public trust agencies, which were established to escape bureaucratic complexities in implementing projects and programs. The trusts, usually managed by banks, administer such tasks as disbursement, procurement, and accounting on a fee basis. They get lump sum fund allocations, sometimes for multi-year periods, and the money remains under trust control outside the budget and treasury systems. Trusts do not have to comply with bureaucratic processes, which allows them to operate more quickly and efficiently than government implementing agencies. Nevertheless, they handle a large amount of resources—which totaled US$3.6 billion at end-2002—outside the budgetary process.

Recommendation. Public trusts should be more closely monitored by the Ministry of Finance and Accountant General's office to assure their transparency and accountability.

Accounting System

The Accountant General introduced accrual basis planning and budget accounts in 1996 and their use was expanded in 2000 to almost all government institutions. These accounts provide the only financial management data for comparing budget planning and execution for central and sub-national entities. While the Accountant General's system uses double-entry and cumulative recording (accrual), which allows cash operations to be tracked more easily, and planning accounts to track multi-annual investment plans in each sector, the Comptroller General consolidates government accounts on a cash basis. This leads to discrepancies that make assessing budget performance—and planning—extremely difficult.

However, this accounting system does not contribute to the National Fiscal Council's financial management analysis of financial accounts (CONFIS-DANE), because the information is presented too late and is not comprehensive. The system does not provide timely, accurate, and complete information on public financial management.

Recommendations. The Accountant General's office should be strengthened and must have its role clarified to avoid accounting and reporting overlaps with the Comptroller General's office, besides adopting a single accounting method for entering and consolidating the information. Financial management would benefit from assigning the budget consolidation function to the Accountant General, which would prevent overlaps with the Comptroller General and increase transparency by ensuring that all budget transactions were publicly recorded in a single institution. To increase the value of the accounting system it needs to be incorporated into the Ministry of Finance's Integrated Financial Management Information System (SIIF), but this cannot be done until both systems use the same accounting basis.

The public accounting chart of accounts should be revised to follow international public accounting standards, and the new accounting system should include only one chart of accounts covering all PFM, financial transactions and budgetary needs.

With regard to fiscal 2003, it must be pointed out that the Comptroller General, in his 2004 audit of the National Consolidated General Balance Sheet, stated that after seven (7) years in the negative, the consolidated financial, economic and social information reasonably reflects the situation and its results, thanks to finishing the accounting clean-up process carried out under Law 716 of 2001, extended pursuant to Laws 863 of 2003 and 901 of 2004.

Public Debt

The public debt system is based on a comprehensive legal framework of well defined and clear regulations and covers external and internal debt operations for all Colombian public entities. In recent years, the Government has made important progress in strengthening its debt management capacity through technical and institutional strengthening of the Finance Ministry and implementation of a new public debt information system. The 2003 Fiscal Responsibility and Transparency Law strengthened regulation of sub-national government indebtedness, although this still requires attention. Furthermore, the Government has put in place an information system to register contingent liabilities on national, sub-national, and public works contracts; the system includes the creation and operation of contractual contingency funds. All operations are in the public domain, and information on debt is published on a regular basis.

Coordination among the Public Debt Directorate and the Treasury and the other Finance Ministry units on central government domestic debt remains insufficient at the time the CFAA study was done. With the merger in early 2004 of the Public Debt Directorate and the Treasury, the Government provided better coordination mechanisms.

Recommendation. Colombia should continue to improve inter-institutional coordination by appointing a high-level committee to oversee public debt management and use the new Fiscal Responsibility and Transparency Law to strengthen oversight over sub-national debt. The Finance Ministry should take advantage of the opportunities of synergy in the financing and treasury activities based on the strengthening of the Public Debt and the Treasury Directorate.

Fiscal Control and Oversight

Under the 1991 Constitution, fiscal control is vested in the external and internal control systems. The Comptroller General, Colombia's supreme audit institution, and the regional comptrollers are in charge of external audits, and each public entity has an internal control unit. The fiscal control system also includes the Auditor General, who is responsible for supervising administrative management of the Comptroller General and the regional comptroller offices.

The Comptroller General's office has improved its performance in recent years, winning ISO 9000 certification in 2003. IDB is supporting a multi-year project to modernize the Comptroller General's Office and improve its audit capacity through training and improved information technology systems.

The external control system presents a clear definition of the functions and responsibilities of the agencies involved in fiscal control. From a constitutional and regulatory point of view, a clear understanding of the nature and scope of external control on the part of the Comptroller General is normally observed in Colombia, and conditions that reveal limitations in compliance with fiscal control regulations have not been noted. However, in practice there are problems in the correct application of the existing normative framework because of different interpretations on the part of the various actors responsible for carrying out fiscal control. For example, the responsibility for issuing external control system regulations is assigned to both the Comptroller General and Auditor General, and each is required to audit the other, causing an obvious conflict of interest which, in practice, affects the independence and objectivity in carrying out their functions.[7] At the same time, the law makes the Comptroller General responsible for overseeing the use of funds disbursed by the central government, while control over funds from other sources rests with the regional comptroller offices. Thus, the control and audit functions are split, based on the origin of funds, preventing comprehensive control and supervision of public entity performance. The Comptroller General both consolidates and audits the budget and public debt accounts of government agencies and parastatals—which creates a potential conflict of interest. The laws governing corruption and poor performance are also unclear and difficult to enforce.

Recommendation. The Government should clarify the legal framework defining the functions and responsibilities of the fiscal control agencies, assigning the task of issuing internal and external control regulations to a single agency. It should also strengthen legal sanctions against negligence, corruption, and misuse of public funds.

Legislative Oversight

Legislative oversight of public financial management is limited and does not ensure adequate executive branch transparency or accountability. Colombia's Congress has no staff resources to provide legislators with technical analysis of budgets and government

[7] During recent fiscal years, the Auditor General has expressed a negative opinion with regard to the financial statements of the Comptroller General and has assigned a risk rating of medium to the effectiveness of the internal control system.

accounts, and must depend on the Comptroller General's office for technical support. While this support has improved in recent years, it remains quite limited, so that Congress is unable to provide timely and useful financial management oversight.

Recommendations. The oversight role of the Colombian Congress should also be strengthened by providing the Joint Congressional Commission on Accounts with a team of technical experts in audit and financial management to assist it in reviewing and supervising the national accounts. The team could be composed of permanent congressional staff members or expert consultants.

Information Systems

The electronic information and government systems constitute two of the 12 crosscutting strategies of the PRAP. Its general objectives are to create a modern public management system that focuses on obtaining information that is reliable, public and in real time; as well as to define an information policy that guarantees transparency in governmental management and high efficiency in the services provided to citizens, the production sector, and the Government itself. The Government's information management systems, while much improved in recent years, are not yet comprehensive enough to allow full tracking of expenditures. As a result, the systems are poorly integrated and government agencies have not yet been integrated into a single information network. The Public Debt and Treasury Directorate's SIIF—which includes budget, treasury and accounting modules—registers and incorporates timely and reliable information on the expenditure process. The Government has also developed a National System for Evaluation of Results of Public Sector Performance (SINERGIA) to evaluate the results of public expenditures, and has begun putting in place a provincial/municipal integrated information management system (FOSIT) and programs to track financial information and purchases. The National Planning Department (DNP) is also developing a system to monitor public investment (SUIFP), as part of the MAFP II project.

Many entities that manage public resources do not use the same accounting conventions, work with different dates for data submission, and do not carry out systematic data reconciliation. Colombia is adopting International Federation of Accountants (IFAC) reporting standards on the content of financial statements, which now frequently omit public debt and losses of cash and stores. Expenditure reports are often inaccurate, and the accrual accounting basis gives an incomplete picture by bringing non-cash assets and all liabilities into the accounts.

While transparency and civil involvement in government have been improved by the introduction of an e-government system, the quality of information about public finances remains highly uneven, limiting the transparency of government actions and imposing difficulties in financial reporting. Furthermore, Colombia is only in the initial stages of developing a results-based system of monitoring and evaluation.

Recommendation. The SIIF is in the process of migrating the client-server platform to one that is web-based, which will improve security, maintenance and system coverage. It is recommended that this process be accelerated, to allow this new tool to be used as soon as possible. A national IT policy should be developed in trying to standardize the existing tools and to guide future developments. The Government should add PFM tools to SIIF and extend its coverage to all central government organizations. It should inventory its hardware and software information technology assets and develop a master plan to modernize its IT infrastructure, including estimated costs for replacement and maintenance. The Government should expand its e-government system to enable the public to monitor procurement by including information on procurement regulation and documentation, bidding documents, and contract awards.

State-owned Enterprises and Second-tier Public Banks

Colombia has begun a process of reorganizing, consolidating and closing its almost 320 state-owned enterprises (SOEs), and second-tier public banks many of which suffer from poor financial management and are not financially viable. They suffer from excessive regulatory intervention by the central government, and their liabilities and debt range from 30 to 70 percent of their assets, posing a major potential burden on government finances.

Recommendations. The Government should redesign the budget and accounting regime for state-owned enterprises to increase their autonomy and adopt a more hands-off regulatory policy that enables SOEs to concentrate on operating profitably. Government representatives on SOE boards should keep them in line with general government policies, while allowing them to work freely in a competitive national and international market environment.

Fiduciary Risk Rating

Colombia's country fiduciary risk rating is **moderate.** The CFAA examined the risks posed by weaknesses in public financial management systems, the way in which public resources flow in the system, and the strength and reliability of the control framework applied to financial transactions.

The administration of projects financed with World Bank (WB) and Inter-American Development Bank (IDB) resources has generally been satisfactory, although government fiscal adjustments caused problems in providing counterpart resources, and restrictions in expenditure and cash flow management. PFM improvements already underway in Colombia or triggered by the CFAA action plan and recommendations are also expected to contribute reasonable fiduciary assurance as WB shifts increasingly to structural adjustment lending that lacks project coordination units to support project implementation.

The moderate rating is based on a fiduciary risk assessment framework of nine good practice principles and 18 benchmarks for assessing adherence to them developed by Britain's Department for International Development (DFID). The CFAA team assessed how actual practice in Colombia measures against the benchmarks for each principle.

The Report

Chapter 1 of this report presents background information about Colombia, WB and IDB country strategies, and about the CFAA process. Chapter 2 provides an analysis of the information collected during the CFAA study to ascertain whether the Colombian

Government's systems and processes contribute to efficient, dependable, transparent, and accountable public financial management. Chapter 3 provides a country fiduciary risk assessment. The CFAA team's findings and recommendations are summarized in Chapter 4, which includes an action plan matrix. That action plan is consistent with the Country Assistance Strategy (CAS) and other WB activity in Colombia.

CHAPTER 1. BACKGROUND AND CONTEXT

1.1 Colombia is a large mountainous country with a surface area of 1.1 million km^2, population 42.3 million and a per capita GNP of $1,830. It has vast natural resources, including fertile land, hydropower, oil, natural gas, and coal, and minerals such as nickel, gold, and emeralds. It is the only South American country with coastlines on both the Pacific Ocean and the Caribbean Sea.

1.2 Abundant physical resources, a reliable and educated labor force, a robust private sector, competent macroeconomic management, and political stability led to strong economic development and social improvement over the last 30 years. Colombia's economy grew every year from 1931 through 1998. The drop in exports caused by recession in the economics of Colombia's main commercial partners, falling oil production, and low international coffee prices have since stalled economic growth. This has led to fiscal difficulties and increasingly tight budgets. Colombia's economy and social structure have, however, been undermined by a 40-year insurgency that has claimed 40,000 lives in the past decade, and the deteriorating security conditions have dissuaded private investment.

1.3 The law and order situation and difficulties in communicating with remote mountainous and forested areas have led governments since the early 1980s to decentralize power by building up provincial and local government structures. Their increasing autonomy—formalized in 1991 in a new Constitution—also aimed to increase fiscal independence in provincial and municipal governments. This process has not, however, been successful, as the taxing power ceded by the center has been extremely limited. Instead, it has led a multitude of new actors of varying political power laying claim to national revenues.

The Structure of Public Financial Management

1.4 Colombia's Government is led by a strong executive branch headed by the President, Álvaro Uribe Vélez, who took office in August 2002. Its legislative branch is a bicameral Congress with a 102-member Senate and a 166-seat House of Representatives. President Uribe's Liberal Party holds the largest block of seats in each house.

1.5 Colombia's efforts to reform PFM since 1989 have decentralized spending authority and oversight from the Finance Ministry to line ministries and public enterprises. In the early 1990s Colombia further decentralized expenditure authority to its 32 departments (provinces) and more than 1,000 municipalities, and the 1991 Constitution gave provinces and municipalities increased responsibilities and greater—though still quite limited—taxing authority. It eliminated ex-ante external controls and replaced them with internal control systems and mechanisms supervised by internal comptroller offices in each entity. While decentralization of spending power has made government more responsive, it has also created competing claims on resources that have increased political pressures on the budget process.

1.6 The 1991 Constitution and its implementing laws do not yet draw clear lines of responsibility between government levels. The central government, thus, retains the ability to intervene in areas—such as education and health—that have ostensibly been transferred to the provincial and municipal levels. The health and education ministries, for example, often override local decisions on policy definitions and service levels. Conversely, these sub-national governments have retained the right to demand financial support from the center. This diffuses responsibility, and reduces transparency and accountability. Overly complex organizational and functional structures also lead to duplication of roles between national, provincial, and municipal entities. While corruption is moderate,[8] society has little ability to exercise control over public fiscal management.

1.7 The new Constitution sets the schedule for the yearly budget process, and establishes quantitative rules governing expenditure levels. While it prohibits earmarking of revenues, broad loopholes in this provision and political infighting for resources have led to almost 96 percent of expenditures being mandated for specific purposes. This rigidity severely limits the Government's planning flexibility, and makes it extremely difficult to undertake new programs or capital investments.

1.8 Colombia's central government debt is growing rapidly. Over the last seven years gross public debt has risen steadily, from 27 percent of GDP in 1997 to about 45 percent in 2002. Interest payments to service that debt now stand at nearly 5 percent of GDP, approximately a quarter of the central government's expenditures and more than twice its investment budget.[9]

1.9 Although reliable estimates still do not exist, contingent liabilities arising from legal actions could reach 2 percent of GDP in the medium term, and are aggravated by the Government's weak capacity to defend itself in court. Under a 2000 law, Congress strengthened the Ministry of Interior and Justice's role in defending the state and mandated an information system (the National Judicial Management System) to track lawsuits within the framework of the crosscutting strategies of the Public Administration Renewal Program.

1.10 Colombia put a central government information management system (SIIF) in place over 1999-2001 and began installing a provincial/municipal system and programs to track financial information and purchases (FOSIT). The systems are not yet comprehensive and the process of integrating all government agencies into a single information network has not been completed. Even if such a network were in place, PFM would be hampered by the lack of headroom created by budgetary rigidities.[10]

1.11 Colombia's public sector modernization process forms part of another crosscutting strategy of the PRAP, involving public employees and the use of human

---

[8] *Transparency International's* 2003 Corruption Index ranks Colombia the 59th most corrupt of 133 countries rated. Its 3.6 score (on a scale in which 1.0 represents zero perceived corruption and 10.0 widespread perception of corruption) places it 6th among 17 Latin American countries rated.

[9] A 2002 World Bank study of Colombia's debt sustainability found that the public sector would have to generate a permanent primary surplus of 3.5 percent of GDP to avert a rapid rise in the debt-to-GDP ratio. This would require a substantial fiscal adjustment, on the order of 2 percent of GDP, which would allow the net debt of the public sector to stabilize at about 55 percent of GDP by 2010.

[10] Addressing the issue of budgetary rigidity is the task of the Public Expenditure Review (PER) being prepared by WB's Poverty Reduction and Economic Management network.

resources management to improve PFM. There are few civil service regulations, and civil servants have almost no protection against reassignment or arbitrary firing; many are replaced with each change in administration. While civil servants are usually well qualified, they are poorly paid, and frequent turnover undercuts institutional memory and program implementation. This is an issue that goes beyond the scope of this assessment and because of its importance will require a separate study.

1.12 Colombia needs to improve its PFM systems and processes to come to grips with—and, ultimately, resolve—the fiscal problems that now prevent it from meeting its development goals. The Government is establishing the legal and normative framework for reforms to strengthen PFM and address fiscal rigidities under WB's two 2003 Fiscal and Institutional Adjustment Loans (FIAL). The FIAL program addresses procurement, budget, royalty transfers and fiscal policy. Tax policy and administration reforms under the program should reduce evasion and the amount of time banks hold collected tax revenue, while increasing efficiency.

1.13 The WB Public Expenditure Review (PER) deals with the issue of making budgets and revenue estimates more realistic to enable the Government and its subsidiary ministries and agencies to plan on the basis of achievable targets, rather than the wish lists that now characterize its planning. Making information management systems compatible and comprehensive would give the Government much greater control over expenditures, while increasing transparency for Congress, and civil society. Improving the legislature's oversight capability and clarifying the roles of external control agencies would provide valuable checks on executive branch performance.

The Government's Public Administration Renovation Program

1.14 The Uribe Government campaigned on a platform that included improving the accountability of public financial management systems. Its Public Administration Renewal Program (PRAP) has the goal of implementing the "Communal state, an Efficient state, a state that is austere and produces results." The program is directed at the executive branch agencies of the National Order (ministries and administrative departments and their associated and affiliated agency networks). Under this program, public administration is being rethought in at least in two dimensions: one "vertical" dimension that involves the organization of the 19 sectors of the executive branch (sector head agencies and their corresponding institutional network), and a "crosscutting" dimension, which refers to the necessary structural processes, such as information systems and e-government, among others.[11]

CFAA Objectives and Coverage

1.15 A preliminary review of Colombia's PFM structure showed weaknesses that exacerbate the very real fiscal problems the country faces and allowed the team to identify the major PFM areas to be assessed by the CFAA. This CFAA analyzes

---

[11] Some of the crosscutting strategies of the program are led by different agencies, as in the case of the budget issue, led by the Finance Ministry, and the National Judicial Management Strategy, led by the Ministry of the Interior and Justice.

Colombia's financial systems, practices, and arrangements to assess the effectiveness and accountability of public resources management systems. It recommends measures to address systemic and practical issues of public financial management. The CFAA also aims to help the Government define its development, governance, decentralization, and public debt and institutional management capacity objectives. Local and provincial governments were not assessed in this study. Due to their importance and the importance of the decentralization process, they warrant a separate specific study with the same reach and depth.

1.16 The 2005 CFAA report prepared during the period of August 2002 until the present, follows up the September 1998 CFAA, which found an adequate legal framework and systems in need of modest improvement. It found that Colombia had an abundance of legislation regulating public finances, but that compliance was low and little effort was made to punish lawbreakers, increasing the risk in public resources management. This 2005 CFAA comes to many of the same conclusions, while placing even greater emphasis on the importance of enforcing existing laws and regulations.

