

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

This Report on the Observance of Standards and Codes on Fiscal Transparency Module for **Nicaragua** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **March 14, 2002**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Nicaragua** or the Executive Board of the IMF.

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Nicaragua

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

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March 14, 2002

EXECUTIVE SUMMARY

This report provides an assessment on fiscal transparency practices in Nicaragua in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency*, based on the responses to the questionnaire and other information provided by the authorities.

Nicaragua has made notable progress in recent years in improving fiscal management and fiscal transparency. The public sector has been downsized, and the different branches and levels of government have been more clearly defined. The budget is providing more comprehensive information on the government's fiscal activities in the framework of institutional, programmatic and economic classifications. The implementation of a financial management information system and a treasury single account are providing more timely and more reliable information on budget execution and borrowing and improving cash management and expenditure control. However, in some important aspects, Nicaragua does not fulfill several important practices of the fiscal transparency code.

Many improvements in fiscal transparency can be introduced in Nicaragua in the short term by: (i) making the central government budget more comprehensive and clear; (ii) disseminating periodic reports on the execution of the budget and on the volume and composition of the public debt; and (iii) providing additional information in the budget documents on the macroeconomic underpinnings of the budget, and the goals and priorities of fiscal policy.

In the medium term, efforts are needed to: (i) reorganize and strengthen the internal and external control systems; (ii) include information on tax expenditures, contingent liabilities and quasi-fiscal activities in the budget; (iii) integrate the budget process in a medium-term framework; and (iv) clarify the fiscal roles and responsibilities between branches and levels of government.

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ABBREVIATIONS, ACRONYMS, AND WEB LINKS

ABL	Annual Budget Law
BRL	Budget Regime Law
CBN	Central Bank of Nicaragua (www.bcn.gob.ni)
CGR	Office of the Comptroller General of the Republic
DGB	Directorate General for the Budget
DGPI	Directorate General for Public Investment
GBR	General Budget of the Republic
IMF	International Monetary Fund
MFPC	Ministry of Finance and Public Credit (www.hacienda.gob.ni)
NFPE	Non-financial Public Enterprises
PFI	Public Financial Institutions
PIP	Public Investment Program
REB	Report on the Execution of the Budget
SETEC	Technical Secretariat of the Office of the President
SIGFA	Integrated Financial Management and Audit System (www.hacienda.gob.ni/sigfa)
TSA	Treasury Single Account

I. INTRODUCTION¹

1. This draft report provides an assessment of fiscal transparency practices in Nicaragua against the requirements of the IMF *Code of Good Practices on Fiscal Transparency*. The authorities have completed the fiscal transparency questionnaire prepared by the IMF staff. The assessment has two parts: the first part is a description of current practices, prepared by the IMF staff on the basis of the responses to the questionnaire and additional information provided by the authorities; and the second part is an IMF staff commentary on fiscal transparency in Nicaragua.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. **The responsibilities of the different branches of the state are defined by law,² but clearer distinctions between commercial and noncommercial activities are needed.** Design and execution of public policy are primarily the responsibility of the central government and of government agencies located in the 17 departments into which the country is divided, as well as, to a lesser extent, in the 151 municipalities. Certain governmental functions are carried out by decentralized or deconcentrated entities whose creation and functions are governed by legislation passed by the national assembly. For purposes of supervision, these entities are associated with the Office of the President of the Republic or with the ministries. There are some ambiguities, however, with regard to the boundaries between the governmental sector and the rest of the public sector. In particular, the decentralized entities include units that carry out noncommercial functions, as well as some that act primarily in response to market criteria, non-financial public enterprises (NFPE) and public financial institutions (PFI).³

¹ Prepared by an IMF staff team consisting of Julio Viñuela (head) and Juan Ramón Ruiz, based on a mission that visited Managua during June 24–July 4, 2001.

² According to the political constitution of the Republic of Nicaragua (Title VIII, of the Organization of the State), the state is organized in four branches (legislative, judiciary, electoral, and executive). Law 290 dated July 3, 1998 (on the organization, areas of authority, and procedures of the executive branch) states that the executive branch is formed by the president, the vice-president, 12 ministries, and governmental entities. Governmental entities may be deconcentrated entities or decentralized entities. Deconcentrated entities have some kind of technical autonomy, while decentralized entities have a higher functional autonomy, financial autonomy, and their own assets. Universities are constitutionally autonomous.

³ For example, Law 290 includes among the non-commercial decentralized entities, the Central Bank of Nicaragua, the Nicaraguan Institute of Insurance and Reinsurance, and the Nicaraguan Investment Fund, which are PFI. (See paragraphs 6 and 8 below).

