

Report No. 40496-PA

Panama Country Financial Accountability and Procurement Assessment Report

December 31, 2006

Central America Country Management Unit
Operations Services Department
Latin America and the Caribbean Region
The World Bank

Regional Operations Department 2
Modernization of the State
Division (RE2/SC2)
Inter-American Development Bank



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

CURRENCY EQUIVALENTS

Currency Unit = Balboas
US\$1 = 1 Balboa (the US\$ has legal tender)

GOVERNMENT FISCAL YEAR

January 1 – December 31

MAIN ABBREVIATIONS AND ACRONYMS

BNP	National Bank of Panama	NFPS	Non-financial public sector
CGR	Office of the Controller General of the Republic	<i>Panamacompras</i>	Procurement Information System
CFAA	Country Financial Accountability Assessment	PER	Public Expenditure Review
CSO	Civil society organization	PFM	Public Financial Management
CSS	Social Security Institute	SIAFPA	Integrated Financial Management System
CPAR	Country Procurement Assessment Report	SRPG	Budget Recording System
DCP	Public Procurement Directorate	SIGADE	Debt Management and Financial Analysis System
IDB	Inter-American Development Bank	SNIP	National Public Investment System
IMF	International Monetary Fund	SPIG	Presidential Secretariat for Government Innovation
IT	Information Technology	WB	World Bank
MEF	Ministry of Economy and Finance		

World Bank

Vice-President	Pamela Cox
Country Director	Jane Armitage
Sector Director	Stefan Koeberle
Task Managers	Enzo de Laurentiis Manuel Vargas

Inter-American Development Bank

Regional Manager	Máximo Jeria
Sector Chief	Jorge Sapoznikow
Task Managers	Roberto Camblor Stephen Doherty Stefano Tinari

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This report was prepared by a team composed of Diomedes Berroa (Sr. Procurement Specialist, WB), Roberto Camblor (State Modernization Specialist, IDB), Patricia de Baquero (Sr. Procurement Specialist, WB), Enzo de Laurentiis (Regional Procurement Manager, WB), Stephen Doherty (Sr. Social Development Specialist, IDB), Stefano Tinari (State Modernization Specialist, IDB) and Manuel Vargas (Sr. Financial Management Specialist, WB). Other staff members and consultants contributed with background papers (Annex V). Carlos González (Budget Director, MEF) and Edilberto Ruíz (Procurement Director, MEF) coordinated the report on behalf of the Government of Panama.

The preparation team thanks the Minister of Economy and Finance, Mr. Héctor Alexánder, the Controller General, Mr. Carlos Vallarino, the former Controller General, Mr. Dani Kuzniecky, and other Government authorities and officials for their cooperation and support. The Team also appreciates the support of Jeremy Gould (Resident Representative, IDB) and staff of IDB's Resident Mission in Panama, and Jamil Sopher (Consultant), as well as the leadership of Bernard Becq (former Regional Procurement Manager), Roberto Tarallo (Regional Manager - Financial Management, WB) and Jorge Sapoznikow (Sector Chief, IDB).

PREFACE

The Country Financial Accountability and Procurement Assessment Report (CFAA/CPAR) is a diagnostic tool that covers the government's ability to fulfill its fiduciary responsibility to the citizenship, in managing public resources through sound public financial management (PFM).¹ As such, it seeks to support development objectives by facilitating a common understanding of the state of PFM systems, practices and accountability arrangements. On that basis, the assessment makes recommendations with the ultimate goal of increasing the efficiency and transparency of public expenditures. Information obtained in CFAA/CPARs can also help development agencies to identify potential risks to the use of loan or grant proceeds, posed by weaknesses in PFM arrangements.²

The World Bank and the Inter-American Development Bank (IDB) have agreed to collaborate in the overall coordination of PFM diagnostic work. The two participating Banks expect that their collaboration in Panama will foster a common understanding of how the CFAA/CPAR could support the country's development agenda, and make good use of their combined efficiencies of scale.