1.17 The CFAA was coordinated with the WB's PER, which covers fiduciary aspects in public expenditure management and the instruments and the systems used in financial management, with the WB's 2003 FIAL, and with the International Monetary Fund's ROSC, which covers other aspects of Colombia's fiscal management..

WB Strategy in Colombia

1.18 The WB 2003-06 strategy, as set out in its January 2003 CAS, seeks to support Colombia's quest for peace, for achieving fast and sustainable growth, for sharing the fruits of that growth more widely across Colombian society, and for building efficient, accountable, and transparent governance. Therefore, its lending program focuses on operations to achieve fast and sustainable growth while protecting the poor. About half the lending program is expected to be in the form of quick-disbursing adjustment operations. As these operations lack the close supervision that WB gives traditional projects, Colombia's ability to track, monitor, and manage public financial performance will be a key to the success of this strategy.

IDB Strategy in Colombia

1.19 The IDB 2003-06 country strategy identifies three overarching objectives as the frame of reference for its activities: (i) laying the foundations for economic revival and jump-starting growth; (ii) fostering social progress and making sure society's most vulnerable sectors are protected, and (iii) strengthening governance and further modernization of the state. To help reinvigorate the economy, IDB will foster competitiveness and support agricultural development and natural resources management. The aim of IDB actions to foster social progress and ensure that society's most vulnerable are protected will be to improve social protection systems, leave low-income groups less vulnerable, and extend the coverage, quality, and efficiency of essential social services, including employment assistance. In the governance and modernization of the state sphere, IDB will support: (i) national public sector reform, (ii) local management capacity building, (iii) initiatives to foster transparency and combat corruption, and (iv) judicial reform.

1.20 The breadth of the policy agenda related to WB and IDB activity in Colombia will challenge the Government's capacity and will require reforms that improve its main functions—how it budgets, procures, audits, evaluates, regulates, supervises, and reports. The context in which those functions are performed should also be the subject of reform. The two banks are concerned both with the wisdom of budgetary allocations and with assisting Colombia in developing PFM systems, practices, and accountability arrangements that enable spending according to articulated priorities.

Coordination with Other Institutions and Methodology

1.22 The Government formally requested a new CFAA study in January 2003. This CFAA is the work of a joint WB-IDB team whose main mission took place in May 2003. Interviews, questionnaires, and financial self-assessments focused on the Finance Ministry, its Budget, and, Public Debt and Treasury Directorates, the Accountant and Comptroller General's offices, and several parastatal agencies. The CFAA team also consulted with the International Monetary Fund ROSC team.

1.23 WB concentrated on budget, treasury, accounting, transparency and accountability, and decentralization, while IDB focused on public debt, internal and external fiscal control, and information technology.

Dissemination of the CFAA Findings

1.24 The findings of this report were discussed with the Colombian Government in a two-day workshop. A draft of this report was presented to the Government for additional discussions and its reactions were taken into consideration in the final version. WB, IDB, and the Government would like the CFAA findings to be broadly disseminated and discussed in Colombia, and the Government intends to hold a dissemination workshop to present them to government leaders, private business interests, and civil society. The WB-IDB team also plans to circulate the CFAA findings to leading international and bilateral organizations involved in Colombia.

CHAPTER 2. CFAA ANALYSIS AND MAJOR ISSUES

Budget

2.1 Colombia's budgetary institutions were judged by the IDB to be the best in Latin America through the mid-1990s.[12] This achievement did not prevent a fiscal deterioration at the end of the decade through 2002, as a consequence of slowing economic growth and rising public debt that have led to extremely tight fiscal restrictions. The legal framework and a detailed analysis of current budget practices are presented in Annex 2, with the main points of the analysis presented here.

2.2 Colombia's budget formulation process—the basic building block for public financial accountability—is highly complex as a result of the fragmentation of responsibilities and the multiplicity of related documents prepared by different agencies. The overall efficacy of the process depends on the—not always guaranteed—success of important formal and informal coordination efforts.[13] The complexity of the formulation process is evidenced by the necessity to expand interdepartmental coordination mechanisms to the level of each budget implementation agency. This requires the creation of "functioning budget committees with officers of the corresponding agency, of the National Budget Directorate, and the National Planning Department for the comprehensive programming process."[14]

2.3 The Ministry of Finance's Budget Directorate (recurrent expenditures) and the National Planning Department (investment expenditures) share initial responsibility for drawing up the budget proposal sent to Congress each year between July 20 and 29.[15] Differences between the two agencies are worked out in the National Economic and Social Policy Council, where the Planning Department—which reports directly to the President—usually prevails regarding investment expenditure decisions. This arrangement has led to two almost separate budgets for current and capital expenditures and an inability to analyze the current expenditure consequences of public investment or ensure coherence between capital and current spending. Medium-term financial planning cannot be carried out, or fiscal aggregates correctly calculated, unless investment and current expenditure are seen as interacting factors of the same function.

2.4 The agencies' operating and investment budgets are drafted and presented separately and with non-combinable classifications that inhibit a vision of the relationship between

---

[12] *América Latina tras un década de reformas*, IDB, 1997

[13] Number 14 of the report on fiscal transparency of the IMF.

[14] Point A.1.2, Page 25, "General Aspects of the Colombian Budgeting Process," MHCP-DGPN.

[15] The Finance Ministry, in turn, delegates part of this process to its greatly understaffed Superior Council of Fiscal Policy. The Budget Directorate itself has only seven professionals to carry out its important fiscal policy functions, and another four to review and analyze all the information in the budget. Furthermore, the Planning Department has little ability to track national and sub-national investments or to project and plan for recurrent expenditures to maintain them. These tasks would be carried out by two new tools, the SPI and the SUIFP, which have not been implemented as of yet.

them in terms of common program objectives.[16] In addition, the program calendar also separates the formulation of the two budgets, since the National Planning Department (DNP) submits a draft of the investment budget before June 20 of each year for consolidation into the total budget, while the agencies submitted their "comprehensive" operating budget proposals before March 15. It is doubtful that such procedures can ultimately guarantee the overall integrity of debt and investment-related operating expenses of the budget proposal presented to Congress in the final analysis.

The practice of earmarking budgets, making transfers to provinces and municipalities, as well as budget claims for such areas as education and health mandated in the Constitution, and obligations carried over from previous years under the heading of "future fiscal years," eat up some 96 percent of annual budgets, leaving planners with almost no flexibility. Central government expenditures included external and internal debt service (38 percent), automatic transfers to sub-national entities for education, health, and other purposes (35 percent), staff expenditures (12 percent); pre-assigned investment expenditure (9 percent), and general expenditures (1.5 percent).

2.5 The expenditure rigidities caused by earmarking are exacerbated by revenue estimates that could affect the budget implementation when calculated too optimistically. The following two tables—one prepared by the Accountant General for all revenues, including the territorial agencies and the second prepared with information from the Public Debt and the Treasury Directorate with information referring only to the general national budget—show the trend during the last four years that were analyzed. In the Proposed Renewal Law of the EOP, which is currently on the floor in the National Congress, the Government has proposed measures to reduce the budget deficit, by strictly limiting it to accounts payable due at the close of the fiscal year.

[16] Article 14 of Decree No. 568 of 1996, EOP regulations, establishes an obligatory classification in Programs and Sub-programs only for investment expenditures, without relating them to the classification of operating expenses.

Table 2.1– Comparison of Budgeted and Actual Revenues Collected, FYs 2000-2003.

Account	NATIONAL TOTAL			
	12/31/2000	12/31/2001	12/31/2002	12/31/2003
APPROVED REVENUES (DB)	71,819,175,679	93,348,071,348	105,706,834,640	114,329,955,125
NON-ASSESSED REVENUE (DB)	1,743,721,503	4,992,827,215	2,649,825,061	6,211,189,075
TOTAL REVENUES FOR THE FISCAL YEAR	**73,562,897,182**	**98,340,898,563**	**108,356,659,701**	**120,541,144,200**
COLLECTIONS IN CASH (CR)	-63,113,304,248	-88,427,732,311	-98,784,106,283	-110,937,664,049
COLLECTED IN DOCUMENTS, ETC. (CR)	-679,732,811	-1,786,733,432	-2,116,769,632	-2,890,815,371
ACKNOWLEDGED (CR)	-86,132,359	-22,505,415	-57,822,149	-61,756,201
TOTAL COLLECTED	**-63,879,169,418**	**-90,236,971,158**	**-100,958,698,064**	**-113,890,235,621**
REVENUES TO BE COLLECTED (CR)	**9,683,727,764**	**8,103,927,405**	**7,397,961,637**	**6,650,908,579**

Note: Includes the budgets of the territorial agencies.
Source: Comptroller General. 2004

Table 2.2– Comparison of Financial Plan and Revenue Collections, FYs 2000-03.

(billions of Pesos)

	Year			
	2000	2001	2002	2003
ESTIMATED REVENUES OF THE FINANCIAL PLAN - TOTAL NATIONAL REVENUES	40,176.0	54,926.0	48,240.0	59,151.0
REVENUES COLLECTED	41,181.2	53,653.5	48,044.4	60,963.5
DIFFERENCE	1.005.2	(1,272.5)	(195.6)	1,812.5

Source: Financial Planning Documents and Reports from the DGCPTN.

2.6 The Government of Colombia develops four-year financial plans at the beginning of each presidential administration, but does not use them as tools to set program financial goals or anticipated resource availabilities for the medium term. Without such a framework, balancing budget obligations and revenue flows requires constant adjustments to the yearly budget acts passed by Congress, which reduced the transparency of the accountability. As existing cash flows determine what gets spent—and when—formal budgets become nearly meaningless. The overall weakness of the financial management system fosters a culture in which agencies use political artifices and legal loopholes to avoid compliance with budget limitations. This jockeying for limited funds increases opportunities for non-transparent budget manipulation.

2.7 The budget process also does not include monitoring and evaluation systems to track how the use of public resources responds to the Government's fiscal, economic, and political objectives—or to evaluate the performance of those responsible for implementing the budget. Budget economic classifications and procedures do not follow international standards, but the Government plans to adopt the International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants. The production of standardized information under functional and economic categories will improve analysis of the impact of public sector activities on the economy and enrich budgetary debates in Congress.

2.8 The present expenditure classifications by economic category, however, are not compatible with international classifications (for example, the budget's investment heading includes subsidies and debt service), spending is not classified by function or target, and classification by programs is limited to capital spending. In December 2003 the Government submitted to Congress draft legislation to reform the Organic Budget Code, which regulates budget planning, formulation, approval, and implementation. It is important to recognize that the Government is making a serious effort to overhaul the budget system and has proposed a bill, which at the time of the writing of this report is on the floor in Congress, to bring these classifications into line with international classifications.

2.9 The budget system also does not adequately track capital investments. The Planning Department is building a Unified Public Financial Investment System (SUIFP) to evaluate and monitor investment projects. The database is not yet operational, however, and will need to be backed by an institutional structure to ensure that that the recurrent expenditure needs of projects are factored into the budget.

2.10 The Ministry of Finance's SIIF financial management information system, completed in 2001,[17] has not been fully implemented or integrated with other systems—some of which remain manual—and remains an ineffective tool for either oversight or planning. The 2002-06 Public Financial Management Modernization (PFMM) II project seeks to extend SIIF to cover the full public financial sector, but there is no certainty it will be integrated with other systems. SIIF provides the Ministry of Finance real-time data on budgetary flows, and the ministry's website presents monthly and quarterly reports on budget execution at the aggregate and institutional levels that are used by its staff to monitor budget implementation, and detailed internal reports, such as expenditures by line item. However, there is still some discussion over whether this information is sufficient for budget monitoring by public sector entities and civil society. Under the FIAL program, the ministry is surveying the data requirements of entities such as the Comptroller General's Office, line ministries, and NGOs, and plans to provide that information to these entities.

National Treasury

2.11 Colombia's Treasury has gone through a steady strengthening process since 1996, when government payments were centralized in it and Treasury was allowed to raise money through open market operations, freeing it from dependency on central bank financing. However, a fragmented revenue collection system reduces efficiency, slows payments, and reduces transparency. Aligning disbursements with annual budgets is further complicated by spending agencies entering into obligations beyond their budget allocations, which forces the Treasury to come up with the resources needed to pay off

---

[17] SIIF was supported by the WB's 1996 and 2002 PFMM projects I and II and remains in effect until the present.

these commitments. The legal framework and a detailed analysis of current treasury practices are presented in Annex 2, with the main points of the analysis presented here.

2.12 Taxes are collected by several commercial and semi-public banks, which profit from extensive floats (14 to 18 days) before forwarding them to the Treasury. This creates significant time lags in revenue inflows, so that monthly cash allocations cannot be aligned with the January 1 fiscal year.[18]

2.13 The Treasury's management of disbursements is severely hampered by revenue shortfalls that force it to ration its transfers and spread budget allocations over several years, undercutting the concept of annual budgets and making medium-term planning extremely difficult. While budgets are drawn up on an annual basis, ministries and agencies are allowed to undertake commitments that further reduce flexibility in future years. It is a requirement that this mechanism be used responsibly, especially when managing investment projects, and its use should not be extended to current expenses.[19] Although the use of multi-year commitments has been reduced in recent years, the Government has run up significant arrears with providers, largely because anticipated budget allocations from Treasury have been curtailed by revenue shortfalls and the need to cover bills and commitments outstanding from previous years. Greater cooperation is needed between the Public Debt and Treasury, and Budget Directorates to align budget allocations with anticipated revenues within a medium-term budget framework.

2.14 Colombia has undertaken the challenge of establishing a single unified account in the Treasury to handle all budgetary payments, but several other funds and accounts continue to exist. Resources that come out of the single account are transferred in batches to spending entities, which then carry out actual payments. This mechanism is maintained to provide each implementing entity with the option of maintaining its own account and, therefore, it is not possible to administer all of the transactions under a single account. It is important that the concept of single account be consolidated by ensuring that all national government revenues flow into it, and by enabling payment to be authorized by spending entities through the budget execution system, checked automatically against spending allocations, processed through the single account, and transferred directly from there to final beneficiary bank accounts. The mechanism of direct payment to suppliers should be implemented, especially since there are no technical blocks.

Public Trusts

2.15 Colombia has a large number of public trusts established to comply with public policy objectives, which in practice help to bypass bureaucratic complexities in implementing projects and programs for agencies of the central government. In many cases, the multilateral funding organizations themselves have required the intervention of

---

[18] The National Department of Tax and Customs (DIAN) has entered into several agreements with banks to allow the banks to receive funds from taxpayers. Since their operating costs cannot be covered by the State (which lacks the budget for it), in lieu of these, the banks are allowed to retain these funds for the duration of the float.

[19] Law 819 of 2003 imposed restrictions on tapping into future fiscal funds, barring entering into "multi-year commitments" without any type of control.

such intermediate technical assistance entities to collaborate in the execution of projects. The trusts, usually managed by banks, administer such tasks as disbursement, procurement, and accounting on a commission basis. They get lump-sum fund allocations, sometimes for multi-year periods, and the money remains under trust control outside the budget and treasury systems. Trusts do not have to comply with bureaucratic processes, which allows them to operate more quickly and efficiently than government implementing agencies. They move significant resources, totaling more than US$3.6 billion at end-2002. The Government should fortify the accounting evaluation mechanism of the public trusts.

Public Debt

2.16 The Finance Ministry's Treasury (short term) and Public Debt (long term) Directorates are in charge of public debt operations. They base their decisions on central government debt operations on recommendations by CONFIS (National Fiscal Policy Council), the National Planning Department, and the Central Bank; the ministry's Fiscal Support Directorate advises on provincial and municipal debt. The Public Debt Directorate prepares cost/risk evaluations for alternative strategies for managing the national debt portfolio, providing the inputs for the decision-making on financing alternatives.

2.17 The public debt system is based on a comprehensive legal framework of well-defined and clear regulations and covers external and internal debt operations for all Colombian public entities. The regulations assign each stage of the debt issuance process to a single entity, allowing effective implementation. All operations are in the public domain, and information on debt is published on a regular basis.

2.18 Public debt management has improved significantly in recent years through technical and institutional strengthening of the Finance Ministry and implementation of a new public debt information system. The 2003 Fiscal Transparency and Responsibility Law has strengthened regulations governing the indebtedness of sub-national governments. The Government has also implemented a valuation and registration information system to track contingent liabilities from public works contracts, contractual contingency funds, and sub-national debt. Although important progress has been made in controlling sub-national debt, this area still requires increased attention. The Fiscal Transparency and Responsibility Law sets benchmarks for sub-national debt levels that should improve this aspect of the system. The law does not, however, cover central government debt.

2.19 In early 2004 the Government folded the Public Debt Directorate into the Treasury in order to enhance the coordination of internal indebtedness. A WB Public Debt Management and Domestic Debt Market Development team has undertaken a three-year project to improve this coordination.

Public Sector Accounting

2.20 Colombia's 1991 Constitution created an Accountant General function to oversee the national accounts, define accounting policies, principles, and regulations, and prepare consolidated accounts. The Accountant General's main operational functions are providing technical assistance to line agency accountants and verifying the integrity of reports. Nevertheless, the Constitution is unclear in differentiating between the roles of the Accountant General and Comptroller General, and there is considerable overlap in their functions.

2.21 The Accountant General consolidates government accounts—**on an accrual basis**—using data sent to it by individual agencies. These financial statements do not fully comply with International Public Sector Accounting Standards; a review is underway to adapt those standards to the Colombian public accounting system. The accounts are very comprehensive and cover all budgetary and financial accounts, from asset management, depreciation, amortization and revalorization, to planning and results for the medium and long term. The Comptroller General's office now both consolidates and audits the budget accounts of government agencies and parastatals **on a cash basis**. There is no mechanism to reconcile these parallel exercises, which leads to discrepancies that make assessing budget performance—and planning —extremely difficult.

2.22 The regulations setting out the competencies of the two agencies establish that the Accountant General's main function is technical assistance and verification of the integrity of reports, while the Comptroller General performs financial control over compliance with regulations, including the application of accounting norms issued by the Accountant General. In practice, there is duplication in budget information management because the Constitution gives the Comptroller General responsibility for preparing the final budget consolidation, while the Accountant General is responsible for the public accounts and the public sector financial statements, and for planning and budgeting accounts. No agency is responsible for reconciling the budget accounts that the Comptroller General and Accountant General generate.

2.23 The Accountant General lacks enforcement powers, which are given to the Comptroller General, and there are problems of timeliness in handling information. Therefore, weaknesses in entities are detected very late and remedial actions and the information adjustments to be made cannot be performed in the Accountant General's office before balance sheets are prepared. Adjustments are generally made in subsequent fiscal years, affecting the quality of accounting information. The accounting system is complex and does not efficiently assist public sector decision-making.

2.24 The chart of accounts has 9,000 accounts; the Accountant General is developing a project to analyze and simplify the chart to bring it into compliance with international public sector accounting standards. A 2001 survey by the Accountant General revealed that instructions on management procedures, chart interpretation, and new account creation were required to improve the use of information.