3. **The separation between the fiscal functions of the executive and legislative branches is generally well defined, but certain areas are in need of clarification.** The executive branch is responsible for developing and implementing the general budget of the republic (GBR)⁴ as well as the budgets of the decentralized entities, while the national assembly is responsible for the amendment and legislative approval of the GBR. The budgets of the decentralized entities are approved by their governing bodies and, pursuant to the constitution, are required to be submitted to the national assembly along with the GBR, only for the purpose of providing information. If the GBR is not approved, prior to the budget year in which it is to be implemented, the budget proposed by the executive branch is put into effect. The national assembly may not increase budget outlays without a corresponding increase in revenue, which, in turn, requires the passage of a separate law,⁵ nor may it alter employee compensation, pensions or debt service. There are, however, certain contradictions between the regulation provided by the constitution and by the legislation governing the two branches' authority to modify the budget during the current budget year.⁶

4. **Intergovernmental relations are generally well regulated by law, but there is certain lack of transparency in expenditure and revenue assignments.** Constitutionally and legislatively, local governments enjoy political, functional and financial autonomy.⁷ Nonetheless, the lack of definition in their respective responsibilities for providing municipal services leads to duplication of spending. Moreover, though local own revenues from taxes, fees, and special contributions are clearly regulated by law, the transfers necessary to cover the difference between such revenue and spending obligations are subject to annual negotiation, as are the criteria governing distribution of funds among municipalities. At the same time, the central government's practice of providing exemptions from municipal taxes for development purposes obscures the distribution of taxing functions provided by law.

⁴ The budgeted entities are the national assembly, the supreme court, the electoral council, the office of the comptroller general of the republic, the office of the president of the republic and the ministries.

⁵ The annual budget law may not create new taxes, nor modify or eliminate existing ones.

⁶ For example, according to article 112 of the constitution, as amended in 1996, the national assembly must approve any increase or decrease of specific line items or transfers of expenditures between institutions. However, Article 32, not yet abolished, of the Budget Regime Law assigns this role to the President of the Republic.

⁷ Constitution, Title IX, Political Administrative Division; Law 40 of August 17, 1988, regarding municipalities, modified in 1997; Decree 52 of 1997, approving regulatory provisions of the law on municipalities. A municipal tax code is currently under parliamentary review. Municipal tax revenues are regulated, in a general way, by laws approved by the national assembly. Municipalities set tax rates within the ranges specified in these laws. Local borrowing must be approved by the local council and, when it materializes in issued debt instruments, by the ministry of finance and public credit. Debt service cannot exceed 20 percent of current revenues.

5. **The GBR does not, in practice, cover all central government expenditure and earmarking is high.** The GBR does not show the expenditure of all the entities comprising the central government. As noted, the budgets of the decentralized entities are to be submitted to the national assembly along with the GBR. However, compliance with this requirement is not rigorously observed.⁸ The annual budget law (ABL) establishes that all foreign grants that finance programs or projects of budgeted units should flow through the budget. However, since this depends on the donors, a portion of foreign grants is not part of the GBR. Likewise, decentralized agencies' own resources should go into the treasury account, but in practice some of these funds are not reported to the treasury and are not in the GBR. Furthermore, approximately 21 percent of regular revenues are earmarked, either by the constitution or by statute.⁹

6. **The Central Bank of Nicaragua (CBN) is a decentralized entity under the control of the office of the president of the republic.** The president of the CBN is appointed by the president of the republic, and the minister of finance and public credit is an ex-officio member of the bank's board of directors. The remaining members of the board are appointed by the president of the republic subject to ratification by the national assembly. The president of the CBN is, by law, a member of the economic cabinet.

7. **The CBN has limited autonomy to conduct monetary policy, and provides some support for fiscal policies.** By law, the CBN may not provide direct or indirect credit or debt guarantees to the government or to NFPE to compensate for revenue shortfalls. It may, however, lend the government up to 10 percent of the average current taxes collected in the foregoing two years. Such loans must be repaid, with market-rate interest, during the same fiscal year. However, this last requirement is not always observed. According to the law establishing the CBN, the government must cover the bank's operating and exchange losses. In the former case, this is done by providing negotiable securities in the amount necessary to compensate for the capital deficiency, and these securities must generate interest at the same average rate as the banking industry. In the latter case, non-negotiable, non-interest-bearing securities are employed.¹⁰ The CBN issues negotiable investment certificates to finance Treasury operations that are undertaken to rescue banks in crisis and to subsidize fuel for the transportation industry.

⁸ The 2001 GBR does not include the budgets of either the universities or of the following decentralized agencies: Emergency Social Investment Fund; Nicaraguan Institute of Rural and Urban Housing; the social insurance funds for the police and the military; Nicaraguan Agriculture and Forestry Institute; and the Nicaraguan Institute for Small and Medium Enterprises.

⁹ In the 2001 revenue budget: universities (6.9 percent); supreme court of justice (4.6 percent); customs administration (1.8 percent); internal revenue service (1.8 percent); municipalities (1 percent); and ministries and agencies' own revenues (4.7 percent).

¹⁰ As of May 31, 2001, the treasury's debt to the CBN in these categories was US\$1.6 billion.

8. **Government now plays a very minor role in the banking sector.** Private banks currently hold 97 percent of the total assets of the Nicaraguan banking system, representing a considerable gain over the last few years, due largely to the reform process undertaken by the government, involving the authorization of new private banks and the privatization of the Nicaraguan Bank for Industry and Commerce (Banco Nicaraguense de Industria y Comercio), the liquidation of the National Development Bank (Banco Nacional de Desarrollo) and, currently underway, the liquidation of the Popular Credit Bank (Banco de Crédito Popular). The role of the public sector is limited to the state ownership of the Nicaraguan Investment Fund (Financiera Nicaraguense de Inversiones), a second-tier bank that acts as the public development agency, employing funds it receives primarily from multilateral financial institutions. The reform process has also affected other parts of the financial system, such as insurance, in which the Nicaraguan Institute of Insurance and Reinsurance (Instituto Nicaraguense de Seguros y Reaseguros), though it retains a large segment of the market, has lost its monopoly position.