This report was prepared on the basis of: (i) interviews held with several government officials and stakeholders from the private sector, non-governmental organizations, and development agencies; and (ii) a series of reports and other documentation (summarized in Annex V).

The Participating Banks' Assistance Strategies

On account of the government's "Strategic Vision of Economic and Employment Development Toward 2009", the World Bank's Interim Strategy Note (ISN) for FY06-07 lays out a step-wise program that aims to generate a more robust policy dialogue, based on the preparation and findings of several core diagnostic analytical pieces (including the CFAA/CPAR) and a development policy loan (DPL) in FY06. Then building from this base, in FY07 the Bank would undertake additional analytical work and could finance a few selected investment projects.

The core of the IDB's Country Strategy for 2005-2009 is to promote sustainable economic growth and to reduce poverty. It will seek to do this through promotion of competitiveness and investment in human capital. Central themes running through this strategy are the improvement of governance and transparency. The achievement of fiscal sustainability will be sought by, among other measures, strengthening the financial situation of both central and local government and improving the management of public expenditure and external debt. The specific measures which the strategy will support include: the implementation of the Fiscal Responsibility Law, the Fiscal Equity Law and the reform of Social Security. On the income side of budget, the bank will support the strengthening of the Internal Revenue and Customs Services and the Directorate of Land Registration. On the expenditure side of the

¹ The CFAA/CPAR combines two exercises that have traditionally been carried out separately: the Country Financial Accountability Assessment (CFAA) and the Country Procurement Assessment Report (CPAR).

² The CFAA/CPAR, however, is neither an audit nor is prepared following audit procedures (World Bank, 2003).

budget, the Bank will promote actions to improve the management of Social Security and the management of the budgetary process. The latter includes the implementation of a single Treasury account, modernizing the system of public acquisitions, improving the programming of public investments, the introduction of management by results, improving the management of state assets, and the consolidation of the Integrated Financial Management System³ at both national and local levels.

In addition to its inherent value as a diagnostic tool, the CFAA/CPAR has special relevance through its relationship to the participating Banks' assistance strategies, lending programs, and policy dialogue with the country. The linkages are particularly strong in three areas:

Reform of public finance and modernization of the State. Public financial management systems that contribute to operational and allocative efficiency are critical elements of public sector effectiveness. These features, together with fiscal transparency, can positively influence the governance environment.⁴ Hence, in these areas the CFAA/CPAR constitutes a key non-lending service of the participating Banks.

Design and implementation of the participating Banks' lending program. The exercise can provide valuable information to help the government with the design of capacity-building programs under its ongoing modernization agenda, and will feed into the implementation of ongoing operations (e.g., IDB's Second Fiscal Management Project and World Bank's Public Policy Technical Assistance Project), and the preparation of prospective follow-up operations.

The central component of the World Bank's ISN will be a single-tranche DPL operation, founded on the Government's medium-term development strategy and based largely on fiscal and pension reforms enacted to date. Following its dual developmental-fiduciary role, the implications for the CFAA/CPAR are two-fold: (i) while emphasizing country ownership of reforms to date, PFM policy dialogue around the DPL would be strengthened, facilitating the government access to technical expertise and global experience; and (ii) the review of the country's PFM arrangements will inform whether and how the DPL should include measures to address identified fiduciary weaknesses.

Management of the participating Banks' lending portfolio. Since the public sector main fiduciary issues have an effect on the implementation of investment projects, the CFAA/CPAR recommendations should help streamline the correlated processes and reduce transaction costs, under adequate fiduciary safeguards.

³ Currently being supported by IDB loan "*Programa de Gestión Fiscal II*" Loan 1430/OC-PN approved in 2002.

⁴ The governance environment and certain PFM functions (e.g., procurement and revenue administration) are also important aspects of a country's enabling environment for business and investment.