2.25 The Accountant General sets public sector accounting rules,[20] provides government agencies with technical assistance in accounting, and verifies the integrity of their reports. His office oversees compliance with financial regulations, including the application of accounting rules. Problems with timeliness of information mean that weaknesses are detected much later than they should be, and adjustments to the general balance often lag, which reduces the quality of accounting information.

[20] Some entities supervised by regulatory agencies—including banks and state-owned enterprises—are required to keep their accounts under different criteria.

2.26 The Accountant General introduced accrual basis planning and budget accounts in 1996 and their use was expanded in 2000 to almost all government agencies. These accounts provide the only financial management data for comparing budget planning and execution for central and sub-national entities. This accounting system does not contribute to financial management analysis and decision-making, however, because the information is presented too late, is not comprehensive, and is not reconciled with the budget information system—different charts of account are used for budget and accounting purposes. To increase its value, the system needs to be incorporated into SIIF, but this cannot be done until the budget accounting system is changed from its present single-entry cash basis to an accrual basis. The Accountant General's system uses double-entry and cumulative recording, which allows cash operations to be more easily tracked, and planning accounts to track multi-annual investment plans in each sector. Colombia has a comprehensive vision of internal accounting control, but needs to improve the quality of information and to focus more on accounting management. To this end, the Accountant General has issued technical guidelines as to how to carry out the accounting process to detect weaknesses in agency accounting practices.

2.27 An Accounting Improvement Law passed in 2001 directed all public and private entities that manage public resources to use the Accountant General's public accounting system to prepare their financial statements. These entities had to provide the Accountant General with additional information regarding accounting problems they encounter by end-2003. A 2002 disciplinary law (Law 734) made non-compliance with public accounting norms subject to disciplinary measures, including fines and dismissals. The Accounting Improvement Law has improved Colombia's PFM by imposing an integrated internal accounting system across government and state-owned enterprises that standardized processes and procedures and responsibilities for implementing and monitoring the accounting system. The law also requires the President to present an annual report to Congress that includes a chapter on the internal control of accounting. These measures have increased accountability—internal comptrollers now report to the President's Office, rather than the entities they oversee—and the transparency of accounting information. The Accountant General's Office has an internal coordinating committee that meets every quarter to evaluate the agency's accounting internal control systems through a risk map that is based on self-assessment and critical analysis of tasks. These assessments have uncovered problems in managing the security of goods purchased by the Government.

2.28 The Comptroller General, in his task of evaluating the public consolidated account, has determined with respect to the 2003 fiscal year, that this information reasonably represents the Government's financial situation and its consolidated results, thanks to the completion of the application of Law 716 of 2001, which was extended to December 31, 2005 by means of Laws 863 of 2003 and Law 901 of July 26, 2004.

Public Sector Fiscal Control

2.29 Under the 1991 Constitution, fiscal control is vested in the external and internal control systems. The Comptroller General, Colombia's supreme audit institution, and the regional comptrollers are in charge of external audits, while public entities have their own internal control units. The fiscal control system also includes the Auditor General, as the organization responsible for supervising the administrative management of the comptroller offices. The external control units perform ex-post selective audits and are responsible for supervising the administrative management of public organizations.

2.30 External audit works well at the national level, but is seriously deficient at the sub-national level. Audit reports are prepared in a timely manner; the most common problems they show are shortcomings in internal control compliance, results monitoring, and evaluation and of efficiency in the use of funds. The legal framework is unclear in defining the functions and responsibilities of the entities involved in fiscal control, and a seven-layer bureaucracy often makes the control process sluggish. While the external control system has abundant legislation, regulations, and guidelines, these are sometimes unclear in defining the functions and responsibilities of the entities involved in fiscal control.

2.31 From the constitutional and regulatory point of view, there is a generally clear understanding of the nature and the scope of the external control under the leadership of the Controller General. The CFAA noted no conditions that reveal limitations in compliance with fiscal control rules and regulations. In practice, however, there are shortcomings in the correct application of the existing rules and regulations because of the different interpretations by the various entities responsible for implementing fiscal control. For example, the responsibility for issuing regulations for the audit system is assigned to both the Comptroller General and Auditor General. Each is also responsible for auditing the other, which generates conflicts and jeopardizes their independence and objectivity in carrying out their functions.[21] The Comptroller General's role in consolidating national budget and public debt data also creates a conflict of interest, as the agency both reconciles this information, and then examines and judges its correctness. The laws governing corruption and poor performance are also unclear and difficult to enforce.

2.32 The Comptroller General is responsible for auditing the use of funds that originate with the central government, while regional comptroller offices oversee the use of funds from other sources. This effectively divides the control and audit function at the territorial level, based on the origin of funds, thereby preventing comprehensive control and the supervision of the performance of all public entities.

2.33 In recent years, the Comptroller General has greatly improved its management. It has set up a system to supervise public procurement, issued regulations for financial reporting, and produced procedural manuals. It was granted ISO9000 certification in 2003. Support from an IDB-financed program is being used to modernize and automate the control system. The agency still suffers from institutional problems, however. Fiscal control is highly centralized, and provincial comptroller offices have little autonomy and a bureaucratic structure that unnecessarily duplicates the work of the central government.

2.34 The IDB project to strengthen Colombia's fiscal control system aims to build up institutional and management capability in the Comptroller General and Accountant

[21] During recent fiscal years, the Auditor General has expressed a negative opinion about the financial statements of the Comptroller General and has assigned a risk rating of medium to the efficiency of its internal control system.

General offices. Therefore, to streamline the agency, the project financed the mandatory retirement of a large part of the Comptroller General's staff, some of whom were rehired to new positions after retraining. Internal procedures and processes were improved, and new hardware and software were used to bolster information technology. A national council for the supervision of the national fiscal control system was created. Strengthening of the Accountant General's office has moved more slowly, and only a few training programs have been implemented.

Box 2.1 External control: Auditing and Accounting Oversight in Colombia

Colombia's fiscal oversight is handled by several entities. Reconciling their output to provide the integrated picture of fiscal performance needed by the executive branch, Congress, and civil society has proven impossible, however, as the Comptroller General audits on a cash basis, the Accountant General works on an accrual basis, and individual agencies mix the two. Several oversight entities also base their analyses on differing fiscal years.

While Colombia should ideally maintain all accounts on an accrual basis, it is not realistic to expect this reform in the near future. As inconsistency across national, sub-national government, and public enterprise accounting units is the most serious problem, unifying accounting standards by moving the Accountant General and other agencies to modified cash-basis accounting that records revenues on a cash basis and expenditures on an accrual basis would standardize accounting data across the Government and make an eventual evolution to full accrual accounting easier.

The Comptroller General, Colombia's supreme auditing institution, is appointed by Congress. It is an autonomous entity supported by auditing fees. The office audits budget execution of all Colombian public and private sector entities that manage public goods or resources. Financial and non-financial public enterprises are audited by private firms, which submit their results to the Comptroller General. The Comptroller General can impose fines on agencies if audits turn up discrepancies, and can recommend prosecution for criminal violations. The Comptroller sends yearly General Budget and Treasury Accounts to Congress, audits and certifies the Finance Balance Sheet compiled by the Accountant General, and prepares the Public Debt Report and the Report on the Status of Natural Resources and the Environment.

The **Accountant General,** appointed by the President, consolidates the activities of the Colombian public sector, provides information on balance sheets and financial statements, and submits an Annual Balance Sheet to Congress. The Accountant General follows double-entry accounting and includes asset accounting, with active and passive accounts and accrual-based treatment. On the other hand, the Accountant General cannot impose sanctions on entities that do not provide timely information, which delays the consolidation exercise.

Colombia's 1991 Constitution also calls for appointment of an **Auditor General** by the President's Council of State to oversee the accounting and controlling functions, but this office was not established until the late 1990s. It has proven ineffective, and the Government is considering closing it.

The **National Fiscal Council**, a committee under the Minister of Finance, compiles yearly estimates of public sector fiscal results on a mixed cash and accrual basis to establish the Government's deficit and make fiscal projections.

Sub-national government entities are audited by external controllers appointed by departmental and municipal councils. National and sub-national public entities utilize an "internal control" process that checks their compliance with budgetary regulations and processes, rather than internal audits.

2.35 The Comptroller General's office needs to move from largely manual information processing to computerized systems and is carrying out a modernization program that is expected to improve its performance. The Auditor General's office should undergo a similar modernization process to enable it to design and implement a fiscal supervision and management control system. Each public sector agency also has an internal control unit under the Civil Service Administrative Department's National Internal Control System. This system is regulated by a plethora of other agencies and does not meet international standards for internal control. Various entities play important roles in the internal control system. The Finance Ministry helps in the preparation, execution, and control of budget allocations, the Administrative Control Department sets public management policies, the Accountant General coordinates compliance with the national accounting system, and the Comptroller General assesses internal control unit performance.

Box 2.2 – Internal Control

According to the Accountant General's report on the improved internal accounting control, "... *At the majority of the national level Agencies the quality of the information improved significantly or, at least, there is a clear diagnosis of the most frequent deficiencies that are the object of refinement in the context of the Accountant General's rules and regulations and of Law 716 of 2001 and its regulatory Decree 1282 of 2002, with the ongoing need for working on improving the aspects explained below.*"

The evaluation by the Comptroller General's Office and the self-evaluations reveal an inconsistency in the evaluation of risk evaluation and lack of homogeneity in the standards for such measurements. In general, the integration of the Internal Control System structure into a general application model and its implementation and operation in accordance with the international standards has been a very slow process. There is little reliability in the financial and operating information, a lack of compliance or erroneous application of the legal standards, and inefficient and ineffective management of public resources, including a lack of transparency in the contracting processes.

In spite of all efforts, instructions, and advice, the concept and practice of the division of roles between the Internal Control Office and the internal control system is not well understood by the national and the regional Agencies. Public sector managers and their staff have yet to become familiar with and fully accept the necessary level of direct responsibility that they bear regarding implementation of internal control.

The Renovation Program of the Public Administration of the present Government includes strategies directed at strengthening the internal control system, with the goal of redefining the mission's objectives in the state agencies.

Contingent Liabilities

2.36 While the Government long felt it could keep contingent liabilities off its balance sheet, it is now aware of the financial management risk they pose and is building a systematic framework to track and manage them. Systems are being put in place to track counter-guarantees for sub-national governments, lawsuits, and arrears to providers.

2.37 The laws regulating contingent liability management—and the inclusion of those liabilities in budgetary appropriations—were strengthened in 1998. These contingent liabilities include payments pursuant to court rulings against the State, payments to service publicly guaranteed debt (including guarantees on sub-national government debt), and payments resulting from executing guarantees provided to partners in joint venture contracts in the context of privatizations or concessions. To operationalize the law, the Government has established two special funds to manage specific contingencies: the Public Entities Contractual Contingency Fund and the Territorial Entities Contingency Fund.

2.38 Public entities budget and deposit resources to these funds to cover possible losses associated with the contingencies for which they are responsible. Colombian law mandates that provisions for those guarantees must be included in the budget to avoid fiscal strain if these guarantees are executed. The adjustable loan program for implementing fiscal and institutional reform of the public sector, FIAL, is conducting a complete analysis of the contingent liabilities topic. Therefore, the evaluation here is meant to give a brief overview and present several complementary concepts.

2.39 In accordance with the FIAL II Program, the 2004 budget represents a substantial improvement over previous budgets, since it includes the contingent liabilities. In addition, the Government has approved the Fiscal Responsibility Law, which, among other things, specifies the annual presentation of a mid-term fiscal framework that includes fiscal goals related to debt sustainability, a report with the debt management results, including the entire public debt, to be presented to the Congress, and the contingent liabilities. Despite this progress, there remain problems in managing other liabilities. The Government has run up significant arrears with providers, largely because anticipated budget allocations from Treasury have been curtailed by revenue shortfalls. In addition, the handling of pension liabilities and contingent liabilities related to lawsuits represents an important financial management weakness.

2.40 Although reliable estimates still do not exist, contingent liabilities arising from legal actions could reach 2 percent of GDP in the medium term if current trends continue. These claims have varied origins, including labor and administrative disputes, but the most significant source is contracts in areas such as concessions or public works that have gone into arbitration. These contingent liabilities are aggravated by the Government's weak capacity to defend itself in court, and a reluctance to pursue legal action against civil servants that means corruption involves little risk.

2.41 Pursuant to Law 790 of 2003, Congress strengthened the Ministry of Interior and Justice's role in defending the state and mandated an information system to track lawsuits; this system is being supported by an IDB technical assistance project, which is seeking financing for several PRAP issues.[22]

2.42 The 2003 Fiscal Transparency and Responsibility Law has strengthened regulations governing the indebtedness of sub-national governments. The Government has also implemented a valuation and registration information system to track contingent liabilities from public works contracts, contractual contingency funds, and sub-national debt. There remains, however, no system for monitoring potential liabilities for pensions. The Fiscal Transparency and Responsibility Law also establishes that mid- and long-term contingent liabilities must be set out in the annual financial plans of national and sub-national entities, but these records are still incomplete.

Legislative Oversight

2.43 Legislative oversight of public financial management is limited and does not ensure executive branch transparency or accountability. A commission representing both houses of

[22] As of the present date, the information system has been designed and its first and second phase has been implemented.

Congress is charged under the Constitution with exercising oversight of government finances by examining and approving the public accounts. For the past eight years, however, it has been unable to do so because it found the information deficient and inaccurate. On the other hand, Colombia's Congress has no staff resources to provide legislators with technical analysis of budgets and accounts, and must depend on the Comptroller General's office for technical support. While this support has improved in recent years, it remains quite limited, so that Congress is unable to provide timely and useful financial management oversight. Consequently, the effectiveness of political control is very limited and does not ensure transparent legislative branch oversight over the executive or effective and timely accountability.

Information Management

2.44 Colombia has been slow to adopt and integrate information management systems. While a number of computerized systems have been installed, they are not adequately linked and information gathering and analysis are still largely manual. In order to modernize the State Information System, the Interdepartmental Information Policies and Management Committee (COINFO) was created pursuant to Decree 3816 of 2003, which seeks to articulate the information systems initiatives in the different sectors, and generate scale economies in the development and administration of public information technologies. Within the framework of this Committee, policy guidelines have been defined in the area of information standards, interoperability and systems construction for Enterprise Resource Planning, and 64 information systems projects have been evaluated.

2.45 The WB-financed PFMM projects (MAFP I and II) have supported the Government's measures to strengthen institutional capacity and analysis through development of SIIF, and bilateral aid from several countries has helped the Government develop SINERGIA to evaluate the results of public expenditures.[23] Additionally, the MAFP II project finances the development of a public investment tracking system in the National Planning Department. With IDB assistance, it has also begun putting FOSIT and programs to track financial information and purchases in place. However, the systems are not yet comprehensive and the process of integrating all government agencies into a single information network has not been completed.

[23] In order to strengthen the result-oriented public management instruments, the CONPES Document No. 3294 was approved, by means of which the tracking components, the focalized evaluations, the accounting and diffusion of the public management results, as well as the constituent parts of the national System of Evaluation of Results were institutionalized. An important result of this material is an increase of 6.83 points in the annual percentage of the national investment budget being evaluated.

Box 2.3 Colombia's PFM Information Systems

PFM Areas	IT System/Institution	Comments
Budget and Treasury	**SIIF** (Integrated Financial Management System), Public Debt and Treasury Directorate, Ministry of Finance	Covers budget execution, treasury and accounting information
Public Debt	**SIDCO** (Colombian Public Debt Information System), Public Debt and Treasury Directorate, Ministry of Finance	Registers and monitors public sector debt information.
Investment	**BPIN** (Investment Projects Database), National Planning Department	Registers and tracks public expenditures in investment projects
Monitoring and Evaluation	**SINERGIA** (National System for Evaluation of Results of Public Sector Performance), Comptroller General's Office	Monitors public expenditures in investment projects and contributes to evaluate project results.
Under Development		
Investment	**SUIFP** (Unified Financial Public Investment System), National Planning Department	Will track consolidated at the national level information on public expenditures in investment projects
Sub-national and Municipal government financial data	**FOSIT** (Provincial/municipal integrated information management system), Ministry of Finance and Accountant General's Office	Will consolidate and track financial information and purchases provided by other existing information systems.
Accounting	**CHIP** (Financial accounting information system), Accountant General's Office	Will consolidate and track public debt, accounting, transfers, and budget execution. The Accountant General does not use these systems but asks entities to send it accrual basis information by diskettes and more recently by email in a few cases.
Fiscal Control	The Comptroller General uses SIIF budget and public debt information, but bases its work on information submitted to it by diskettes and email.	

2.46 IDB is also supporting a multi-year project to modernize the Comptroller General's Office and improve its audit capacity through training and improved information technology systems.

2.47 The Government began implementing an e-government program in 2003 under the Comptroller General's office system that aims to provide public access to most government information, including the budget, investment projects, and procurement at the central and sub-national levels. This program will include an inventory of all projects and allow electronic bidding.

State-owned Enterprises and Second-tier Public Banks

2.48 Colombia has begun a process of reorganizing, consolidating and closing its almost 200 state-owned enterprises (SOEs), and second-tier public banks. These entities generally suffer from poor financial management and many are not financially viable in the medium to long term. They also suffer from excessive regulatory intervention by the central government and political influence by the central government, which often uses its positions on SOE boards to siphon off earnings to the general budget. The SOEs take up 8.13 percent of the national budget, have poor financial management systems and lack adequate financial information databases. Their liabilities—particularly pension obligations—and other debt range from 30 to 70 percent of their assets, posing a major potential burden on government finances. The CFAA examined the major state-owned enterprises and their impact on the Government's financial risks. Details on Bancoldex, Finagro, and Banco Agrario may be found in Annex 3.

2.49 As part of the vertical reforms, from August 2002 until the December 2004, 141 agencies have been restructured in the 19 public administration sectors, which have generated a savings of close to $362 billion. Of these, 63 have modified their plant and/or organizational structure, 30 liquidated, 8 were created, 4 merged and 36 carried out different redesign actions, such as contract withdrawals for the performance of services, withdrawals of vacancies with budget appropriations, changes in assignment or divisions through which the number of State institutions were reduced by 26, decreasing from 302 in 2003 to 276 in 2004.