9. **The NFPE sector, which is now beginning to be privatized, is occasionally used for fiscal purposes.** Along with traditionally public companies such as water, electricity, telephone, mail, ports and airports that function as monopolies and constitute the nucleus of the NFPE sector, there are other, much smaller entities that could reasonably be categorized as non-business decentralized entities. The distribution side of the Nicaraguan Electric Company (Empresa Nicaraguense de Electricidad) has been privatized, and privatization of the Nicaraguan Telecommunications Company (Empresa Nicaraguense de Telecomunicaciones) is currently underway. Centers of higher education are exempt from paying for water, electricity, and telephone and mail services, and revenues from the water company (Empresa Nicaraguense de Acueductos y Alcantarillados) are, for social purposes, being used to provide cross-subsidies.¹¹

10. **Government intervention in the non-financial private sector is very limited.** The Nicaraguan economy has been liberalized to a substantial degree, and regulations affecting the private sector are neither numerous nor complex. The government continues to hold some ownership positions in numerous small enterprises outside of the non-financial public sector, and little information about these holdings is made public.¹²

11. **The legal framework governing fiscal management establishes sound principles, but enforcement and transparency should be strengthened and some ambiguities need**

¹¹ In the year 2000, the water subsidy for household users and settlements was US\$6 million, and unbilled water use by universities was US\$1.6 million.

¹² These cases involve enterprises nationalized by earlier governments that have been gathered under CORNAP, a holding company in charge of returning them to the former owners or of privatizing them to the employees. Privatizations are approved by the national assembly. The estimated value of the 37 remaining enterprises amounts to some US\$100 million.

to be resolved.¹³ Though not always observed in practice, the Budget Regime Law (BRL) recognizes the budgetary principles of legality, universality, uniqueness, and publication and presentation of transactions in gross terms. There is provision for the GBR to include a contingency fund, which may be used upon approval by the President. It may constitute up to 10 percent of total spending, though in practice it is generally far less. The president may approve supplementary budgets only in case of war, natural disaster or grants earmarked for specific projects, and must periodically submit such budgets to the national assembly for its approval. Borrowing limits are set by the ABL, but no limits are established on public guarantees. All domestic and foreign borrowing must be authorized by the ministry of finance and public credit (MFPC). Entities funded by the GBR may not borrow directly from banks or incur debts to providers of goods or services without budgeted appropriations. However, there is a need for clear regulations regarding the respective functions, for purposes of budget preparation, of the directorate general for the budget (DGB), of the MFPC, that prepares the current budget, and the directorate general for public investments (DGPI) of the technical secretariat of the office of the president (SETEC), that prepares the public investment program (PIP).¹⁴ Law assigns responsibilities for public borrowing, to the CBN, and to the directorate general for public credit of the MFPC. Responsibility for internal controls—shared by the DGB, internal audit units associated with expense centers, and the office of the comptroller general of the republic (CGR) are in need of legislative clarification. As discussed further below, the law does not include any commitments to make periodic and end-year accounting reports available to the public.

12. The tax system has an explicit, complete and public legal basis, but its administrative capacity is weak. Only through legislation can taxes be created, modified, or eliminated, and exemptions created. The law should also establish sanctions. Tax laws and regulations are published in the official gazette. The Common Tax Law, which was passed in 1962, has weaknesses in the regulation of basic aspects of taxation, taxpayers' rights and guarantees, the system of sanctions, and jurisdictional issues.¹⁵ The simplicity and clarity of

¹³ The constitution, Article 112–115, reformed in 1995, contains certain general fiscal principles. The Budget Regime Law, Law 51–1988 modified in 1991, regulates procedures for preparation, execution, control and evaluation of the budget. The annual budget law, in addition to covering budget revenue and outlay and financing of the deficit, specifies changes in the government's budget bill approved by the national assembly. A decree by the ministry of finance and public credit, regarding standards for budget execution and control, includes detailed provisions for budget execution, along with general provisions that are repeated each year and would more appropriately be included in the budget regime law or in a budget code. Presidential Decree 44, promulgated in 1998, defines, regulates and determines operational criteria for the integrated financial management and audit system. Presidential Decree 2-93 regulates the formulation, approval, coordination of the execution, control and evaluation of the budgets of the autonomous and decentralized agencies.

¹⁴The DGPI, which prepares more than 40 percent of the national budget, lacks an explicit legal basis. Its organization and functions are not covered by any sufficiently specific regulation.

¹⁵ A tax code bill awaiting passage in the national assembly will address these problems and has broad support by social agents.

regulations concerning various taxes are seriously compromised by the vast number of tax exemption rules contained not only in those laws, but also in other laws designed to address a wide range of purposes.¹⁶ The internal revenue service and the customs administration, which are deconcentrated entities that report to the MFPC, are responsible for tax administration. Their administrative and management procedures are currently being revised to provide for assignment of specific responsibilities, reorganization of human resource structures to create an administrative career system, increased capacity for audits and inspections, and strengthening of computer systems to enhance monitoring of tax compliance.