EXECUTIVE SUMMARY

This Country Financial Accountability and Procurement Assessment Report (CFAA/CPAR) analyzes the government's fiduciary responsibility to manage public resources through transparent institutions and efficient systems of budgeting and procurement. Accordingly, the recommendations contained in this report seek to identify areas where public financial management (PFM) can be improved, with the goal of strengthening fiscal discipline, enabling more efficient allocation of resources, and increasing operational efficiency. In that sense, emphasis is made in short-term recommendations that can be implemented under the framework of the government's strategy and available resources, and medium-term strategic initiatives to address remaining principal challenges.

This approach and the ensuing recommendations are consistent with the government's own reform vision and program, and reflect an intense policy dialogue on PFM system reforms with key government counterparts over the past several months. They are also fully integrated within the broader context defined by the public expenditure review (PER) prepared by the World Bank. The draft CFAA/CPAR was discussed with the government and the feedback received was incorporated into this version.

Main conclusions and key recommendations

The PER conveys at least three messages that are of critical relevance to the CFAA/CPAR: (i) in spite of a recent successful turnaround in Panama's fiscal performance, the public debt ranks among the highest in Latin America, stressing the need to persevere in maintaining fiscal discipline and in reducing the debt toward a less vulnerable level; (ii) there is significant room for improving the efficiency of public spending, as evidenced by the social outcome indicators that are not commensurate with the amount of public spending; and (iii) there also appears to be significant room for improving the distributional impact of public expenditures. Furthermore, many features of Panama's public finances that reduce the impact and efficiency of public spending, and that have resulted in missed opportunities on the revenue side, are common across sectors, including but not limited to: (i) absence of proper sector planning and budgeting; (ii) imbalance between maintenance and investment expenditures, and blurred distinction between both in sector budgets;⁵ (iii) lack of systematic monitoring and evaluation of programs and projects; (iv) inadequate targeting and allocation of resources; and (v) weak administration of public assets.

The design and performance of public financial management and procurement systems can influence the above-mentioned factors. In that sense, the following paragraphs summarize the main CFAA/CPAR conclusions and recommendations. These are elaborated further in the subsequent sections of this executive summary and in the body of the report.

⁵ In accordance with comments from the MEF, availability of resources for maintenance in the recurrent budget is very low. Therefore, institutions incorporate those expenditures into the capital budget.

The CFAA/CPAR concludes that the PFM system in Panama possesses a number of strengths that permit fiscal discipline control,⁶ such as legal powers to contain budgeted expenditures, timely monitoring of budget execution data and cash flows, centralization of revenues, and adequate debt management. Furthermore, concrete actions have been taken recently to enhance transparency of public finances, such as the increase in information that has been made publicly available and the legal protection given to rights of access to that information.

The cited qualities are good bases to continue advancing in the areas of strategic allocation of resources and operational efficiency. With respect to the former, the initiatives underway to develop a medium-term budget framework should continue, with particular emphasis on the gradual development of the “bottom-up” budgeting process (i.e. preparation of costed strategic plans with aligned investment programs), and on better control of in-year budget modifications to enhance the credibility of the original budget as the main tool for policy implementation.

In terms of operational efficiency, traditional procurement practices in the central government and the seemingly cost-ineffective internal controls, restrict the capacity to generate important savings in budget implementation. Government procurement could be optimized under the framework of a comprehensive public procurement strategy comprising, among others, cost reduction strategies (price benchmarking, consolidation for economies of scale) and more efficient procedures (including basic tools such as standard documents, manuals and guidelines). Transactional controls (both ex-ante fiscal control and the entities’ own procedures) could be streamlined and applied more selectively, based upon risk management considerations, and complemented by strengthening of external audit capacity.

Implementation of the previous suggestions should consider three fundamental actions: (i) execution of training and capacity building programs, including sectorial entities; (ii) development of monitoring and evaluation systems applicable to both reform and performance of public procurement and financial management; and (iii) review of the institutional settings that may be leading to duplicate or conflicting functions (e.g., between external audit and other administrative-type operations).