2.50 With the modernization of the State in full swing, a total savings of over $410 billion have been generated to date, and through decisions already taken for 2006, the savings forecast is close to $791 billion. These results, in turn, have contributed to the fiscal adjustment and to the adequate management of the finances, which is constituted as another proposal of the objective. This is reflected in a 0.09 point fall in the share of GDP required for central government operating expenses between 2002 and 2003, from 4.37 to 4.28 percent of GDP. During the first semester of 2004 this positive tendency has been maintained, as indicated by a decrease of 0.29 points of GDP in relation to the same period in 2003. At the close of fiscal 2003, the operating expenses of the executive branch of the Government and the SOEs (leaving aside the defense sector and other government agencies) presented an actual decrease of 7.7 percent compared to fiscal 2002. Personnel expenses were reduced by 8.5 percent and general expenses decreased by 6.8 percent compared to the expense accounting of fiscal 2002.[24]

2.51 **TELECOM.** In June 2003, the Government ordered the liquidation of TELECOM, its national telephone company, then reconstituted and reopened it with one-third as many staff. The firm had been losing market share since Colombia opened long-distance and international calling to competition in 1997 and had fallen into such financial disarray that it was unable to bill and collect for its services. The Government also assumed the firm's pension obligations for the staff that was let go. The new, leaner, company expects gross profits of US$80 million in 2003, as opposed to a loss of US$158 million in 2002. The Government, on the other hand, has taken on a large pension obligation. Together with the creation of the new Colombian Telecommunications company, it has allowed this entity to generate income of $804 billion pesos in 2003. In the same year, the operating profits were $457 billion pesos and in 2004, until the month of April, the new entity registered profits of $312 billion pesos, surpassing the deficit generated by TELECOM before its liquidation, which was close to half a billion pesos annually.

2.52 **ECOPETROL.** A month after closing TELECOM, the Government split the energy parastatal ECOPETROL into three new entities. A new, and much smaller, ECOPETROL will explore for and produce hydrocarbons and refine and distribute them. The National Hydrocarbon Agency negotiates and issues licenses for exploration, drilling, and production of petroleum and natural gas and sets market prices for energy products. The third entity is a research and promotion agency.

[24] Source: DNP/PRAP.

2.53 **The Social Security Institute (ISS).** Colombia established the Social Security Institute (ISS) in 1946 to provide pensions and health services to all workers. In 1993 it opened the market to competition by creating new private firms to compete in delivering pensions and health care. Aggressive competition from these private firms has left the ISS as the health care provider for only the poorest Colombians. It lacks control over its expenditures, manages its revenues poorly, and provides poor health services.

2.54 The ISS suffers from extremely poor financial management. Its information management systems are a poorly meshed amalgam of manual and computerized systems that do not allow it to track payers and non-payers or verify the status of beneficiaries. Health service contributions are not enough to cover operational costs, which are excessive for the services it renders. Its pension reserves are estimated to be just sufficient to cover one year of payments to the beneficiaries still in the system.

2.55 In June 2003 the Government split the ISS health and pension services in an attempt to bolster its financial situation and provide better services to beneficiaries. This measure did not, however, solve the agency's financial administration and internal control problems.

2.56 **BANCOLDEX.** Colombia's Foreign Trade Bank (BANCOLDEX) mainly finances foreign trade activities, although a 2003 financial reform authorized it to participate in mergers, acquisitions, and transfers of assets and liabilities. It is one of the healthiest and most solid financial institutions in Colombia, with prudent and orthodox management and sufficient assets to expand its operations. BANCOLDEX has maintained its financial strength, despite the requirements imposed by the State to compensate for the effects of the 1998 fiscal crisis.[25] To maintain its reserves at the legally required level the bank was forced to raise the provision on its credit portfolio from 1 to 2 percent. The Government also required BANCOLDEX to take on the functions of the Industrial Development Institute, a fund that supported small and medium industry through promotional and loan programs and was liquidated in mid-2003.[26]

2.57 **FINAGRO.** The Agricultural Financial Fund (FINAGRO) implements the National Agricultural Credit System by providing subsidized credit to farmers. Its capital is provided by the Ministry of Agriculture and Rural Development (60 percent), two other government banks (29.5 percent), and a private bank (10.5 percent). FINAGRO's financing of low-profit forced investments creates significant distortions in Colombia's overall financial intermediation system. FINAGRO is not authorized to get resources directly form the domestic market through instruments to promote savings, and can only raise resources by issuing securities with authorization from the central bank.

2.58 **Banco Agrario.** The Agro-business Bank (Banco Agrario) was created in 1999 as a successor to the Agrarian, Industrial, and Mining Credit Society, founded in 1930. The bank's predecessor organization managed seed factories, owned cattle breeding farms, ran a network of some 440 sales outlets for agricultural raw materials, administered housing subsidies for the rural sector, and included an insurance company. Starting in 1975, however, it experienced recurrent losses that brought it to the edge of dissolution. This situation was worsened by continuous political pressures that forced Banco Agrario to make subsidized loans.

[25] The government insists that this has not been a special policy, but that BANCOLDEX has, since its creation, maintained a policy of profit distribution to its shareholders.

[26] The Ministry of Exterior Commerce holds 89.4 percent of the BANCOLDEX shares, the Ministry of Finance has 7.6 percent and the Industrial Development Institute has 2.7 percent; the remaining 0.3 percent is held by private investors.

2.59 Banco Agrario's main charge is to finance operations related to rural and cattle breeding activities, fisheries, forestry, agricultural and related business activities, and to provide financial services to localities where there are no banks.

2.60 Banco Agrario's financial structure reflects many of its predecessor's problems, as it must maintain a great number of offices all over the country and has a complicated organizational structure. In the medium to long term the bank is exposed to an important liquidity risk as its liabilities far exceed its equity. The bank can rediscount its loans with FINAGRO, and has attempted to raise more money by taking deposits from the public. Its financial situation remains precarious, however, as it is still required to make subsidized agricultural loans and the Government siphons off significant amounts of its liquidity for its general funds.

2.61 In 2003, for example, Banco Agrario was instructed to distribute its profits beyond banking regulations minima to the Government and other shareholders. This distribution reduced the bank's margin of solvency from 20 percent in December 2002 to 14 percent in April 2003, which could have important implications for its financial stability.

2.62 **External Control and Legislative Oversight.** Second-tier banks and development financial entities are overseen by the Comptroller General and Congress. Additionally, the supervision of the financial, stockmarket and insurance activities pertain to the President of the Republic, by means of the superintendencies. In practice, the Congress exercises little oversight in these areas, leaving that function largely to supervisory agencies. The control authorities have detected problems in Banco Agrario's accounting systems that stem from inaccuracies in the asset and liabilities accounts transferred from its predecessor. ISS has been unable to provide the accounting information required by oversight bodies in a timely and reliable manner. Many of its remote offices do not send accounting information with the required frequency. Its overseers—including the Superintendents of Banks and National Health—have differing information requirements, many of which do not match those established by the Comptroller General.

2.63 **Transparency and Accountability.** The Organic Code of Financial Systems sets criteria for transparent management and adequate accountability that are largely adhered to by parastatal agencies. In general, the management of government programs through FINAGRO and the inclusion of administrative costs seem to be clear, though they are not easily available to third parties. The financing of FINAGRO operations through forced investments reduces transparency of the intermediation process, and its impact in terms of achieving goals is not clear.

2.64 FINAGRO and BANCOLDEX undertake some practices that are not transparent by setting higher provisions than needed as an accounting tactic to prevent the Government, as majority shareholder, from siphoning off profits.[27] Banco Agrario is subject to inspection and oversight by the Banking Superintendent. Although the legal framework that supports the guarantee of transparency in financial information and the use of public resources and the savings of the public is adequate, its predecessor's poor recordkeeping initially hindered the process of purging its asset and liabilities accounts. ISS financial statements are available to the public only when requested, which reduces transparency and public ability to exercise effective control.

[27] Legal reserves must consist of 20 percent of the annual liquid profits of every year until they cover 50 percent of the authorized capital, thereafter, 10 percent needs to be accumulated.

2.65 **Institutional Development, Coordination, and Financial Management Capacity.** BANCOLDEX financial management is adequate in terms of ensuring its sustainability, with appropriate risk management mechanisms, and high revenues and profits. Unlike many other Colombian entities, its institutional strength produces the expected results and facilitates resource management, despite central government interference.[28]

2.66 Although FINAGRO's National Agricultural Credit System was designed to be the only channel for agricultural credit, other credit programs are directly managed by the Ministry of Agriculture, and a lack of coordination in agricultural financing reduces policy effectiveness. FINAGRO's financial management is adequate in terms of ensuring its sustainability, with appropriate risk management mechanisms and reasonable levels of revenue and profits. FINAGRO, as a financial entity, shows an adequate institutional development and has an appropriate management capacity, considering the rigidities of its legal framework.

2.67 Banco Agrario has designed a successful strategy to ensure its sustainability, but its institutional development has been slowed by the problems it inherited from its predecessor.

2.68 ISS has low administrative and financial management capacity and limited institutional development, which impedes its financial recovery plan. Its major structural imbalance is found the health business and its lack of control over expenditures, poor management of revenues, and the low quality of the service provided in an environment of aggressive private sector competence. The June 2003 spin-off of ISS's health services may improve this situation.

[28] Source GoC: According to different risk certification agencies (Fitch, Standard & Poors and DCR) and the Private Colombian Office for Transparency, the primary strength of Bancoldex are its administrative transparency and information management, independence of the central government, its technical capacity and risk analysis, among others.

Box 2.4 Fiscal Decentralization In Colombia

Colombia has led Latin America in political and administrative decentralization since the mid-1980s. This CFAA does not include a full examination of provincial and municipal financial accountability; such a study should be undertaken in the immediate future to provide a full picture of Colombia's public administrative and financial management system.

Colombia granted sub-national governments autonomy to manage their interests in a context of political and fiscal crisis. As the taxing power of sub-national governments is severely limited, fiscal decentralization is based on mandatory central government transfers that represent more than 6 percent of GDP and 48 percent of current revenues. In 2002 the central government absorbed 38.5 percent of the budget, sub-national governments 14.26 percent, state-owned enterprises 8.1 percent, and public financial sector and decentralized entities 39.1 percent. In addition to these automatic transfers, provincial and municipal governments receive specific funds, royalties, and co-financing resources. A 1991 constitutional amendment that set the level of these transfers for the next decade, with fixed percentages for each sector, greatly increased budget rigidity.

Weak provincial and municipal financial, physical, and human resources management capacity has put the efficiency of public sector expenditure and macroeconomic fiscal stability at risk. The automatic transfer system generated immense problems, as transfer levels were based on estimations of revenues that often did not materialize. Under the June 2003 Fiscal Responsibility Law, the amount of the transfers is calculated on the basis of the global amount of the expenditures established by law, which increase annually according to a fixed percentage of increment plus inflation; this is expected to provide more transparent and reliable transfer calculations.

Since 2000 the Government has focused on strengthening that management capacity through a program to promote fiscal and financial improvement in provincial and municipal governments by reorganizing their administration, rationalizing expenditure, restructuring debt, improving liabilities, and strengthening revenues. The program has been successful in curbing deficits and generating current savings.

CHAPTER 3. FIDUCIARY RISK ASSESSMENT

3.1 Colombia's fiduciary risk rating is **moderate.** The CFAA examined the risks posed by weaknesses in the legal and institutional framework supporting public financial management systems, the adequacy and reliability of systems, policies, and public financial management system regulatory procedures, the way in which public resources flow in the system, and the strength and reliability of the control management framework applied to financial transactions.

3.2 The financial administration of projects financed with WB and IDB resources has generally been satisfactory, although the Government's fiscal adjustments are causing problems in the provision of counterpart resources. Colombia's public sector is also undergoing a renovation process that has shifted human resources and affected the management of some projects. Projects have experienced restrictions in expenditure and cash flow management as a consequence of Colombia's difficult economic situation. This problem may be worsened as the WB shifts increasingly to structural adjustment lending in which there is no project coordination unit to support implementation and project financial management.

3.3 Colombia's PFM has advanced greatly since the September 1998 CFAA. Successive governments have maintained—in sometimes difficult circumstances—a reform path that has produced important improvements in PFM systems, practices, and accountability arrangements. New, or improved, information systems have increased Colombia's ability to track public finances, including contingent liabilities and arrears. The recent consolidation of public debt operations in the Treasury Directorate gives much clearer direction to debt management. The Comptroller General's office and external auditing have been significantly strengthened.

3.4 Progress has not been even on all fronts. The auditing and fiscal oversight functions that are one key to effective PFM remain contradictory, with overlapping responsibilities within an unclear legal framework. A fragmented budget formulation system prevents programmatic planning and budgeting. The new information systems are not yet adequately integrated or being used to their full potential.

3.5 Most importantly, however, Colombia's reform process remains dynamic. The Government recognizes the areas in which financial management is at risk, and is working to improve its performance. Recent improvements in procurement performance, the passage of the 2003 Fiscal Transparency and Responsibility Law, and new instruments to track government liabilities show a government that remains fully engaged in improving PFM.

3.6 Colombia's recent PFM improvement and record of dedication to the reform process over successive administrations justify an assessment that fiduciary risk is only moderate. Maintaining—or improving—that risk assessment will, however, require continued Government action to implement the actions recommended in this CFAA, the forthcoming PER, WB's FIAL loans, and the IMF's Fiscal Transparency Report on Standards and Codes to integrate budget formulation, and increase expenditure control, transparency, and accountability.

3.7 This fiduciary risk assessment is based the definition of fiduciary risk developed by Britain's Department for International Development (DFID): the expected value of the loss of developmental benefits that may result from gaps between generally accepted financial management standards and actual practices in the country. Ultimately, fiduciary risk implies the risk that funds do not reach their intended destination.[29] The CFAA team assessed how actual

---

[29] Managing Fiduciary Risk When Providing Direct Budget Support, London, DFID, March 2002. The DFID definition builds on the IMF Code of Good Practices on Fiscal Transparency, the IMF/World Bank

practice in Colombia measures against nine good practice principles and 18 benchmarks for assessing adherence to them.

3.8 The risk of non-compliance with each good practice principle is assessed on a scale ranging from low to high risk. These ratings represent the level of seriousness and concern with which any prudential shortcoming is viewed by the WB, and the corresponding level of benefit expected from reform. Table 3.1sets out Colombia's performance under each principle and its applicable benchmarks.

reviews of 25 HIPC countries, and IFAC/PSC international public sector accounting standards. Fiduciary risk is not *financial risk* or *credit risk*, as it is not a measure of a country's fiscal situation or its ability to repay sovereign debt obligations.

The important issue of whether public sector management of the flow of funds process is reliable and well coordinated is not covered by the DFID principles. In Colombia, significant backlogs of payable bills and outstanding commitments, which in some years have reached 2.5 to 3 percent of GDP, have made the final volume of expenditure each year quite different from the amounts appropriated by Congress. This is the result of unrealistic programming, which is then corrected in the course of the year by rationing cash to spending units. The fiduciary risk related to this issue is, however, moderate, and provides further validation of Colombia's overall moderate risk rating.

Table 3.1 Fiduciary Risk Principles

Principles and Assessment Benchmarks	Risk Factors
1. A clear set of rules governs the budget process. A budget law specifying fiscal management responsibilities is in operation. Accounting policies and account code classifications are published and applied.	While Colombia's legal framework specifies basic fiscal management responsibilities, it splits budget formulation responsibilities between the Finance Ministry's Budget Directorate (recurrent) and the National Planning Department (investment). There is little coordination between these agencies, and the recurrent expenses associated with investment projects are often not accounted for. Accounting policies and account code classifications are published and applied. The budget code allows the Budget Directorate to withhold—and carry over to future years—resources appropriated by Congress if there is a revenue shortfall. This means that line ministries and other agencies cannot be confident as to the budget amounts they will receive each year—and that congressional aims in passing budgets that specify appropriations for particular agencies and purposes may not be met. The process also lacks transparency, as there is no real time record of deviations from the budget law, and legislative oversight is inadequate.
2. The budget is comprehensive. All general government activities are included in the budget. Extra-budgetary expenditure is not material.	Colombia's government budget is relatively comprehensive and includes all central government expenditures, including transfers to local authorities and public enterprises. While local authorities and non-commercial statutory bodies prepare their own budgets, their expenditures are generally not substantially different from the transfers made to them, so the omissions in central budget coverage are not critical.
3. The budget is aligned with the national development strategy. Budget allocations are broadly consistent with medium-term expenditure plans for sectors and the overall budget.	Colombia's yearly budget process takes place within the framework of a four-year financial plan that sets each new administration's development goals. Each year Congress also receives a Presidential Message that outlines fiscal and development policy. There is no explicit linkage between that message and the budget, however, and the fragmentation of budget preparation among government agencies and the fiscal burdens of carry-overs mean that development goals are often not reflected in the budget.
4. **The budget is a reliable guide to actual expenditure.** Budget outturn shows a high level of consistency with the budget.	Revenue constraints and a legal framework that allows the Government to withhold appropriated payments—or stretch them over two or more years—mean that the budget passed each year by Congress is not a reliable guide to actual expenditures. These constant adjustments to the budget prescribed by Congress greatly limit the budget's transparency and its utility as a fiscal and planning tool. They are judged to present only a moderate fiduciary risk, however, as they do not lead to misuse of funds, and the 2003 Fiscal Responsibility Law is expected to lead to more realistic budgeting in future years by requiring publication of the annual financial plan and annual reports to Congress on fiscal results.
5. Expenditure within the year is controlled. In-year reporting of actual expenditure. Internal controls operating to prevent fraud and error. Systems operating to control fiscal environment, commitments and arrears.	The Government prepares monthly expenditure reports that are used for cash management and to monitor adherence to budgets. The Accountant General produces quarterly reports that are earlier and more accurate under the SIIF information management system. The computerized systems being introduced include registration of commitments, receipt of goods/services, and payments, so that outstanding commitments (contingent liabilities) and arrears (overdue creditors) can be better controlled. However, the systems are not fully rolled out to all spending agencies and users, and there are problems of access, report generation, server capacity, and control of individual advances. The Finance Ministry does not monitor compliance with internal controls or provide systems support, routine reconciliation are months in arrears, and internal controls are widely ignored or evaded.