13. **There are laws and codes of ethics¹⁷ governing the behavior of public employees, but enforcement needs to be strengthened.** There is a specific code of ethics for employees of the internal revenue service. A revision of these laws is being undertaken to provide for a clearer definition of what constitutes criminal behavior by public employees. This revision is carried out in the frame of a national integrity plan approved in May 1999, that includes diverse measures to face the corruption problem in general, and in the civil service in particular.

B. Public Availability of Information

14. **The GBR is published, but its diffusion is restricted.** As noted, excluded in the 2001 GBR are the budgets of universities, which have a special autonomy under the constitution, and of six noncommercial decentralized entities.¹⁸ The budget document submitted to the NA includes: (i) the budget bill; (ii) budgeted revenue disaggregated according to tax, non-tax and ministries' own revenues; (iii) budgeted spending classified by institutions:¹⁹ legislative, judicial and electoral branches; the CGR; 12 ministries; direct transfers from the GBR to autonomous, governmental and other entities; and service of the public debt. A statistical annex includes: the overall balance of the GBR and the financing thereof, with distinctions between grants, domestic and foreign borrowing; spending disaggregated by economic category and by function; additional information on capital

¹⁶ The absence of any compilation of the various tax exemptions, and of an assessment of their impact on tax collections makes it difficult to predict revenues or assess compliance with tax obligations.

¹⁷ Law on the moral integrity of public employees (Decree 39-1979). Code of ethics for the public employees of the executive branch (Decree 124-1999). Criminal Law.

¹⁸ See footnote 8.

¹⁹ Budget allocations for each institution are disaggregated by program. For each program information is provided on aggregate current spending and aggregate capital spending, physical goals, and investment projects indicating, in each one, its source of financing: the treasury, foreign donations or foreign loans. Finally, for each institution, spending is broken down into categories similar, but not identical, to economic categories, lines and accounts. Transfers to decentralized entities that are subordinate to the institution appear in the category of current transfers.

spending; and the budgets of most decentralized entities and a few public enterprises. This document, along with the final approved budget, is published by the MFPC, but its dissemination is limited. The gazette publishes only the ABL. A consolidated statement of the institutions included in the GBR is not provided.

15. **There is no legal obligation to publish either the final report or the quarterly reports on implementation of the national budget.**²⁰ According to the BRL, at the end of the budget year, the MFPC is required to prepare a report on the execution of the budget (REB) and submit it to the president and to the CGR. During the first quarter following implementation, the president is required to submit the report to the national assembly. The ABL requires the MFPC, in the first 20 days of each quarter, to collect information on the physical and financial execution of the budget during the preceding quarter from the bodies receiving funds under the national budget, and to forward to the national assembly a report on the financial execution of the GBR for that same period. Neither the REB nor the quarterly budget execution reports are published. The CBN publishes monthly information on the results of the central government's budget implementation and on the non-financial public sector and its financing, but without covering all the entities involved. The new municipal budget regime law requires that local budgets and final account be published.

16. **Dissemination of information on the public debt is improving.** Complete information on the public debt is available broken down by owner, term and debt instrument. The MFPC is beginning to publish monthly debt information on its website. The published information on domestic and foreign loan balances is still fragmentary and highly aggregated, with changes in the former aggregated by type of debt instrument, and changes in the latter aggregated by creditor. The CBN publishes more highly disaggregated information on foreign public debt, its distribution by creditor, debt forgiveness and delays in debt servicing in its quarterly *Economic Indicators* bulletin. Information on financial assets is not published.

17. **It is not a practice in Nicaragua to include information on tax expenditures in the budget document, quasi-fiscal activities and contingent liabilities.** Information on past and future fiscal activities is not provided.

18. **Municipal government operations are relatively minor, but limited information is available on municipal budget execution or borrowing.** The recent Municipal Budget Regime Law²¹ has noticeably improved regulation of budget preparation, execution and reporting at the municipal level. In particular, it introduces a process whereby social agents may participate in public hearings in order to suggest changes in the budget bill and in funding sources prior to passage by the municipal council. It also mandates that a copy of the

²⁰ Nicaragua has not reported to the GFS Yearbook since 1996.

²¹ Law 376 dated April 4, 2001.

approved budget and of the year-end report be forwarded to the CGR and to the Nicaraguan Institute of Municipal Development.

C. Open Budget Preparation, Execution and Reporting

19. **The macroeconomic underpinnings of the budget are not included in the budget document, and no medium-term budget scenario is prepared as a framework for preparing the budget.** The macroeconomic predictions developed by the CBN and the MFPC as an aid in the preparation of the GBR are published, in part, when the minister of finance and public credit submits the justification for the budget bill to the national assembly. But the procedures and assumptions used to prepare the macroeconomic and fiscal predictions are not provided. The government plans to develop a medium-term budget scenario in connection with the 2002 GBR, but strictly for use as an internal document.

20. **The GBR contains limited information on fiscal policy goals and guidelines, and does not include an analysis of sustainability.** It includes only the overall balance, on the basis of which the current balance and primary balance can be calculated. Analyses, by international financial institutions, of the sustainability of fiscal policy are used in the budget planning process but these are not published nor explained in the budget presentation.

21. **Budget planning is not well coordinated with decision making regarding the disbursement of foreign funds from grants and concessional financing.** When the budget bill is prepared in the second and third quarter of each year, there is no reliable prediction of foreign funds that will be available in the coming year.²² Consequently, the budget bill includes only those projects for which disbursement of such funds throughout the budget year is guaranteed. Though there have been notable improvements in mechanisms to provide coordination with providers of foreign financing, the continuing information gaps necessitate numerous budget modifications during the fiscal year.²³ When the new foreign aid requires Treasury counterpart funds not specified in the GBR, a supplementary appropriation law has to be approved by the national assembly.²⁴

22. **Coordination between current spending and capital spending is weak and their differentiation in the GBR is not clear.** The MFPC is responsible for preparing the national budget. However, as noted this function is divided between the DGPI, which establishes the

²² Only predictions at the beginning of the budget year, when the secretariat of foreign cooperation has concluded negotiations and signed protocols with donors, are reliable.

²³ The 2001 budget legislation gives budgeted entities the authority to incorporate in their budgets the unanticipated amount of donations and disbursements of concessional loans earmarked for projects and programs.

²⁴ Technical assistance agencies themselves sometimes offer loans to executing units, to be repaid during the following fiscal year with treasury funds included in that year's national budget.

PIP²⁵ and the DGB, which sets the current spending budget on an incremental basis.²⁶ These two documents are not, at present, well coordinated; thus, at times, the budget does not provide for the current spending necessary for new investments to be effective. On the other hand, since the DGPI has not differentiated between capital and recurrent expenditure within each project, the investment program records all items under capital spending. Therefore, a not yet quantified part of capital spending is, in fact, current spending.

23. **Budget classification requires strengthening in a number of respects.** Government transactions are generally presented in gross figures and spending is categorized according to economic criteria, function, program and institution. There are problems, however, in the functional classification, in terms of providing reliable information on specific spending policies. Function-based classification of spending information in the GBR is of a very general nature, broken down into only five groups²⁷ that are disaggregated by administrative units, thus constituting a new ordering of the institutional classification. Furthermore, the institutional or organizational classification in the GBR is at the ministerial level and does not identify the different administrative units, within the ministries, responsible for implementing the different spending programs. This hinders the process of assigning responsibility for the collection and use of public funds.

24. **The gradual implementation of an integrated financial management and audit system (SIGFA) and the introduction of a treasury single account (TSA) are considerably improving fiscal management.** SIGFA integrates budget, accounting, treasury, public credit and procurement subsystems, using a common set of rules and procedures and an integrated accounting database. Presently, the system is operational in the MFPC (SIGFA-Central). Budget entities report monthly to the MFPC according to SIGFA formats and the extension of the system to them (SIGFA-Local) is planned for 2002. Based on SIGFA data, the MFPC prepares monthly, quarterly and annual budget execution reports. Since last year, the treasury is operating a TSA in the CBN, which captures nearly all budgeted revenues and most of the expenditures of the central government.²⁸ SIGFA and the TSA allow a fast reconciliation of cash flow and accounting information. However, until

²⁵ The PIP, which represents 42 percent of budgeted spending in 2001, is financed mostly (62 percent) by foreign grants and concessional loans linked to specific projects. The volume of investment is determined largely by the foreign funds committed, and to a lesser extent by the availability of Treasury funds to cover local counterpart contributions. Distribution of funds, by project, is based more on the priorities of donors and providers of concessional financing than on the government's policy priorities.

²⁶ There is a Technical Committee for Investment, which is responsible for approving the PIP. It is composed of representatives from SETEC, the DGB, the Foreign Ministry's Secretariat of International Coordination, and the CBN. Given the structure of the PIP, SETEC has the greatest responsibility and plays the lead role in program development.

²⁷ Social services, infrastructure and production, defense and security, general services, and public debt service.

²⁸ See paragraph 5.

SIGFA-local will be operational, a reliable reconciliation of MFCP and budget entity positions will not be available.

25. **The accounting system embodied in SIGFA permits recording the main stages of the spending process, but some adjustment is needed to provide reliable reports on payment arrears.** Revenue is recorded at the time of collection, rather than at the time the right of collection comes into effect. Budget entities provide the MFPC quarterly information on all their commitments. Accrual liabilities are recorded simultaneously with the payment order. Payments are recorded when the checks are issued and not when they are delivered to the provider or creditor, which is the point at which the government debt is actually settled. Therefore, accounts payable includes only a portion of the balance of accrued liabilities to be paid. The authorities are aware of this weakness in the system and are ready to solve it along with the implementation of SIGFA-local. Consequently, although SIGFA has the capacity to implement accrual accounting, for the time being it is operating a modified cash basis of accounting.²⁹

26. **Regulation of public procurement is sufficiently clear and accessible, and its management is being strengthened.** Significant steps are being taken to improve procurement-related planning, management and monitoring capacity. Recent legislation on administrative contracts,³⁰ which applies to all entities within the public sector, establishes a bidding system for the awarding of contracts above a given value. A project to enhance transparency and efficiency in public procurement is also slated to begin. This project is designed to increase management and monitoring capacity for purchases and hiring in the seven public sector entities with the greatest hiring volume, provide support for hiring offices in the ministries and other entities, and train personnel. However, there are two provisions in the new rules that may affect the effectiveness of administrative management and the transparency of public works contracts. First, the intervention of the CGR in appeals submitted by participants in the bidding process is likely to substantially delay the execution of contracts. Second, public enterprises reporting to the ministry of transportation and infrastructure can contract directly with the administration, without being subject to the bidding processes established by law.³¹

²⁹ The deadline for recording payments of obligations recognized in the preceding fiscal year is February 15.