6. The Government carries out procurement in line with principles of value for money and transparency. Appropriate use of competitive tendering rules. Decision making is recorded and auditable. Effective action taken to identify and eliminate corruption.	Colombia's central government procurement arrangements were evaluated in the Bank's 2001 Country Procurement Assessment Report, which found that a lack of clarity and loopholes in the legal framework fostered abuse and corruption. The study noted lack of uniform procurement procedures, delays, and uncertainties about payment that made it very costly and risky to do business with the Government. Colombia's public procurement legislation is transparent, and uniform for all of the levels of government and provides for disclosure, objective selection, and the right of appeal. It requires public agencies to publicize the opening of bidding, competitions and other selection procedures, and the rules for awarding contracts. There is a single, public, registry of bidders in which registration must be renewed annually. The law requires that copies of bids submitted and actions taken must be provided to anyone who shows a legitimate interest. Bidders have the right to learn about reports, opinions, and decisions produced during the bidding process, and may submit and objections. The law does not, however, regulate subcontracting, and allows exceptions for clear emergencies such as public disasters, the procurement of minor amounts, scientific or technological activities; procurement of goods with regulated prices, real estate; and goods and services for national defense and security. The Government's Information System for Monitoring Public Procurement (SICE) includes all significant information on public procurement and performs an on-line (and real time) comparison of prices paid for purchases. SICE helps structure purchasing plans and makes it possible to compare them with actual contract outturns. The Vice President initiated an anticorruption program in 2002 that included several actions to identify corruption by increasing transparency.
7. Reporting of expenditure is timely and accurate. Reconciliation of fiscal and bank records is carried out on a routine basis. Audited annual accounts are submitted to Congress and approved within the statutory period.	The Government's information management systems, while much improved in recent years, are not yet comprehensive enough to allow full tracking of expenditures. For the central administration as a whole, the SIIF—which includes the budget, treasury and accounting modules—registers and incorporates timely and reliable information on the expenditure process. Many central administration agencies and other entities that manage public resources do not use the same accounting conventions, work with different dates for data submission, and do not carry out systematic data reconciliation. Colombia also does not meet international reporting standards on the content of financial statements, which frequently omit public debt and losses of cash and stores. Expenditure reports are often inaccurate, and the accrual accounting basis gives an incomplete picture by bringing non-cash assets and all liabilities into the accounts. Detailed reconciliations are not done on a timely basis during the year, and bank reconciliation are grossly in arrears. While audited annual accounts are submitted to Congress, these have not been approved for the past eight years.
8. There is effective independent scrutiny of government expenditures. Government accounts are independently audited. Government agencies are held to account for mismanagement and criticisms and recommendations by the auditors are followed up.	While the Balance Sheet and the General Budget and Treasury Account are submitted to Congress yearly, the legislature lacks the staff skills to provide effective oversight. The Comptroller General monitors central government fiscal management; provincial, and municipal governments have their own comptrollers. There is, however, little monitoring of follow-up on comptroller recommendations, and sanctions are only rarely brought for misconduct.
9. The financial management process is transparent. Information on government fiscal activities is available in the public domain. Information is presented in a way that facilitates policy analysis and promotes accountability.	Information on public sector financial operations is available to the public at various stages of the budget cycle. The media and members of the public have access to the published budget, accounts, and official audit reports, although these are often delayed. There is no public access to in-year expenditure reports. The coverage of the NFPS is broad and includes the central government, SSI, public enterprises, and territorial and decentralized entities. The Banking Superintendency publishes information on the financial public sector. However, data quality and calculation methodologies vary from sector to sector. Information on public enterprises and state banks can be

	obtained on an accrual basis, and the central government publishes its outturns on a cash basis with accrual adjustments; information on territorial entities is on a cash basis, and difficult to obtain although there are more detailed reports on these entities in the Accountant General's Office. The obligation to disseminate information to the public is not established in law, but the authorities and public officials understand that this is an important feature of their management responsibilities, and the Network of Citizen Inspectors has been systematically exercising the right of citizens to access public sector information. The **SIIF** gathers, processes, and disseminates fiscal information on most entities included in the budget; its coverage reaches 87 percent of the value of the budget. The public entities that are still not covered are to be integrated into the system in the course of this year. The public does not yet have access to the SIIF, but is expected to get it under the *Government On Line* initiative, which will give citizens Internet access to national public entities in 2004.

CHAPTER 4. RECOMMENDATIONS AND ACTION PLAN

4.1 Colombia has a history of sound public financial management. Its systems and processes have, however, grown weak in several areas, and significant gaps and rigidities remain that impair the planning and implementation needed to foster macroeconomic stability and economic development. The Government has launched an ambitious Public Administration Renewal Program to reform its financial systems and strengthen anticorruption efforts, transparency, accountability, and information systems. It has also reorganized state-owned enterprises, such as ECOPETROL, TELECOM, and the ISS. This chapter presents the CFAA team's major recommendations and an action plan to achieve them. In addition, Annex 4 presents a comparative analysis of budget and treasury arrangements in nine Latin American countries, the US, UK, Canada, and Spain that is intended to provide a background for purposes of discussion of the CFAA recommendations for Colombia in these two areas.

Budget

4.2 Colombia needs to clarify its budget process to establish a single clear line of authority in drawing up and implementing a budget that identifies the products and results public entities are committed to achieve, and the resources assigned to achieve them. Current and capital expenditures—including maintenance—should be integrated for each budget executing unit.

4.3 The budget process now involves two separate entities—the Finance Ministry's National Budget Directorate and the Department of Planning, which reports directly to the president. While the Budget Directorate is responsible for the final budget proposal sent to Congress, the Planning Department draws up each year's investment budget. The resulting budget proposals often far outstrip available resources. The recommendations presented in the Fiscal Transparency Study of the IMF have been analyzed and they coincide with the ones presented in this present evaluation.[30] The IMF recommendations are:

- The Organic Budget Code (EOP) should contain an exhaustive listing of the various public agencies that participate in the national budget, distinguishing between the central administration and the different types of decentralized agencies on the basis of their legal nature.
- Transfer of the investment competencies of the Planning Department (DNP) to the Finance Ministry for the purpose of effectively integrating the operating and investment budgets.
- Preparation of a multi-year expense scheme that provides a realistic and rigorous estimate of the expenses for the current fiscal years.
- Periodic review of the actions concerning the expenses of implementing agencies, until a functional and program-oriented classification is obtained, and a strengthening of the evaluations for the purpose of preventing stagnation of expense policies that are unnecessary or have lost their priority.
- Creation of a political-institutional organization with sufficient powers to make decisions on the new expense budgets to be included in the national budget. Such an organization

[30] Fiscal Transparency Report on Standards and Codes (ROSC) and the study entitled: "COLOMBIA: LA REFORMA ORGÁNICO DEL PRESUPUESTO (COLOMBIA: THE ORGANIC RENEWAL OF THE BUDGET)," by Julio Viñuela, Maria Albino, Alberto Espejo and Gustavo Ortiz.

should be made up of heads of ministries and interdepartmental administrative departments with responsibility in fiscal subjects.

4.4 The Government has revised the Organic Budget Code that underlies the budget process. With the new code, the Government is proposing a better job of coordinating the budget system management between the National Budget Office and the Planning Department and integration of current and capital expenditures for each budget executing unit. The new Organic Budget Code should strengthen budget programming and control by establishing a new mechanism that uses the four-year financial plan developed at the beginning of each administration to coordinate expenditures across a medium-term framework that takes into account financial programming goals and anticipated resource availabilities. The renewal of the Organic Budget Code should be used to strengthen budget programming and control by establishing a new mechanism to coordinate the expenditures within a medium-term framework in which the goals of the financial programming match the anticipated resource availabilities.

4.5 Nevertheless, Colombia may not be able to use its budget as an actual planning instrument until the ministries and government agencies are liberated from the accumulated expenditure commitment load for future fiscal years. To avoid these transferred balances, the Organic Budget Code renewal would be adequately complemented if it can prevent the organizations from entering into premature contracts, except when explicitly approved by the central government within a multi-year budget framework.

4.6 The system would be vastly improved if a single responsible entity would be established to draw up the budget, whether it be the National Planning Department or the Ministry of Finance, by means of its Budget Office. The Government should also adopt international standards for budgetary classification.

Treasury

4.7 The Government should fully implement the Treasury single account. The single account and the direct payments to suppliers should be implemented in the short term, thereby improving the cash flow of the treasury and increasing the transparency of the system.

4.8 The present system of collecting tax revenues leads to long lags between collection by the banks and transfers to the Treasury. Taxes are now collected by several commercial and semi-public banks, which profit from extensive floats before forwarding them to the Treasury. This can delay the payment of monthly allocations under annual budgets—which are supposed to start January 1—by three months or more. In practical terms, it pushes the start of the fiscal year back from January to April, and leaves the Treasury playing catch-up for the rest of the year.

4.9 Speeding the transfer of tax revenues from the banks to the Treasury would greatly improve the forecasting of cash flows and enable it to bring monthly allocations to ministries and agencies into line with the fiscal year. The Government should amend its revenue collection system so that the Treasury pays a set fee for tax collection services and gains immediate access to these funds and information on each bank's collections.

4.10 Managing the budget regime under the revised budget code will require much greater coordination between the Ministry's Public Debt and the Treasury and Budget Directorates to align budget allocations with anticipated revenues. The CFAA recommends that the ministry establish a high-level mechanism to facilitate this coordination. This would improve management performance capacity by increasing inter-institutional coordination in the budget formulation and execution processes, while bringing more transparency and coherence to the setting of goals and the assessment of results.

4.11 Trust funds should be more closely monitored by the Ministry of Finance and Accountant General's office to assure their transparency and accountability. Relative to the Annual Monthly Cash Plan, the study has adopted the recommendations made by the IMF and considers that additional recommendations are not needed. The main recommendation of the IMF ROSC is the introduction of a commitment control system that regulates the speed with which commitments are acquired. This measure would provide greater capability to the Finance Ministry for the control of the shortfall and would introduce a greater a degree of certainty in the availability of appropriation and commitment amounts and would enable the control of future commitment amounts to be paid. With the introduction of a commitment control system, annual trimestralized program of commitments would be established by the entity, which would generate payments during the current fiscal year, the following and the subsequent fiscal years, as the case may be (this would exclusively be the case for long-term investment projects or contracts). The commitment control system has good operating prospects, considering that currently the entities or implementing agencies are obliged to pay any commitments to be assumed within the year.[31]

Public Trusts

4.12 Colombia's public trusts, while often quicker and more efficient than government implementing agencies, move significant resources out of the budget and treasury systems. Public trusts should be more closely monitored by the Ministry of Finance and the Accountant General's office to assure their transparency and accountability.

Accounting System

4.13 The Government should assign the budget consolidation function exclusively to the Accountant General's office to prevent overlaps with the Comptroller General, a move that would require a constitutional amendment. This clarification would increase transparency by ensuring that all budget transactions were publicly recorded in a single institution. The Comptroller General, Colombia's supreme audit institution, would then audit the accounts to ensure that expenditures were proper. This assignment of roles would transform public sector accounting into a much more effective management tool by bringing budget, financial, and equity accounting into a unified system.

4.14 The public accounting chart of accounts should be revised to follow international public accounting standards, and the new accounting system should include only one chart of accounts covering all PFM, financial transactions, and budgetary needs

Public Debt

4.15 Colombia should continue to improve inter-institutional coordination by appointing a high-level committee to oversee and coordinate day-to-day public debt management, as debt is issued by many levels of government (federal, departmental, municipal), often acting in isolation. It should also make use of the new Fiscal Responsibility and Transparency Law to strengthen oversight over sub-national debt.[32]

---

[31] Sources: Fiscal Transparency Report on Standards and Codes (ROSC) and a study entitled *Colombia: La Reforma Orgánico Del Presupuesto* (Colombia: The Organic Renewal Of The Budget), by Julio Viñuela, Maria Albino, Alberto Espejo and Gustavo Ortiz.

[32] A WB Public Debt Management and Domestic Debt Market Development team also recommended in February 2004 the establishment of such a committee to coordinate and oversee public debt on a strategic and policy level.

Fiscal Control and Oversight

4.16 The Government should clarify the legal framework defining the functions and responsibilities of the fiscal control agencies, assigning the task of issuing internal and external control regulations to a single agency. It should also strengthen legal sanctions against negligence, corruption, and misuse of public funds.

Information Systems

4.17 The SIIF is in the process of migrating the client-server platform to a web-based platform, which should improve the security, maintenance and overage of the system. It is recommended that this process be speeded up, to enable the initiation of this instrument as soon as possible. Timely and trustworthy data from an integrated and comprehensive information management system will be a key to improving governance and financial management. The Government should continue to give priority to extending, integrating, and deepening its SIIF information system—and the development of a companion system to track provincial financial information and state purchases.

4.19 A national IT policy is being implemented, which should standardize the existing tools and guide future development. The Government should add PFM tools to SIIF and extend its coverage to all central government organizations. It should inventory its hardware and software information technology assets and develop a master plan for the modernization of its IT infrastructure, including the estimated costs for replacement and maintenance.[33]

4.20 The Government should expand its e-government system to enable the public to monitor procurement by including information on procurement regulation and documentation, bidding documents, and contract awards.

Legislative Oversight

4.21 The oversight role of the Colombian Congress should be strengthened by providing the Joint Congressional Commission on Accounts a team of technical experts in audits and financial management to assist it in reviewing and supervising the national accounts. The team could be composed of permanent congressional staff members or consultants. These actions would increase transparency and accountability across Colombia's public sector.

State-owned Enterprises

4.22 The Government should redesign the budget and accounting regime for state-owned enterprises to increase their autonomy. It should also adopt a more hands-off regulatory policy that enables SOEs to concentrate on operating profitably. Government representatives on SOE boards should keep them in line with general government policies, while allowing them to work freely in a competitive national and international market environment.

Action Plan

4.23 Many of the recommendations above could be implemented through existing Colombian Government projects. Several fall within the scope of the ongoing WB-financed Administrative Modernization of Public Finances II project, which includes a wide range of actions aimed at

[33] In order to remedy this deficiency, an Interdepartmental Information Policy and Management Committee was created. See Decree 3816 of 12/31/03.

strengthening budget management, public accounting, public revenues, and financial information systems, and other ongoing and proposed institutional structural adjustment loans. Furthermore, the Comptroller General's office is being modernized and strengthened under an IDB-financed project. The Vice President's office is directing a program aided at reducing corruption and strengthening information systems.

Table 4.1 Recommended Action Plan

The timing for implementing these recommendations will be discussed with the Government and will be contingent on such factors as the need for new legislation. Priority 1 recommendations require urgent Government attention; Priority 2 and Priority 3 recommendations, while also important, are of lesser urgency.

Issue	Priority	Recommended Actions	Responsible Agency	Comments
Budget				
Colombia needs to clarify and strengthen its budget process.	1	Reform the Organic Budget Code in order to: Improve interdepartmental coordination and, if necessary, centralize all operational budget functions in a single entity. Integrate current and capital expenditures for each budget executing unit. Use the Government's Financial Plan as a multi-year instrument to coordinate expenditures across a medium-term framework that takes into account financial programming goals and anticipated resource availabilities. Create a mechanism to align budget allocations with anticipated revenues. Strengthen legal sanctions against negligence, corruption, and misuse of public funds.	Ministry of Finance Budget Directorate and National Planning Department.	There already is a proposal for reform before Congress that contemplates some of the concerns presented in this study. The suggested recommendations complement the Bylaws amendment. It is not logical to think that any recommendations made in this study, that are not included in the proposed amendment, can be included in this one, but we consider the recommendations to be valid and they should be taken into account in the future. The amendment will have to be approved by Congress. While technical budget governance would be centralized in the Finance Ministry's Budget Directorate, political control would remain in the National Planning Department.
Budget executing units pre-commit to capital and recurrent expenses in future years.	1	The Organic Budget Code reform should forbid agencies from contracting forward commitments except under contracts explicitly approved by the central government within a multi-year budget framework.	Ministry of Finance Budget Directorate.	The amendment considers measures that tend to restrict the management of future commitments. The foregoing comments are also valid in this case.

The Government has run up significant arrears with providers.	1	The Public Debt and Treasury and the Budget Directorate should cooperate much more closely to align budget allocations with anticipated revenues to prevent further arrears from accumulating. The Treasury should also set—and enforce—rules forbidding agencies from entering into contracts, unless it has certified that adequate resources are available.	Ministry of Finance Budget, and Public Debt and Treasury Directorates.	At present, the Treasury has started to restrict the possibility for implementing agencies to enter into contracts that, although they are covered in the budget, they lack the necessary financial resources. Once a firmer fiscal discipline is established, the Government should strengthen these actions.
Treasury				
Banks collect tax revenues but do not forward them quickly to the Treasury	1	Require banks to forward tax payments to the Treasury within 24 hours of their collection. Establish a set fee for tax collection services.	Ministry of Finance and National Directorate of Taxes and Customs	Banks now profit from a float on taxes they collect; this gives them an incentive to delay forwarding them to Treasury.
Monthly budget allocation payments to ministries and agencies do not start until well into the fiscal year.	1	The Treasury should use improved revenue flows from banks to align its monthly budget allocation payments at the start of the January 1 fiscal year.	Ministry of Finance Public Debt and Treasury Directorates.	New regulations should provide a more transparent and reliable operational framework based on new agreements with the banking sector.
Ministries and agencies retain revenues collected from fees and other sources, rather than sending them on to the Treasury.	1	Require all revenues collected by government ministries and agencies to be deposited in accounts controlled by the Treasury	Ministry of Finance Public Debt and Treasury Directorates.	New regulations should provide a more transparent and reliable operational framework based on new agreements with the banking sector.
Establishment of a single unified account in the Treasury to handle all budgetary payments has not been completed.	1	Colombia should fully implement the single account for budgetary payments.	Ministry of Finance Public Debt and Treasury Directorates.	Full implementation of the SIIF system will be required, including direct payments to final providers.

Accounting				
Budget categories and Colombia's chart of accounts differ from international standards	**2**	Modify budget categories, chart of accounts to conform to international standards.	Accountant General.	The Government plans to simplify and consolidate its accounting plan to meet international standards.
The functions of the major budget oversight agencies—the Accountant and Comptroller Generals offices—overlap, and they do not provide timely, accurate, and complete information on public financial management.	**2**	Public financial management would benefit from assigning the budget consolidation function to the Accountant General. This would prevent overlaps with the Comptroller General and increase transparency by ensuring that all budget transactions were publicly recorded in a single institution. The Comptroller General, Colombia's supreme audit institution, would then audit the accounts to ensure that expenditures were proper.	Comptroller General and Accountant General.	This would require a Constitutional amendment. The two agencies have begun a dialogue to develop an integrated approach to budget and accounting information.
Fiscal Control				
The Comptroller General lacks the resources to exercise adequate external control over public financial management performance.	**2**	An institutional development program should be developed to strengthen the capacity of the Comptroller General to perform its duties at the national level	Comptroller General	While IDB is supporting a comprehensive program to strengthen the Comptroller's General's Office, further action is needed.

Public Debt				
Coordination among Treasury and other Finance Ministry units on public Debt remains insufficient.	2	Colombia should appoint a high-level committee to oversee public debt management and use the new fiscal responsibility and transparency law to strengthen oversight over sub-national debt.	Ministry of Finance Public Debt and Treasury Directorates.	This recommendation focuses on the advantages of creating a committee to improve debt management decisions, operational systems, and oversight.
Information Systems				
Government information systems are fragmented and not yet fully operational.	3	Integrate information/database systems and make all modules operational. Add PFM tools to SIIF and extend coverage to all government organizations.	Ministry of Finance and National Department of Planning	The Government plans to extend its information systems to make them more useful to provincial and municipal governments.
Information about the Colombian Government's financial plans and their execution is seldom easily available to civil society. Even government oversight agencies often find it difficult to find the information needed to judge performance.	3	Create a monitoring and evaluation system within the e-government program. This should focus both on software to facilitate this process, and on creating a new approach to budget preparation using programs as cost centers to allow quantitative and qualitative measurement against benchmarks.	Ministry of Finance, Comptroller General, and Accountant General.	One aim of the Government's ongoing Public Administration Renovation Program is to open government agencies and systems by making information on public financial management performance more easily available. Reforming systems that fail to monitor results is a Government priority.
Legislative Oversight				
Legislative over-sight of public financial management is weak.	3	Strengthen the Congressional oversight committee by providing it paid professional staff to analyze public financial management.	Congress	The executive and legislative branches should make joint efforts to provide Congress with additional resources to fulfill its oversight responsibility effectively.