³⁰ Law dated December 2, 1999, reforming Law 323 regarding state contracts, and Decree 21-2000, approving general regulations of the law on state contracts.

³¹ The most significant exceptions to the general regime are for army and national police procurement, and for contracting between public entities.

27. **Comprehensive civil service legislation is not in place.**³² The conditions for public employment and compensation are currently governed by labor legislation. There are no clear procedures for awarding jobs. Public competition is rarely used for this purpose, and there is no administrative career system. The beginning and termination of an employment relationship with the government is unrestricted, as is the level of compensation.³³ Minimum compensation for job termination, which is the same for layoffs and resignations, is also set by labor law.

28. **Internal audit procedures, as well as the entire internal control system are unclear and have weaknesses.** The objectives and scope of audits performed by internal audit units within ministries and other agencies are poorly defined. The fact that they have a dual organizational status—reporting both to the CGR and to the ministries—creates confusion in terms of the objectives of internal administrative monitoring. The annual audit plans prepared by internal audit units, frequently cannot be executed. Overall, these units are poorly endowed with trained personnel and technological means. In addition, they sometimes have to allocate part of their scarce resources to carry out special audits ordered by the minister or the CGR because of misappropriation of funds or failure to justify the accounts in the administrative units. While audits cover legal and financial performance by area (treasury, assets, debtors, creditors, etc.), budget execution accounts are not audited. There are mandatory internal control standards set by the CGR. Based on these standards, ministries and other agencies must design their own system for internal controls and, to date, this has not been done.

29. **Quarterly budget execution reports are made to the legislative branch within a month of period-end, but they are limited in scope and are not made public.** The quarterly reports cover only the budget execution of the centralized administration, not that of decentralized and autonomous entities, for which only transfers are covered. No information is submitted on the implementation of budget programs or on the extent to which their objectives have been achieved. Information on the execution of investment projects is presented with insufficient clarity; it provides figures on spending for each project during the period in question, categorized by funding source, but no comparison with initial predictions is given. Figures on investment financed with foreign funds are not always reliable. Technical assistance agencies often do not wish to be part of the official budget implementation process or channel their resources through the single treasury account, creating project offices at the ministries. This causes duplication in accounting records, complexity in management procedures, and lax observance of the obligation to provide

³² There is a civil service bill in the NA that attempts to fill this gap. With a view to implementing its provisions, the government is updating manuals containing descriptions, analyses and assessments of jobs within the ministries. In addition, it is compiling and reviewing government employee records.

³³ Seventy percent of the 78,000 government employees receive monthly salaries of less than US\$70.

timely information to the central accounting office regarding the degree to which projects have been implemented.³⁴

30. **The REB, somewhat deficient in scope and accuracy, is submitted to the national assembly within three months after the end of the budget period.** This report includes only a portion of the extrabudgetary funds; the central government accounts remain unconsolidated and are not audited. There is no comparison with initial allocations or explanation of the differences. Monetary accounts (bank accounts and borrowing) are not reconciled. For budget programs, there is no evaluation of the extent to which budget objectives have been achieved.

D. Assurances of Integrity

31. **Budget data are not yet reliable indicators of fiscal outturns.** The reliability of budget data has improved to a great extent in recent years, following the 1995 constitutional amendment limiting the capacity of the executive branch to approve supplementary budgets and the improvement in the government's ability to execute the budget as planned.³⁵ However, supplementary appropriations continue to be high, mainly in capital spending, reflecting partly weaknesses in budget preparation and partly insufficient coordination with foreign donors.³⁶ Current expenditures are more tightly controlled. Revenue estimation is moderately reliable

32. **Government accounting standards are not formally included in the budget document or final accounts.** However, the accounting principles, the plan of accounts and the manuals are published on the MFPC website.

33. **The quality of year-end fiscal data is not adequately assured.** Though the fiscal data generated by the government are submitted in a timely manner to the **national assembly** and to the CGR, the information is somewhat limited. Monthly reconciliation of bank accounts and accounting data on receipts and payments are rapidly made, but aggregate reconciliation of "above the line" and "below the line" data are still problematic and are not

³⁴ Executing agencies for projects have incentives to provide timely information on expenditures made in projects financed with treasury funds so as to accelerate payments, but not on expenditures made and paid directly by the project offices of the donor agencies. This creates a lack of reliability in the quarterly budget execution reports prepared by the DGB.

³⁵ In the period 1992–1995, the executed budget was on average 25 percent higher than the initial budget against an average of 5 percent in 1996–2000.

³⁶ In the year 2000, the final amount budgeted for spending was 17 percent greater than the initial figure. Actual spending exceeded the initial budgeted figure by 5 percent, but represented only 90 percent of the modified figure budgeted for spending. In five ministries, spending increases were higher than 20 percent.

shown. The REB is not audited. Comparisons are not made between initial revenue/spending predictions and the revenue/spending actually executed.

34. **The office of the CGR is an independent body, whose members are appointed by the national assembly.** Its independence is mandated by the constitution. Though the functions of this external monitoring agency are rather broad, its activity—due to a lack of human resources—is exclusively concerned with monitoring legality and conducting special audits. Among its responsibilities is that of setting standards for internal control within governmental institutions. Though provided for in the law, the CGR does not perform financial or operational audits, nor does it evaluate budget programs. The auditing staff, which has limited technical expertise, cannot adequately cover the extensive field of ex-post monitoring of governmental bodies, which includes not only ministries, but decentralized entities, autonomous entities and municipalities. The decentralized entities are audited every year by private firms delegated for this purpose by the CGR, but the other entities are not similarly audited. There is no commitment to publish audit reports, though there is a legal requirement to provide them to the public upon request. Although the audited institutions are required, within a set time period, to apply the measures and recommendations that appear in the audit reports, there are no mechanisms to ensure compliance, nor is there a system to provide follow up on recommendations that have been made.

35. **The National Institute of Statistics and Census has technical independence to compile national statistics.** The institute is responsible for compiling and publishing national statistics. Its director is appointed by the president of the republic. The agency's role is to generate and compile all manner of statistics—economic, demographic, and even public finance statistics—though in the case of public finance statistics, only fiscal data provided by the MFPC and by the CBN are published.

III. IMF STAFF COMMENTARY

36. **The last few years have seen notable progress in Nicaragua's fiscal transparency.** The public sector has been downsized through a process of privatization, and government intervention in the private sector is limited. Progress has been made in the scope of the budget, which includes greater information on decentralized entities and on agencies' own funds. The respective fiscal functions of the branches and levels of government have been more clearly defined. Implementation of an integrated financial management and audit system (SIGFA) has begun, making available more timely and more reliable information on budget execution and borrowing. This, along with the TSA, has improved cash management and aggregate expenditure control. The organization of budget categories has improved. Processes are under way to improve public procurement, tax administration, and public sector employment.

37. **Despite this progress, Nicaragua is still far from fulfilling several important requirements of the fiscal transparency code.** In particular, the coverage of the budget and the budget execution reports should be more comprehensive, and their presentation improved to provide a reliable image of the central government's fiscal activity. Fiscal information

should be made more accessible to the public. Budget preparation needs improved internal coordination not only within the executive branch itself, but also from the executive branch with the foreign donors. Internal and external audit is still too weak to assure the integrity of fiscal data. The functions and responsibilities of the different branches and levels of government should be clarified.

38. **Nicaragua has the capacity to introduce many improvements in fiscal transparency in the short-term.** Much of the information that is necessary for financial management is already produced. Better use and dissemination of this information could permit rapid improvements in relevant aspects of fiscal transparency. The staff suggests that the following changes could be easily and quickly made and should receive the highest priority:

- *The coverage of the GBR should be comprehensive.* To this end:
 - the GBR should be accompanied by the budgets of all the entities within the central government. Budgets for each of the autonomous, noncommercial, and decentralized entities should be included in the budget documents and a consolidated budget for the entire central government should be provided;
 - the budgets of the public companies, as provided by the constitution, should also be presented to the **national assembly** simultaneously with the GBR, and this should include a consolidated budget for the non-financial public sector as well. It would clarify matters greatly to provide in the budget documents a list of the different entities comprising the public sector, classified in accordance with the criteria set forth in the IMF Manual on GFS;³⁷
 - own revenue estimates of all the entities comprising the central government should be reported in the budget and the expenditures funded by them presented on a gross basis; and
 - as fiscal information on local government is available, ex-post consolidated information on the general government could be provided with the budget.
- *The presentation of the budget could be made clearer if:*
 - Budget data were compared with outturns of the two preceding fiscal years.
 - The entity responsible for each budget program were identified.

³⁷ In particular, this list should draw a clear boundary between the commercial and non-commercial decentralized and autonomous entities.

- An accurate distinction within the PIP between current and capital expenditures were made.
- The macroeconomic framework used to prepare de budget were provided in a supporting document to the GBR.
- An explanation of the methods and assumptions used in revenue forecasting were included, as it is legally established, in the revenue budget document.
- *Periodic budget execution reports should be more comprehensive and accurate.* In particular:
 - these reports should have the same coverage as the national budget;
 - comparisons of accrued liabilities and payments with the initial and modified appropriations should be provided. This requires introducing small adjustments in SIGFA in order to provide more reliable information on accounts receivable and accounts payable. Specifically, the accrual phase should be separated from the payment order, payment should be recorded at the time the check is delivered to the creditor or when the bank transfer is issued, and the revenue accrual and collection phases should be separated;
 - more attention should be paid to the routine reconciliation of the financing items and the budget balance, a task that could benefit from closer cooperation between the CBN and the MFPC;
 - procedures should be established to record and report operations financed with foreign funds in a timely way; and
 - over time, these reports could also include the degree to which program objectives have been achieved.
- *Relevant fiscal information should be made public.* The budget documents, budget execution reports, and periodic reports on public debt by owners, terms and instruments, and separating government debt from total external debt, should be published, at least on the MFPC website.

39. **Additional delays in the implementation of SIGFA-local should be avoided.** This will provide for greater effectiveness in budget preparation, closer control over execution, and more reliable reporting. The authorities are urged to keep up the implementation as scheduled, so that SIGFA- Local will be operative in 2002. Over time, the authorities should consider gradually adopting a modified accrual accounting system, as this is permitted by SIGFA.