Investment Tracking				
The National Planning Department lacks an efficient mechanism to program and track investment programs.	**3**	Establish in the National Planning Department a uniform public investment system for structuring and evaluating projects and following up their execution.	National Planning Department.	This will require integration and unification of several database/information management systems.
State-owned Enterprises				
State-owned enterprise budgets are subject to heavy government regulation —including siphoning off profits—that interferes with their investment programs and attempts to operate profitably	**3**	Redesign the budget and accounting regime for state enterprises to increase their autonomy.	Ministry of Finance Budget Directorate and Accountant General.	Government representatives on SOE boards should keep them in line with general government policies, while allowing them to work freely in a competitive national and international market environment.

Annex 1: List of Officials Met

Ministry of Finance	Alberto Carrasquilla Carlos Ernesto Lucio	Minister Advisor
Ministry of Finance – Public Debt	Carlos Alberto Rodríguez Hugo Valenzuela Gustavo Navia Carlos León	Director of Public Credit and the Treasury Subdirector of Operations Subdirector of Risk policies Risk Assessment Group Chief
Ministry of Finance - Budget	Carolina Rentería Diana Margarita Quintero Cuello Diego Luis Jaramillo	Budget Director
Ministry of Finance - Treasury	Gloria Inés Cortés Omar Sánchez Jorge Alberto Calderón	Vice-Minister
CONFIS	Álvaro Concha Javier Alberto Gutiérrez Maria Nidia Prieto Pedro Bejarano	Advisor Advisor Advisor Advisor
Ministry of Finance – Internal Control Office	José Elías Parra Parra	Internal Control Office Chief
Ministry of Finance - DAF	Ana Lucia Villa Rosita Sedano Morales Edgar Guio	Director Advisor Advisor
Ministry of Finance – SIIF	Maximino Sosa	SIIF Responsible party
Vice-Presidency of the Republic	Francisco Santos Bernardo Guerrero Lozano	Vice-President Anti-corruption Mission
Comptroller General's Office	Antonio Hernández Gamarra Elvia Mejía Luis H. Barreto N. Carlos E. Acosta M.	Comptroller Vice-Comptroller Delegate Comptroller for Public Economy and Finances Director of Fiscal Accounts and Statistics
Accountant General's Office	Jairo Alberto Cano Pavón Fabio Trompa	Accountant Sub-Accountant

National Planning Department	Santiago Montenegro Alejandro Gaviria Claudia Jiménez Oswaldo Rodríguez	Director Sub-Director PRAP Director Budget Director
National Congress	William Ortega Rojas	Presidential Representative to the Accounting Committee
Social Security Institute	Héctor J. Cadena Clavijo	President
FINAGRO Agrarian Bank	Luis Humberto Ramírez Barrios Omar Francisco Sánchez Mora	Executive Manager Technical Manager
BANCOLDEX	Luis Humberto Ramírez Barrios Omar Francisco Sánchez Mora	Executive Manager Technical Manager

Annex 2: Detailed Information on Budget and Treasury

Budget

Legal and Administrative Framework

Prior to Law 38 of 1989, which reformed the National Organic Budget Code (EOP),[34] Colombia's budget system was characterized by a spending capacity that was highly centralized at the national level and by the use of numerous prior external controls on budget management by those responsible for public spending.

After Law 38 and the new Constitution of 1991, the new regulations were marked by an aggressive policy of territorial decentralization of authority, functions and spending capacities, through an automatic system of budget allocations from the national level to the departmental and municipal levels and the complete elimination of the prior external controls on budget management by those responsible for ordering spending.[35] Consequently, the principal legislation governing Colombia's budget system consists of: (a) the National Development Plan, comprised of a general section and a plan for investments by national public agencies (Articles 339 and 346 of the Constitution); (b) the National Investment Plan issued by law or enacted via a statutory decree (Article 341 of the Constitution; (c) Decree 111 of 1996, which assigned authority under the Organic Budget Code by compiling Law 38 of 1989, Law 179 of 1994 and Law 225 of 1995; (d) Law 87 of 1993 on the National Internal Control System; (e) Legislative Act 01 of 2001 and Law 715/2001, which created and provided regulations for the General Participation System for Departments, Districts and Municipalities;[36] and (f) the general provisions of the annual National Budget laws that establish additional rules for the execution of spending appropriations.

In addition to the automatic transfers of the General Participation System, there are a series of transfers allocated prior to the budget formulation process, all based on specific laws, as seen in the details below from the National Public Budget Directorate. In addition to the legal inflexibility of the budget transfer appropriations, there are the appropriations allocated to servicing the domestic and foreign debt and, to a large extent, the inflexibility inherent in the costs of maintaining the national government employee payroll. Figures from the 2003 Budget reveal that this has all resulted in 95.8 percent of the total budget being inflexible and allocated in accordance with law, so that only appropriations for general spending and public investment are adjustable and free to be allocated and programmed in formulating the budget.

Since the mid-1990s, and particularly beginning with the recession crisis of 1998-1999, the growing inflexibility of budget allocations based on provisions of law has been accompanied by a restrictive

---

[34] There are two levels to the budget system: (a) the National Budget, which includes the three branches of the National Government, the Government Attorney's Office, the Comptroller General's Office, the National Office of Vital Statistics and the National Public Establishments, all governed by all the provisions of the Code; and (b) a second level that includes setting financial goals for the entire public sector and the distribution of the profits of the state-owned industrial and commercial companies.

[35] This involved elimination of the Delegate Budget Offices and the Institutional Audits of the Comptroller General's Office, which used to co-administer the budgetary process.

[36] At present, the automatic transfers are set for the transition period through 2008 at the amount of $10.962 billion Colombian pesos of 2001 and adjusted annually for the inflation rate, plus a real annual increase of 2 percent through 2007 and of 2.5 percent in 2008, apart from the fiscal economic evolution for those years.

macroeconomic and fiscal context[37] that required repeated fiscal adjustment programs that have also taken the form of legal and administrative provisions to regulate the budget process. This fiscal adjustment priority, even over the medium term, is addressed by Bill 230 of 2002 concerning changes to the Organic Budget Code, fiscal responsibility and transparency. It provides for integration of the Financial Plan and the public budgets and introduces quantitative rules concerning primary balances and sustainability.[38]

Current Budget Practice

The combination of (a) inflexibility in budget appropriations as a result of evolving legislation; (b) elimination of interventions and prior external controls in the spending process, which had to be replaced by systems of internal control whose effectiveness is presently doubtful;[39] and (c) recurring fiscal adjustment programs deriving from the macroeconomic evolution and expressed in quantitative rules, has generated a series of administrative practices that, although meant to be a legitimate defense of spending capacities, conspire against the transparency and effectiveness of the budget system, as seen in the following situations:

- Public entities tend to protect their spending capacities by using special laws to ensure predetermined resources and specific budget allocations. The result is an intensification of the inflexibility of appropriations, to the detriment of budget programming and the financial plan itself.
- Because of the appropriation deficit in relation to general spending and investment needs, entities pressure to have future spending commitments signed, with prior authorization from CONFIS, as provided for in Decree 111 of 1996, Article 71.
- The year's appropriations are fully committed even when the Annual Cash Program does not provide for funds to pay them.[40] Therefore, generating appropriation reserves –which are executed the subsequent year outside of the budget for the new period– is an ongoing practice.[41]
- Fiduciary contracts with financial entities have been developed so that the ordering entities can be sure of the total availability of a spending appropriation. Recently, with the governing agencies exerting greater control over fiduciary contracts, the executing entities have been making more use of inter-administrative cooperation agreements with autonomous public

[37] In 1997, the annual growth rate of GDP began to decline and GDP actually contracted in 1999 (-4.2 percent). The subsequent recovery has been slow: 2.7 percent, 1.4 percent and 1.7 percent for 2000, 2001 and 2002, respectively, and 2.5 percent expected for 2003 (Source: Central Bank review).

[38] The final draft of the bill is annexed and it is expected to be approved soon.

[39] All the officials interviewed said that the Internal Control System has been functioning satisfactorily.

[40] Law 734 of 2002 (Disciplinary System) made it illegal to make commitments exceeding the amounts approved in the Month-by-Month Annual Cash Plan (PAC). To reconcile this law with the fact that the Organic Budget Code allows for contracting commitments against the total appropriation while it is in effect, a 24-month PAC is being used in practice, to support a total spending commitment made.

[41] These appropriation reserves, along with cash reserves, i.e., spending that *was* executed but was still awaiting payment as of December 31, comprise what is known as "budget backlog." According to a presentation by the Director General of Public Credit and the Treasury, the inventory of central government backlog had reached 1 percent of GDP by the end of 2002 and had been 3 percent of GDP in 1999. Obviously, the annual variation in this backlog is added to the result of the effective cash operations to determine the fiscal result.

entities or international cooperation agencies, to which they issue the funds and thus consider the public budget to have been executed, which leads to the principle of spending under rules other than those of Colombia's public administration.

- The demands and pressures to set public spending appropriations do not end when the budget is approved. There are frequent additions to the budget towards the end of the year, to cover appropriation shortfalls, so that the final budget exceeds the initial budget by as much as 5 or 6 percent. This also tends to distort the programming tool and drives the detrimental phenomenon of budget backlog.

The five examples above illustrate the institutional rationale that Colombia's budget system has acquired, within a context of prevailing inflexibility and discrepancies between the levels of the Financial Plan and its consequent Payment Plan and the levels of the spending appropriations ultimately approved in the National Budget.

Within the prevailing budget rationale and the existing control environment, the legal limits that determine annual budget appropriations should not be exceeded. The practices described tend to distort and deform budgetary principles, which are also set down in law. The principles most affected are: a) the principle of Annuality (Law 38, Article 10); the principle of a Unified Budget (Law 38, Article 12); and the principle of Integrated Programming (Law 38, Article 13).

Impact of Budget Practice on PFM

Directing a budget system assumes that laws and regulations for the system will be enacted in a centralized manner, that the formulation process will be guided so that it reflects the priorities of government policy, and that execution will be monitored to provide feedback for the budget cycle. In Colombia, this guidance was traditionally a dual function performed by the Ministry of Finance Budget Directorate and the National Planning Department, who were jointly responsible for preparing the Annual Operating Plan for Investments and jointly adjusting the preliminary National Budget, while the general provisions regulating budget execution were the exclusive responsibility of the National Public Budget Directorate.

Within the two directing agencies, the growing process of territorial decentralization has led to a division of some governing functions and the strengthening of the Territorial Development Directorate of the National Budget Directorate with regard to programming and monitoring the General Participation System of Law 715/2001 and to the creation of the Fiscal Support Directorate under the Ministry of Finance Budget Directorate to execute the territorial financial reorganization program (Law 550/99). Furthermore, in terms of monitoring functions, the division of the guidance role has included implementing the Territorial Information System Strengthening Program (FOSIT) directly under the Vice Minister of Finance, and the SINERGIA Program Directorate for management indicators and public investment results, under the National Budget Director.

Obviously, the excessive division of guidance functions requires additional sophisticated mechanisms for coordinating and integrating the information systems used by the central levels of the state.

To judge by the frequency with which the National Fiscal Policy Council (CONFIS) meets, the number of regulations it produces and the technical guideline documents it issues, in terms of coordination within the guidance function, this Council seems to have given way to more direct and informal mechanisms for coordination.

There is no integration of information systems for formulating and monitoring the budget because the only transactional information system that is in operation at present for budget matters is the Central Government Information Management System (SIIF), which efficiently covers the financial execution, but still lacks the modules for formulation, personnel, procurements and administration of goods and services and has only been implemented within the central government entities (GOC) and not even in the national public establishments. The other information systems provided for, such as FOSIT, SINERGIA, BPIN and SINAGEP, are not fully operational.

The present status of guidance is evident in the fact that the National Budget is not providing adequate information on programs, activities and projects and in the fact that the Government's priority investment projects are monitored through inexact and inefficient manual mechanisms for gathering data and preparing information.

Government authorities are aware that the budget system in its present form has collapsed in terms of flexibility, coordination with the financial plan, the possibility of including priority programs, activities and projects, the existence of monitoring information that compares the costs and results of actions, and, lastly, timely evaluation of public spending (all basic requirements) and needs an overall reform. This is why reform of the system is included in the Public Administration Renewal Program as one of the eleven crosscutting reforms currently being designed and executed.

Private Sector Perception of PFM

Within the context described above, the most widespread perception, at least among those related to public investment projects executed under the National Budget, would seem to be that compliance with budgets and work schedules is impossible due to the complexity and conditions of the budget execution process.

Treasury

Legal and Administrative Framework

The Public Credit Directorate and the National Treasury Directorate of the Ministry of Finance and Public Credit is the governing agency for the treasury system and disburses the payments for the required spending, against the National Budget.

The Constitution and the Organic Budget Code (Law 38 of 1989, Law 179 of 1994, Law 225 of 1995) compiled by Decree 111 of 1996) have established the principles that govern management of the Treasury. These are basically: centralization of funds, the constitution of a Single Account against which expenditure payments are made, performance of short-term financing operations, and management and investment of liquid funds.

Legislation governing management of the Treasury underwent a substantial change when Law 225 of 1995 assigned it the function of administering the Month-by-Month Annual Cash Plan (PAC)[42] formerly exercised by the National Budget Directorate in coordination with the National Planning Department. With this change, the Treasury strengthened its financial management authority and integrated all responsibilities in handling liquidity.

According to present legislation, to administer its assigned Annual Cash Plan, the Treasure receives two mandates in each fiscal period: (a) the annual payment goals provided by CONFIS, in function of the Financial Plan; and (b) the Appropriations Law for National Budget Spending. The year's PAC is prepared and approved based on these two pieces of legislation and the scheduling by the executing entities.

---

[42] "The PAC is a financial instrument used to define the maximum monthly amount of funds available in the National [Treasury] Single Account to finance the appropriations of the bodies financed with national funds and constitutes the maximum monthly goal for payments of the public establishments nationwide with regard to their own revenues (their own funds), in order to meet their commitments." Decree 111-96, Article 73, Point 1, and Decree 0630-96, Article 1.

The funds from the National Treasury come through banks from the collection systems of the National Department of Tax and Customs (DIAN) and from the credits from disbursements of the internal and external credit and the deposit of other current and capital income, all of which forms the Single National Account, not including exceptions established by law, such as the Special Funds.

Current Treasury Practice

An adequate control environment has been evident in the Treasury, principally as a result of the implementation and operation of the central government information management system (SIIF), which, based on the burden of institutional budgets, presently allows for administering the PAC sub-processes, spending commitments, obligation or accrual of expenditures and ordering of their payments, plus the generation of information on budget execution and financial and asset accounting.

SIIF is presently operating almost all the central administration budget in real time, which represents 87 percent of the National Budget spending. The remaining 13 percent consists of the decentralized budget of the public establishments that have their own income administered through independent treasuries.

The administration of the PAC is highly sensitive due to its significance as a mechanism through which entities can execute and pay expenditures and it is being done by means of the goals and criteria set by CONFIS. Due to the characteristics of some budget laws that allow for generating annual spending backlogs that can be paid during the next budget period, outside of the budget year, the annual goals of CONFIS do not differentiate between payment of backlogs and the payments of the current year, giving rise to the scheduling problem explained below.

The Treasury assumes the annual goal of payments and must deduct outstanding payments from the appropriation reserves and cash at the close of the previous year. Although the Central Government Information Management System (SIIF) provides it with timely information on the amount of these backlogs, the constitution of appropriation reserves is regulated like a procedure involving the Budget Directorate and the Comptroller General's Office, so the amount deducted for this purpose from the annual payments goal is held in reserve until the backlog is formally accounted for. At that time the PAC corresponding to the backlogs is approved.

Having made these calculations, obviously, the net amount of the annual goal of payments available for the current year is usually insufficient to cover the total amount of appropriations for that year, making it necessary to prioritize the PAC allocation in function of criteria established in the same CONFIS document that reports the goals.[43]

When the PAC for the current year is approved, the entities begin the process of budget execution, which is done throughout the entire National Budget, in strict compliance with the Budget and the PAC. Because legislation allows for committing to appropriations to be executed in two budget periods (in the year following the year the commitment is made in the form of a budget backlog), the PAC administered by the entities consists of 24 months, i.e., until December 31 of the subsequent year. Therefore, the PAC tool has three parts: one for the backlog to come, one for the current budget period, and one for the following budget period. This is the result of legislation that is not firm on the principle of budget annuality and does not prevent making payments without budget coverage in the years in which they are made.

[43] These criteria are explicit and include parameters such as fulfillment of 100 percent of the General Participation System appropriations, so that the PAC availability for other appropriations of the budget period is even tighter.

The IMF also cited this issue.[44] It recommended changing the definition of the budget appropriation authorized by Congress so that the appropriation approved corresponds to the maximum limit of obligations and payments. This would recover the principle of budget annuality, it would recapture the principle of real budget among entities in contracting commitments and obligations in the budget year in accordance with the availability of funds, and would significantly reduce the creation of a new budget backlog.

The section on the close of the business year will analyze possible measures for dealing with both the amount of uncommitted appropriations and the amount of appropriations committed but not obligated at the close of the business year. The Organic Budget Code establishes that after December 31 of each year the appropriations included in the National Budget will expire and so they cannot be committed, added, transferred or counter credited. However, the Organic Budget Code allows every entity at the close of the business year to constitute budget reserves (with the commitments not met by December 31) and accounts payable (with obligations not paid by December 31) that can be executed during the following year without affecting the budget credits assigned in the following year's budget. Both the budget reserves and the accounts payable must be constituted by the agency ordering the expenditure of each executing body no later than January 20.

Although the SIIF still does not have the module that allows it to make electronic deposits to a creditor's bank account, so that a record is made at the time the payment is ordered, and although its technological platform requires migration and development of complementary modules for such things as personnel, administration of goods and services and procurements, the tool has unquestionably permitted a greater transparency, discipline and order in handling the National Budget by the entities and by the National Treasury, all supported by the following principal characteristics:

- Because it is a management system that the entities are required to use in executing their budgets, provision of transaction data in real time is assured.
- Its architecture of centralized bases and network distributed processing ensures the synchronization and timeliness of data and reports.

Impact of Treasury Practice

Within the treasury functions directed by the Treasury, the following problematic aspects have been identified.

- The treasury system shows evidence of inconsistencies arising from the budget system legislation that results in three budget periods co-existing within the annual schedule of payments, for which CONFIS sets the goals. This legislation should be revised in function of

---

[44] Fiscal Transparency, ROSC, and the study entitled *Colombia: la Reforma del Estatuto Orgánico del Presupuesto* (Colombia: The Organic Renewal of the Budget), Julio Viñuela, Maria Albino, Alberto Espejo and Gustavo Ortiz.