40. **Other fundamental improvements on fiscal transparency should be undertaken in the medium term and keep pace with the ongoing reforms in the public financial**

management system. The Nicaraguan authorities, with the assistance of the international institutions and donors, are strengthening the fiscal analysis, programming, and auditing capacity of its fiscal administration and it will take some time for these measures to produce the desired effects. On the other hand, effective use of additional subsystems of SIGFA will have to wait for the implementation of the SIGFA-local. Therefore, the staff suggests the following actions in order of priority:

- *The CGR should concentrate its efforts on preparing a complete audit of the public sector's final accounts.* Increased human, technical and technological capacity is absolutely necessary in the CGR if it is to perform the wide range of functions assigned to it. Improvement must be made in coordinating internal audit units so that the CGR may focus on its specific function, which is to carry out effective ex-post external monitoring. To this end:
 - the CGR should initially focus on a complete financial and compliance audit of the annual REB. This audit should be sent to the **national assembly** along with the REB and the audits of the decentralized entities;
 - over time, the CGR should strengthen its capacity to undertake a more ambitious audit program that includes operational and program audits; and
 - in addition, the conclusions reached as a result of its work should be published, and effective mechanisms should be established to follow up recommendations that are made.
- *Internal control of budget execution must be improved.* Emphasis should be put on:
 - creating rules governing internal control procedures within administrative units (ministries and decentralized and autonomous entities), based on priorities determined by the CGR. Such rules should set forth the various administrative and accounting controls for ensuring that the management of public funds is efficient and is in accordance with current legal provisions; and
 - Increasing human resources in the internal audit units of ministries and other entities, and implementing training plans to increase the effectiveness of ex-post internal controls. This will also requires that more audits be conducted, and that complete financial audits of budget execution be included in the work plans, as well as audits of programs and procedures.
- *Statements of quasi-fiscal activities, tax expenditures and contingent liabilities, should be prepared and included in the budget documents.* In particular,
 - compiling and estimating tax expenditures are important steps for Nicaragua, considering the broad use that has been made of tax exemptions in the past. An important initial step could be to require all new tax exemptions to be subject to a

legally mandated scrutiny, to determine and compare their cost, in terms of revenue foregone, with the benefits they are expected to provide;

- quasi-fiscal activity on the part of NFPE and the CBN should be quantified in order to determine the burden such activity places on them and on the net worth of the public sector balance sheet; and
 - a statement of contingent liabilities should be prepared containing government guarantees for domestic and external loans, and contingencies associated with privatization processes.
- *Further steps should be taken to improve the budget preparation process.*
Specifically:
 - procedures and mechanisms used to coordinate the formulation of the budget should be strengthened. While acknowledging the progress made and the difficulties involved, the importance of coordination between those involved in the preparation of the budget must be emphasized. These include: the MFPC, which serves as the directing entity and is specifically responsible for the process; SETEC, as economic strategy coordinator and designer of the PIP; foreign technical assistance agencies, which provide a large volume of funds and whose priorities may not always coincide with the government's policy priorities, as defined in its economic strategy and in its poverty reduction strategy; and budgeted entities and agencies, which should play a greater role in formulating sectoral priorities. In particular, the functions of the MFPC and of SETEC must be clearly defined in order to reduce the strict separation that presently exists between current budget and capital budget, and in order to plan realistically for current and capital spending for budget programs and their related projects; and
 - budget preparation should gradually be integrated in a medium-term framework. This integration is important, not only in order to realistically define fiscal policy objectives and to ensure that funds are allocated in accordance with policy priorities in an effective manner that allows for increased efficiency in the use of funds, but also in the interest of greater transparency in the budget preparation process. It will require some time to fully achieve this integration. Certain elements needed to make this budget scenario a reality in the medium term are presently nonexistent or in need of strengthening. First, an increased capacity for macroeconomic prediction must be developed, in order to provide an improved assessment of the sustainability of fiscal policy in the medium term and specify realistic spending parameters. Second, there must be a functional classification following international standards and integrated with economic and institutional classifications, making it possible to differentiate between current and new policies. Third, multi-year investment planning must be improved, with reliable estimates of the recurrent spending needed to carry out the investments. In

particular, the budget scenario and the annual budget should include clear identification of spending needed to implement the poverty reduction strategy.

- Earmarking should be reduced. The high size of earmarked revenues is decreasing transparency and introducing rigidities in fiscal policy formulation.

41. **Though it is not an urgent priority, the authorities should place emphasis on clarifying the roles and responsibilities between branches and levels of government on fiscal affairs.** The main issues that should be addressed are:

- The contradictions between the constitution and the BRL on the corresponding powers of the **national assembly** and the president to modify the budget should be eliminated.
- The revenue authority and expenditure responsibilities of each level of government should be clearly defined.
- The important change in fiscal management that has taken place in the late nineties with the introduction of SIGFA and the TSA and the institutional reform of the public administration have not seen a parallel development of the legal framework for fiscal management. It would be advisable to revise the laws and regulations governing fiscal management and incorporate them in one budget code, or financial administration law that would govern all important aspects of fiscal management in a coherent and thorough manner. In particular, this law could fill the present gaps in the regulation of the treasury, public credit and accounting functions, develop the provisions of the BRL by including regulations that are annually repeated in the ABL, and define more explicitly the role of the MFPC in fiscal management relative to SETEC and the CGR, and give emphasis to fiscal transparency.