This possibility of constituting a budget backlog, along with the practice of formulating unreal budgets, has generated a growing proportion of commitments that are deferred to the following budget period. The budget backlog has in fact amounted to between 2.5 percent and 3 percent of GDP in recent years. This size has become unmanageable to the point that some years the investment payments goal planned by CONFIS has come very close to the amount needed to meet outstanding commitments from the previous year. This passive tolerance of the budget backlog undermines fiscal discipline, is detrimental to providers and sometimes forces them into debt. This scheme has also generated considerable overruns in State operations and has significantly affected not only the administration of the entities, but budget transparency as well, so that the annual budget is actually executed biannually.

transparency and consistency between the Financial Plan, the Current Year Budget and Annual Payment Goals.[45]

- For detailed information on funds, the SIIF, and consequently the Treasury's directing function, suffer from a delay of close to two months between the time taxpayers pay their taxes at the bank and the time the Treasury, via the DIAN, receives the budget breakdown from those payments. This delay is attributable to the tax administration's tax collection systems and to the agreements that the tax administration has signed with banking entities.[46]
- Because the SIIF module has not been implemented yet, it has been difficult to reduce the large number of bank accounts to which payments are made and eliminate check handling, which significantly impairs the internal control environment of budget execution.
- Because some SIIF modules are not yet developed, the entities continue to use administrative and accounting packages that are not integrated with the financial administration, requiring parallel records and reconciliation of figures that affect the informational transparency of budget management.
- Handling of the National Treasury's (required or market) portfolio investments is determined by policies and criteria that, although properly documented and supported, are not widely known among the public.
- The Treasury performs its function of inter-institutional coordination by means of CONFIS, in which the agencies directing public investment and finances are represented. As a result, detectable coordination problems are attributable to the level of efficacy of that policy synchronization mechanism.
- Lastly, the entire handling of the approval and modification of PACs is properly documented in minutes and annexes and available to all internal and external control agencies in the public administration.

Private Sector Perception of Treasury Practice

In the context described above, the most widespread perception among the officers interviewed agrees that Treasury management displays a high degree of professionalism.

---

[45] According to figures for 2002, the cost of clearing an historical backlog in an annual budget could be 1 percent to 2 percent of GDP.

[46] Most of the tax returns responsible for revenues collected are not filed electronically. The collecting banks receive the paper return and put it into electronic media themselves. All the services provided by the collecting banks are paid for based on a pre-arranged number of days between payment by the taxpayer and the credit to the Treasury accounts, plus the time taken to provide the support information to the DIAN.

Annex 3: Financial Institutions and Second-tier Banks

Foreign Trade Bank – Bancoldex

Legal And Administrative Framework

Bancoldex is a nation-wide semi-public enterprise, organized as a bank credit institution linked to the Ministry of Foreign Trade. The bank's main purpose is to finance activities related to foreign trade. Because it is organized as a banking institution, it is authorized to undertake all operations and activities allowed to commercial banks, and to discount loans granted by other financial institutions or to acquire their portfolios. Such broad authorization to perform all banking operations entails a significant risk considering that the bank is generally authorized to perform the first-tier operations of a commercial bank. This means that, although it specializes in second-tier operations, the bank could, at any time, grant direct loans (rather than through financial intermediaries) as a result of a decision of the administration and/or national government. In matters of risk, first-tier credit operations differ from second-tier operations in that the bank and its capital would be exposed to a greater credit risk than entailed in operations with credit institutions overseen by the Banking Superintendency. In addition, Colombia's experience[47] has demonstrated that the first-tier portfolio of public financial institutions has a greater tendency to deteriorate than that of private institutions.

As opposed to the other banking establishments, Bancoldex is authorized to directly perform fiduciary operations, especially for the purpose of promoting exports. In providing this service, the bank is a partner in Fiducoldex, a fiduciary corporation administered by Proexport as an autonomous asset.

According to the Organic Code of the Financial System, Bancoldex is subject to inspection and oversight by the Banking Superintendency, which is the supervisory, oversight and control authority. The Banking Superintendency is also the authority in matters of accounting, so Bancoldex observes all the accounting standards issued by the Superintendency, releases financial information in compliance with that agency's guidelines and must meet all the prudential regulation standards it issues.

Level Of Compliance With Standards

On the whole, Bancoldex observes the standards applicable to it as a financial institution within the provisions established by the external control authorities such as the Fiscal Inspector's Office and the Banking Superintendency, while at the same time meeting the requirements of the Accountant General's Office with regard to reporting complete financial information in the format designed for the purpose by that office.

According to the opinion of the Fiscal Inspector's Office (KPMG) for 2001 and 2001, Bancoldex's accounting was found to meet applicable legal and accounting standards, its administrative acts and operations are in line with its bylaws and the decisions of shareholders meetings, there are appropriate measures for internal control, conservation and custody of fixed assets, and it has met the standards established by the Banking Superintendency with regard to portfolio qualification and rating and particularly with the first and second phase of the Credit Risk Administration System (SARC).

Governability and Effects

The nature of Bancoldex as a second-tier public financial institution means that the public sector has a role on its Board of Directors and at its Shareholders Meetings, influencing the institution's financial

---

[47] Public banking crisis in the late 1990s.

decisions. One example of this is the national government's decision to initiate the process of liquidating the Institute for Industrial Promotion (*Instituto de Fomento Industrial – IFI*) by transferring second-tier assets and deposits from the public and Spain's International Cooperation Agency (*Agencia Española de Cooperación Internacional – AECI-ICO*) to Bancoldex. This decision has involved introducing a new element into the bank's mission: service to industrial and commercial sectors by channeling rediscount funds to large, medium, small and micro-enterprise companies. Financing of micro-enterprise involves introducing a new technology for assessing intermediaries that helps evaluate the risk of organizations not overseen by the Banking Superintendency such as some cooperatives and NGOs offering credit to micro-enterprise. The bank has also had to increase its staff to 182 individuals by bringing in IFI personnel (22 people) who are specialists in handling this line.

In addition, Bancoldex had to receive the IFI's liabilities to the public (taken in through the CDT) and to honor that debt with the recovery of the second-tier portfolio it received. It is important to bear in mind that Bancoldex is authorized to take in funds from the public just as a commercial bank does, which is why it had begun such operations even earlier for financial reasons.

Direct government intervention in the financial situation of Bancoldex has been evident in the fact that the institution has repeatedly had to distribute its profits after constituting the reserve fund required by law. Consequently, the bank has not been able to retain a surplus to undertake special activities or to strengthen its capital. However, it is important to note that Bancoldex (before the transfer from the IFI) was one of the soundest and least leveraged of institutions in the Colombian financial system (include solvency margin ratio). This means that it could perform the same activities with less capital, making more efficient and optimal use of its funds.

In any event, the profit distribution ordered by the national government has induced the institution to adopt less than transparent practices in order to retain its surpluses, such as raising the general loan portfolio provision from the 1% required by the Banking Superintendency to 2%. Note that because it is a second-tier bank, the general risk of its portfolio is lower because it involves financial institutions that are under supervision.

The Agricultural Financial Fund – Finagro

Legal and Administrative Framework

Law 16 of 1990 created FINAGRO as a nation-wide semi-public enterprise linked to the Ministry of Agriculture, with its own capital and administrative autonomy. It replaced the Agricultural Finance Fund (*Fondo Financiero Agropecuario – FFAP*), which had been the institution in charge of channeling development funds to the agricultural sector and was administered by the central bank within the directed credit policy in force at the time.[48]

FINAGRO's corporate purpose[49] has been defined as the financing of production and marketing activities in the agricultural sector through rediscounts of operations performed by the institutions of the National Agricultural Credit System (SNCA) and other financial, fiduciary and cooperative institutions authorized by the Banking Superintendency. It was also authorized to enter into agreements with those institutions, with the possibility of agreeing to shared risk with the institution that takes the rediscount.

[48] Under the new Constitution of 1991, the central bank is to focus its activities on monetary policy, so it handed over management of all the development funds it had been administering.

[49] Initially defined by Law 16 of 1990 and later amended by Law 101 of 1993.

The Ministry of Agriculture and Rural Development holds 60 percent of FINAGRO's capital, 29.5 percent is held by the Banco Agrario and Bancafé and the remaining capital is held by BBVA as a member institution of the National Agricultural Credit System.[50] FINAGRO is directed and administered by its shareholders, its board of directors and its president, who is its legal representative. FINAGRO's board of directors is comprised of the Minister of Agriculture or his delegate, two representatives of the shareholders, one representative from the agricultural sector's trade associations, one representative of the small farmer associations and the Director General of Planning of the Ministry of Agriculture (a non-voting director).

FINAGRO was organized as a credit institution overseen by the Banking Superintendency and authorized to take in funds through the issue of securities, undertake foreign credit operations, undertake rediscount operations with the institutions comprising the National Agricultural Credit System and other banking and financial institutions overseen by the Banking Superintendency, and to enter into trust agreements with institutions authorized by the Banking Superintendency.

It manages national government programs such as the Rural Capitalization Incentive (ICR), the Forestry Incentive Certificate (CIF) and the Coffee and National Refinancing Programs (PRAN). It also administers the FAG.

The main source of FINAGRO funds are the forced investments required of all credit institutions, in proportion to their liabilities subject to reserve requirements, to be made in FINAGRO securities with a lower-than-market return. In fact, credit institutions must make quarterly investments in Class A agricultural development bonds (TDAs) with a fixed term deposit rate of –4 and Class B agricultural development bonds with a fixed term deposit rate of –2, whose funds are channeled to finance small producers and medium-to-large producers, respectively.

Under the Organic Code of the Financial System, FINAGRO is subject to the inspection and oversight of the Banking Superintendency as the supervisory, oversight and control authority. The Banking Superintendency is also the authority in matters of accounting, so FINAGRO observes all the accounting standards issued by the Superintendency, releases financial information as required by the Superintendency and must meet all the prudential regulation standards issued by that agency. FINAGRO is not subject to the forced investment and reserves system applicable to the other credit institutions, including Bancoldex, which is subject to reserve requirements.

Level Of Compliance with Standards

Like Bancoldex, FINAGRO is subject to the legislation governing the Colombian financial system and contained in the Organic Code of the Financial System,[51] which also includes the special regime for FINAGRO and the National Agricultural Credit System (SNCA) as a special credit system. FINAGRO is subject to the inspection and oversight of the Banking Superintendency as the supervisory, oversight and control authority. As opposed to Bancoldex, FINAGRO is not registered in the deposit insurance system because it is not authorized to take in funds directly from the domestic market through savings instruments. FINAGRO is only authorized to take in funds from the domestic market through the issue of securities with authorization from the central bank. It is not subject to the forced investment and reserve system applicable to the other credit institutions.

---

[50] This shareholding arises from its specialized operations in the agricultural sector as the Livestock Bank (*Banco Ganadero*).

[51] See previous chapter.

On the whole, FINAGRO observes the standards applicable to it as a financial institution within the provisions established by the external control authorities such as the Fiscal Inspector's Office and the Banking Superintendency, while at the same time meeting the requirements of the Accountant General's Office for the reporting of complete financial information in the format designed for the purpose by that institution. The fund is also 94% in line with the improvement plan defined by the Comptroller General's Office.

Even though it has, to some extent, achieved its objectives of channeling rediscount funds to the agricultural sector, it has not been entirely successful because rediscounts are not always appropriate as the principal instrument for achieving this objective when there are market failures and high risks that obstruct access to credit by sectors such as the agricultural sector. In fact, the focalization of FINAGRO funds (and funds from any second-tier bank) depends on access to bank credit by beneficiaries of government policy. In the agricultural sector, access difficulties are not only due to market failures, but also to the presence of risks typical of the agricultural sector[52] that raise the credit risk beyond what the financial system is willing to assume. Rediscounts as such do not help to resolve these problems, not even when backed by the guarantees from the Agricultural Guarantee Fund, because there is no sharing of the risk among the agents with the capacity to assume it.

Furthermore, many of the financial and amortization conditions of FINAGRO credit lines are specified for specific crops or activities and cannot be adapted to other agricultural activities. This can even raise the credit risk when the cash flow of the financed activity is not in line with the cash flow defined by the FINAGRO loan.

In addition to these difficulties that FINAGRO faces in pursuing its mission objectives, an additional social cost is entailed in its form of financing based on forced low-return investments, which introduces considerable distortions into the financial intermediation process of the entire economy. As discussed below, part of the funds from the investments cannot even be placed in rediscounts, but instead is invested in securities issued by the Treasury.

Governability and Effects

As seen in FINAGRO's institutional framework, the definition of the Fund's financial strategy depends entirely on the CNCA, but also partly on the central bank when it comes to defining forced investments and interest rates. This system arose out of the need to minimize the negative impact of forced investments at the time and to maintain control of their distortion effect on the financial market. However, in practice, the plan to gradually raise the return on the agricultural development bonds (TDAs) has not taken effect, inasmuch as the demand for FINAGRO rediscount funds is lower than cumulative forced investment funds. In fact, the demand for rediscount funds from FINAGRO (or from any second-tier bank) depends on the first-tier intermediaries, which are the ones who ultimately decide who will have access to credit. The less agricultural credit granted, the less FINAGRO funds will be in demand. In the late 1990s, with the liquidation of the Agrarian Credit Society (*Caja Agraria*), the demand fell substantially, producing an accumulation of excess liquidity in FINAGRO because its surpluses depend on the behavior of the funds taken in by credit institutions. In view of this situation, the central bank board of directors created a mechanism for adjusting investments to FINAGRO's need for funds, which was in effect until 2001. In 2002, surpluses accumulated again.

---

[52] Technical, market and public order risks. These are described in detail in:

Marulanda Consultores Ltda., *Análisis Financiero de las Alianzas Productivas para La Paz*, DNP, September 2000.

It would appear that the Fund is not autonomous, but the composition of the CNCA is practically the same as its board of directors, so there is little real difference. In practice, due to the way in which the CNCA functions, decision-making depends considerably on FINAGRO as technical secretary. Therefore, the existence of the CNCA could be redundant.

On the other hand, although the SNCA was closed for the purpose of reordering financing mechanisms toward the agricultural sector through a single credit channel (FINAGRO), in practice the Ministry of Agriculture has been found to be handling loan programs, which generates disorder and lack of coordination in agricultural credit policy.

Just as in the case of Bancoldex, less than transparent practices have been evident in FINAGRO that allow it to retain profits by establishing high provisions even though it is a second-tier bank.

Lastly, financing of FINAGRO operations through forced investments is a mechanism that reduces the transparency of the financial intermediation process in general and its impact on FINAGRO achieving its objectives is not very clear. In effect, forced investments constitute a subsidy by the financial system that raises the margin of intermediation and the cost of credit throughout the whole economy and it is not clear whether the full purpose of the investment is achieved. The channeling of subsidized funds to small, medium and large producers is not in keeping with the magnitude of the corresponding investment and it is doubtful whether the large producers need a subsidy (include figures). FINAGRO's excess liquidity has been partially invested in TES.

Agrarian Bank of Colombia

Legal and Administrative Framework

The Agrarian Bank of Colombia is a nation-wide semi-public enterprise, subject to the state-owned industrial and commercial company system, linked to the Ministry of Agriculture and Rural Development. This bank was created in June 1999 following the liquidation of the Agrarian Credit Society and the transfer of that institution's sound assets and liabilities to Sociedad Financiera Leasing Colvalores S.A., which was immediately converted into the Agrarian Bank.

The purpose of the Agrarian Bank is to carry out the activities of a commercial bank, directing its loan operations towards financing rural, agricultural, fishery and agro-industrial activities and the activities of territorial entities. The bank's objectives also include providing financial services to towns lacking a banking institution. It can also enter into payment and collection agreements, contract to operate offices with other credit institutions and agree to share premises with other public agencies in municipalities where there is no other credit institution.

The Agrarian Bank took over the activities of the former Agrarian, Industrial, and Mining Credit Society that was founded in 1930 and after 63 years of operation had to be taken over by the supervisory and control authorities. The Credit Society had been able to cover a broad portion of Colombian territory thanks to its approximately 850 offices.

Loan Operations

- No less than 70 percent of its new loan operations are aimed at financing rural, agricultural, fishery, forestry and agro-industrial activities.

- No more than 30 percent of its new loan operations are aimed at financing territorial entities and activities other than those mentioned above, providing that the board of directors authorizes the operations, with the attendance and favorable vote of the ministers of Agriculture and of Finance and of the director of FOGAFIN or his delegates.

- In each loan operation structured and granted in the form of a syndicated loan or another similar form, the bank's credit risk cannot exceed 33 percent of the respective operation amount.

- Loans to a territorial entity may not exceed the equivalent in pesos of one thousand (1,000) times the legal minimum monthly wage current at the time the operation is approved, including all balances involved. Syndicated credit operations are not subject to this limit.

- In loan operations guaranteed by the Agricultural Guarantee Fund or by the agency acting for it, the Bank's credit risk may not exceed 20% of the operation. The amount of the operation not guaranteed by the Fund must have guarantees that the Bank considers admissible or sufficient, in accordance with the pertinent regulations issued by the board of directors.

- Loan operations to individuals or legal entities and which are different from the operations described in the preceding points may not at any time exceed the equivalent in pesos of one thousand (1,000) times the legal minimum monthly wage current at the time the operation is approved, including all balances involved. As backing for these operations, the Bank may accept guarantee certificates issued by the Agricultural Guarantee Fund, with a coverage of under eighty percent (80%) of the value of the loan.

- The limits set by this article on the Bank's loan operations do not apply to Treasury operations, the scope, limits and guarantees of which are established by the board of directors.

- The restructuring of the Bank's loan operations are not subject to the foregoing guidelines, but are carried out in accordance with the regulations issued by the board of directors.

Level of Compliance with Standards

The Agrarian Bank is subject to the legislation governing the Colombian financial system and contained in the Organic Code of the Financial System, and is subject to the inspection and oversight of the Banking Superintendency as the supervisory, oversight and control authority. As a first-tier banking institution, it is authorized to undertake all corresponding financial operations, it is registered in the deposit insurance system, it is subject to the reserve system although it is not required to make forced investments in FINAGRO securities because, as a member of the National Agricultural Credit System, it must aim its portfolio directly at the sector.

On the whole, the Agrarian Bank observes the standards applicable to it as a financial institution within the provisions established by the external control authorities such as the Fiscal Inspector's Office and the Banking Superintendency and also meets the requirements of the Accountant General's Office on reporting complete financial information in the format designed for the purpose by that institution.

Nevertheless, the Agrarian Bank has not been adequately meeting the objectives of its mission because, due to the circumstances of its creation and the financial fragility entailed, the funds it takes in from the public are not directed towards providing financial services for rural activities, but rather to investment in treasury bonds. Although this trend did decline in 2002, following the discoveries of the Comptroller General's Office in 2001, there is still a marked diversion of funds towards investments. In addition, most of the funds allocated to financing come from the rediscount in FINAGRO and are aimed especially at financing working capital, a short-term activity par excellence and therefore easy to finance with the Bank's own funds. However, the existence of high risks in the agricultural sector make this financing difficult and actually hinder it in the case of the Agrarian Bank because the Bank must ensure it is sustainable, unless it is done through rediscount funds (for reasons of return) and with the guarantee of the FAG.

Governability and Effects

The board of directors is comprised of public servants who do not necessarily meet the requirements established for members of the board of directors of a credit institution.

Administration of programs such as the VIS subsidy could entail operating costs not clearly specified.

Service in areas where there are no other credit institutions. Offices with low or negative profitability that are on the Bank's profit and loss statement as long as there is no legislation to require the national government to cover these costs.

Guaranteeing availability of cash where no other state agency is present. High costs of handling cash in the remote areas the bank is supposed to service. These costs can be high and this function is more appropriate to the central bank.

Special programs defined by the national government to service conflict zones can alter the development of the bank's financial activity aimed at achieving the bank's financial sustainability.

The national government's demand for funds kept the bank from using its cumulative profits to grow stronger because they had to be distributed when the 2002 balance sheets were finally approved. Its capital is comprised of FOGAFIN securities and retaining profits could have strengthened it and avoided potential liquidity problems.

Under the Organic Code of the Financial System, the Agrarian Bank is subject to the inspection and oversight of the Banking Superintendency as the supervisory, oversight and control authority. On the whole, the financial entities under the oversight of the Banking Superintendency must observe the provisions issued by that entity in matters of registration and release of its financial statements based on the PUC. Balance sheets and income statements are generated daily and released to the public once a month through the Banking Superintendency's website. These balance sheets are available there as of the 10th of the following month. The financial information for intermediate periods or for the business year, which is generally always audited, is available within the thirty days following the close of the month as required by the Banking Superintendency. Again, as in the cases of Bancoldex, FINAGRO and the rest of the financial sector, these measures do not necessarily guarantee effective citizen control due to the lack of market culture knowledgeable about financial operations that are inherently sophisticated.

Although the legal framework meant to guarantee transparency in financial information and the use of state funds and public savings is sufficient and appropriate, in the case of the former Agrarian Credit Society application of the regulatory framework was apparently defective, with repercussions that are still affecting the Agrarian Bank today. In effect, although the Society was also obligated to observe the regulations and accounting standards of the Banking Superintendency, this did not prevent an inadequate reporting of the economic facts, which later hindered the process of purging the loan and deposit accounts received by the Agrarian Bank.

In addition, because it is a semi-public enterprise, the Agrarian Bank must send reports of its financial situation to the Account General's Office. These reports are generated manually each quarter through a process of comparing the figures reported to the PUC of the Banking

Superintendency in accordance with the Superintendency's accounting standards, with those reported to the PUC established by the Accountant General's Office.

Lastly, the Agrarian Bank is subject to the control of the Legal Accounts Commission and of the Comptroller General's Office, which is responsible for overseeing the fiscal management of the State. This also includes exercising control of finances, management and results, on the basis of efficiency, economics, equity and an assessment of the environmental costs.

Annex 4: Comparative Analysis of Budget and Treasury Arrangements in Nine Latin American Countries, UK, US, Canada, and Spain

The table at the end of this annex, prepared by the CFAA team and included in the report at the request of the Colombian Government, compares the budget and treasury organizational models of 13 countries. Each country's fiscal institutions respond to historical processes, some of which evolved after many centuries and should not be considered as ideal types but concrete regimes that undergo regular adjustment processes to improve their functionality.

In countries where government institutions follow Anglo-Saxon traditions, organizational structures are not linked to economic and social development planning but are predominantly related to financial management (Canada, United States and United Kingdom).

In the sample, the countries with higher development levels (Canada, United States, United Kingdom and Spain) have very large domestic capital markets, which have led the governments to behave as one more agent in search of financing to cover its deficit. Consequently, public debt management is within the competence of the financial management departments of the structures that administer the public treasury.

In less developed countries, weak capital markets led to the development of public credit units separate from the treasury that specialize in negotiating and placing loans overseas, in particular with multilateral development banks and through bilateral relationships with countries and other agencies.

The reforms launched in less developed countries in the 1990s eliminated monetary financing by central banks and boosted domestic capital markets based on public treasury bonds. This multiplied treasury and public credit directorate credit instruments to the point that it became difficult to manage and control public debt. This led some countries (Bolivia) to unify debt management under the national treasury, and most countries in the sample have unified responsibility for formulating and administering the execution of the public budget under a single ministerial institution (United Kingdom, Argentina, Mexico, Chile, Peru, Bolivia, Ecuador, El Salvador and Paraguay).

Among the countries where responsibility for formulating and administering budget execution is separate, (United States and Brazil), the agency in charge of budget formulation has a horizontal relationship to other administration systems, such as personnel, procurement, and information technology (the U.S. Office of Management and Budget and Brazil's Ministry of Planning, Budget and Management).

Two other countries separate responsibility for the formulation of budget execution. In Canada, the finance department formulates the budget and at the same time exercises functions related to the financial system, including the central bank, which belongs to it, while the treasury exercises budget financial management once the budget is approved. In Spain, the Ministry of Economy has ample competencies in terms of revenues, expenditure control, and the management of treasury and financing, with ample faculties related to regulation and interventions in the country's commercial and financial systems.

Once public budgets are approved, almost all of the countries in the sample put budget programming and execution tools, mainly cash plans, in the hands of the financial management departments in charge of the public treasury, without the intervention of the unit that formulated the budget (Canada, United States, United Kingdom, Spain, Brazil, Mexico, Chile, Bolivia, Ecuador and Paraguay).

In Argentina and Peru the responsibility for programming budget execution is shared by the treasury and budget general directorates, while in El Salvador the formal responsibility to approve annual cash programs belongs to the budget directorate. Since the 1970s most countries in the region developed public investment systems and project banks under the governance of central economic and social development planning organisms. This fact responded to the concept of the public budget as a development plan tool, and to the demand from multilateral banks to have hierarchical inventories of public investment projects to facilitate the placement of funds through a central agency.

In the 1990s, development planning methodology was changed and master plans were replaced by strategic guidelines that oriented the operational plans of government agencies and executing units. Simultaneously, multilateral banks changed the profile of their placements in the region, substituting global loans disbursed in tranches in accordance with agreed sector policies for investment project loans. For most of the countries in the region, the consequence of these trends was the migration of information systems on public investment projects from planning organisms to the ministries of economy or finance to integrate them with budget processes, as is now done in Argentina, Mexico, Chile, Peru, Bolivia, Ecuador, El Salvador and Paraguay.

Chile is the only country in the sample that assigns tax collection responsibility to the public treasury, leaving fiscal and control functions over taxpayers to specialized tax administration units. In all the other countries, the ministries of economy or finance have specialized dependencies for internal taxes and customs, with a growing tendency to merge them, as is the case of Canada, United Kingdom, Spain, Brazil, Argentina, Mexico, Peru and Ecuador.[53]

These comments present most of the concepts that underlie the recommendation to transfer all budget formulation competencies from the National Planning Department to the Ministry of Finance's Budget Directorate, placing all budget execution programming mechanisms in that ministry's Treasury Directorate, and integrating all public debt management into the Treasury Directorate.

Obviously, the strategic definitions in terms of the institutional development of the public financial administration should be subject to the review and decision of those who are responsible for anticipating the PRAP launched by the Government. The present complementary report is aimed at providing more background for the discussion on the subject.

Relevance to CFAA Recommendations for Colombia's Budget and Treasury

These comments present most of the concepts that underlie the recommendation of the 2004 Colombia CFAA to (a) transfer all budget formulation competencies from the National Planning Department to the Ministry of Finance's Budget Directorate; (b) eliminate CONFIS as the Superior Council and transferring responsibilities for preparing the financial plan to the Macroeconomic Directorate of the Ministry of Finance's Budget Directorate and those having to do with collective decisions on budget policies and projects to CONPES; (c) maintain and enhance the budget execution programming mechanisms in the hands of the financial administration of the Treasury Directorate; and (d) integrate all public debt management into the Treasury Directorate.

In support of these ideas and with regard to the status of public finances in Colombia, it bears repeating that: (a) financing by means of treasury bonds and general sector loans now accounts for almost 90 percent of the fiscal deficit; (b) the decentralization of the autonomous territorial entities changed them into executors of most of the public investment entailed in the National Budget; (c) the successful experience of the National Treasury's administration of the Annual Cash Plan, using the SIIF tool makes its institutional maintenance and continuity advisable; and (d) the budget formulation process through two governing agencies is highly complex and has time schedules and procedures that work against the transparency and efficiency of the project.

[53] In more developed countries, this was demanded by taxpayers in search of a single window, and historically it stems from the specific ministries and organisms responsible for collecting customs duties and excise taxes.

Obviously, the strategic definitions for the institutional development of public financial administration must undergo analysis and decisions by those responsible for furthering the PRAP undertaken by the Government. This annex attempts to provide a background for purposes of discussion on the matter.

Comparative Analysis of Public Financial Institutional Arrangements in North and South America, Spain and Great Britain

Country	Budget Policy Prior to Formulation	Budget Formulation and Draft Preparation	Programming of Execution	Budget Execution, Management and Control	Public Debt and Financing	Comments
1. Canada	Finance Ministry, through its Finance Dept., advises Government on economic and fiscal policy.	Ministry of Finance through its Finance Department prepares federal budget and formulates fiscal policy, including taxation.	Treasury Board with a chairman and vice-chairman who is minister of finance. The board has a secretariat with administrative functions.	The treasury board and secretariat for federal government spending. The finance dept is responsible for handling regional transfers.	Bank of Canada is the central bank, handles public funds and administers public debt. Accountable to Finance Ministry.	In addition to these institutions, there is the Customs and Revenue Agency, with the rank of department (and not accountable to a ministry), which is responsible for overall customs and tax.
2. United States	Office of Management and Budget (OMB) establishes policies and guidelines for the management of public finance, procurement, personnel and government information and statistics.	OMB, structured by major program categories.	Treasury, through the financial management service.	Treasury, through the financial management service.	Treasury through the Bureau of Public Debt, under a commissioner.	The Treasury is accountable to the Internal Revenue Service. The customs is accountable to the Department of Homeland Security (DHS).
3. Great Britain	HM Treasury, under the prime minister, the chancellor and a chief secretary	HM Treasury, including planning and control of spending by local authorities.	Paymaster general, HM Treasury.	Paymaster general, HM Treasury.	Finance secretary, HM Treasury.	The Treasury works closely with Inland Revenue Customs and Excise which is independent, and other collection agencies.
4. Spain	Initially the Government, at the joint suggestion of the Ministries of Economy and Treasury, with a prior report from the Fiscal and Financial Policy Council of the Autonomous Communities sets fiscal objectives for three years, which must be approved by the Council of Deputies and the Senate. Formulation then begins under the Ministry of Finance.	The Ministry of Finance, Secretary of State for Budget directs all formulation and presentation of the public budget law.	Programming of execution is joint work by the Budget Department and the Treasury and Financial Policy Department, both accountable to the secretary for the economy in the Ministry of Finance.	Central operating functions of the execution phase are handled by the Treasury and financial policy department. However, the inspector general of public finance, the control body, is accountable to the secretary of state for budget and expenditure of the Ministry of Finance.	The Department of Treasury and Financial Policy of the Ministry of the Economy concentrates its operational functions on collections and payments, and directs and manages finance and public debt.	The State Tax Administration Agency integrates tax and customs management and is accountable to the finance secretary of the Ministry of Finance. The formulation of tax policy is the responsibility of the secretary of finance of the Ministry of finance, but this is independent of the tax agency.

5. Brazil	The Ministry of Planning advises the Government on budget policy.	The Ministry of Planning is the central and senior agency acting through two departments for formulating the Planning and Strategic Investment, and federal Budget. It prepares a multi-year investment budget and annual budgets.	The Ministry of Finance, through the treasury department, directs the financial administration of the federal government in all phases of the process of financial execution of the budget.	The Ministry of Finance through the department of treasury directs the financial administration of the federal government in all phases of financial execution of the budget.	The Treasury administers domestic public debt. The Ministry of Planning participates in negotiations for financing for investment projects. The central bank does not take part at all.	The department of federal revenues of the Ministry of Finance manages an integrated tax system (customs and local taxes). Proposals for tax policy are prepared by the ministry with the collaboration of the federal revenues department.
6. Argentina	The executive sets general guidelines with the participation of the finance department of the Ministry of the Economy, the organ responsible for coordinating systems in the financial administration.	The budget office of the finance department of the Ministry of the Economy, as director of the budget system in national administration.	Joint responsibility of the budget office and the Treasury, both accountable to the finance department of the Ministry of the Economy.	Budget office and Treasury, based on the system of a single account and electronic payments.	The public debt office of the financing division of the finance department of the Ministry of the Economy directs the system.	The Federal Public Revenue Administration is an autonomous agency accountable to the Ministry of the Economy, which manages an integrated taxation system including customs and local taxes.
7. Mexico	The Ministry of Public Finance participates in the formulation of the Government's development plan and proposes fiscal policy to the Government.	The expenditure department of the ministry directs formulation and prepares the draft federal budget.	The department of public finance of the ministry prepares the financial execution plan consolidating the non-financial public sector and the expenditure department programs execution.	The Federal Treasury, accountable to the ministry, jointly with the expenditure department and using the Integrated Federal Financial System, controls and executes payments.	The public debt division of the public finance department of the Ministry handles internal and external debt of the Treasury.	The Tax Administration Service, a decentralized arm of the ministry, administers all internal taxes and customs.
8. Chile	The Ministry of Finance is responsible for the financial administration of the state, for proposals of economic and financial policy to the Government in areas of its competency,. And for the coordination and supervision of related activities.	The Ministry of Finance, through its budget department, directs the preparation of the budget and drafts the final document.	The budget department program and controls execution.	The Treasury collects revenues and makes payments.	The budget department is accountable to the public finance division which contains an Investment and public debt unit.	The internal tax service and the customs service are accountable to the ministry and have administration and control functions, but collections are effected by the Treasury.

9. Peru	The Ministry of Economy and Finance (MEF) is the executive agency responsible for fiscal policy.	The budget management law makes the MEF public budget department responsible for directing the entire budget cycle. The investment office of MEF directs the National Public Investment System and coordinates with the budget.	The public budget department directs programming of execution, It is supported by the Treasury Department of the MEF and the SIAF information project.	The public budget department is the central authority for administering execution assisted by the Treasury, which basically acts as paying agent- There is no legislation to organize the treasury system).	There is no regulation of the public debt system as part of an integrated financial administration. The public debt department is the senior body responsible for public debt.	SUNAT (taxes) and the Customs Superintendency act as autonomous collection agencies. SUNAT recently absorbed the Customs function.
1-. Bolivia	The Ministry of Finance is the executive agency responsible for all fiscal policy, assisted by an economic CONEPLAN and a macro group in the central bank. All pursuant to the SAFCO Law for financial and control management systems.	The Ministry of Finance, through the Budget and Accounting Department, assisted by the Public Investment and External Finance Department, is responsible for formulating and directing the budget system.	The Treasury and Public Credit Department has most powers to program execution, including monthly amounts for commitments, obligations and payments. The computer tool SIIF is used.	The Treasury and Public Credit Department have powers to administer execution of the budget.	The Treasury and Public Credit Department concentrates powers to manage debt. However, the Public Investment and External Finance Department directs negotiations with multilaterals and bilaterals.	Tax and customs administration is in the hands of two autonomous agencies accountable to the Ministry of Finance through the Taxation Department.
11. Ecuador	The Ministry of Economy and Finance (MEF) formulates, directs and executes fiscal and debt policy. The Planning Division of the Office of the Vice President has lost its powers over public investment.	MEF directs the national budget through the Finance Department, which prepares the general budget for the state.	The Finance Department of MEF has Budget, Treasury and Public Credit Divisions. The first two of these directs the programming of execution, including the cash program.	The Treasury Division, through SIGEF and the single account administers and controls execution.	The Division of Public Credit coordinates the process.	The tax and customs were formerly two technical and autonomous entities, but have recently merged.
12. El Salvador	The Ministry of Finance propose financial policy for the public sector to the president and directs and coordinates all subsystems in the Integrated Financial Administration, including Budget, Treasury, Investment, Public Credit, Accounting and Government.	The Budget Department of the Ministry of Finance plans, directs and evaluates developments in all stages of the budget process, including the drafting of bills.	Monthly schedule of payments is prepared by agencies and approved by the Budget Department.	Execution is in the hands of the agencies using the computer tool SAFI, and payments are made through the Treasury subsystem through a single account.	External, multilateral and bilateral debt is managed by the Investment and Public Credit Department, which directs the related subsystem. However, Treasury undertakes short-term operations.	

13. Paraguay	The Ministry of Finance is responsible for formulation and direction of fiscal policy and domestic and foreign debt policy of the public sector.	Based on ministry guidelines approved by the executive. Formulation is in the hands of the Budget Division of the Finance Department of the Ministry of Finance.	The Treasury Division of the Finance Department is responsible for programming of execution.	The Treasury Division is the highest authority for administration and control of execution.	The Public Credit Division of the Finance Department manage public debt with due dates at more than one year. The Treasury Division handles short-term operations.	Tax and customs functions are at division level, and are accountable to the Taxation Department.

References and Sources of Information for the Comparative Analysis Table

COUNTRIES	SOURCES OF INFORMATION
Canada	Websites Department of Finance: www.fin.gc.ca Treasury Board Secretariat: www.tbs-sct.gc.ca
USA	Websites Office of Management and Budget: www.whitehouse.gov/omb Department of the Treasury: www.ustreas.gov
United Kingdom	Website HM Treasury: www.hm-treasury.gov.uk
Spain	Law 18/2001: General Budget Stabilization Law Royal Decree 689/2000 for the Organizational Restructuring of the Ministries of Economy and Finance Royal Decree 1330/2000 for the Organizational Restructuring of the Ministry of Finance
Brazil	Law 101/2000: Fiscal Responsibility Law Decree 4430/2002 on Competencies of the Ministry of Finance Decree 4781/2003 on Ministry of Planning, Budgeting and Management Organization Structure
Argentina	Law 24156/1992: Financial Management Law
Mexico	Ministry of Finance and Public Credit Internal Regulations
Chile	Budget Law Decree 1263/1975
Peru	Law 27209 on Government Budget Management; Law 27293 on the National Public Investment System; Law 24680 on the National Accounting System; and Law 27312 on Management of the General Public Account
Bolivia	Administration and Control Law 1178/1990 (SAFCO Law) and Budget Administration Law 2042/1999
Ecuador	Executive Decree 1429/1977, or LOAFIC Law; Public Sector Budget Law 18/1992 and Economic Regulation and Public Spending Control Law 122/1983
El Salvador	Law Decree 516/1995 on Financial Administration Law Decree 172/1977 on Public Investment
Paraguay	Law 109/1991 on the Functions of the Ministry of Finance Law 1535/1999 on Financial Administration

See also the book, *Presupuesto y Control, Pautas de reforma para América Latina* (Budget and Control, Bases for reform in Latin America), by Humberto Petrei, IDB, ISBN: 1-886938-28

MAP SECTION