Finally, and in large part as a result of increased transparency, issues with the reliability and quality of financial information (e.g., tax and payment arrears, quality of financial statements, and coverage of financial audits) have emerged and should gradually be addressed.

Methodology

The evaluation of the financial management system is based largely on the PFM Performance Measurement Framework.⁷ The framework assesses six critical dimensions: (i) budget

⁶ The report does not address the quality of fiscal policy or whether fiscal discipline has actually been maintained, but it looks at the features of the system that -used properly- would support that objective.

⁷ The Measurement Framework includes a set of 28 high-level indicators and has the following main objectives: (i) to constitute an integrated framework to support the government and other stakeholders in monitoring the performance of country PFM systems, processes and institutions over time; and (ii) to contribute to the PFM modernization process, by determining the extent to which actions are yielding improved performance and by increasing the ability to identify and learn from reform success. The framework has been developed by Public

credibility; (ii) comprehensiveness and transparency; (iii) budget planning; (iv) predictability and control in budget execution; (v) accounting, recording and reporting; and (vi) external scrutiny and audit.

Procurement aspects are organized in the report around the four key pillars set forth by the Baseline Indicator System (BIS) developed by the OECD-DAC/World Bank Joint Venture on Procurement.⁸ These pillars are: (i) the legal and regulatory framework; (ii) the institutional framework; (iii) procurement operations and market practices; and (iv) integrity of the system. While a full application of the BIS indicators was not included in the scope of this report, the government is currently undertaking this exercise as part of its efforts to establish a procurement monitoring and evaluation system.

The report updates the findings of the previous CPAR presented to the government by the World Bank in 2001, which are largely still applicable. However, this update focuses primarily on short-term actions and medium term strategic initiatives which can ensure the sustainability of the reform, improve the efficiency of procurement process, and generate savings, areas identified as the main challenges and priorities for the government. Implementation of several of the actions discussed during the preparation of the CFAA/CPAR is already underway.

In addition, this report includes an in-depth review of procurement procedures and practices of two public sector entities, the Panama Canal Authority (ACP) and the Social Security Administration (CSS), which are recognized as having efficient procurement systems. These systems are defined by distinct, in the case of the first entity, and supplementary, in the case of the second, sets of rules. However, these rules contain the same basic principles found in the public procurement law (Law 56), and the entities mostly operate within the same domestic market and draw from the same pool of human resources as the rest of the public sector. The analysis clearly demonstrated that their success is the result of several combined factors which are present in all sound procurement systems and, consequently, can be used as benchmarks for improving the overall public procurement system in Panama. Many of these practices can be replicated even utilizing, in some cases, the same tools and/or actively transferring knowledge from the two well performing institutions to the rest of the government.

The subsequent sections of this executive summary present the key conclusions and recommendations for each of the dimensions and pillars mentioned previously. The body of the report is organized as follows: Chapter I provides a brief country context, Chapter II describes the PFM legal and institutional framework, including the integrity of the system, Chapter III looks into key cross-cutting issues, Chapter IV examines thoroughly the budget cycle, and Chapter V discusses procurement operations and market practices.

Expenditure and Financial Accountability (PEFA, 2005), an international partnership including, among others, the World Bank and the IMF. Additional information can be found in www.pefa.org.

⁸ The BIS was the joint product of a wide group of donors and developing countries and was endorsed by the Paris High Level Forum on Development Effectiveness of 2005.

Specific Conclusions and Recommendations – Financial Management

Budget credibility. The execution outturns of the recent three years as compared with the original budgets show good ratios at the aggregate levels of revenues and expenditures, a key feature in terms of the ability to maintain fiscal discipline. However, when the outturns are broken down to the institutional level, and particularly in capital expenditures, significant variances (resulting in part from numerous and large in-year budget modifications) emerge. Improved control of budget modifications and execution variances could enhance the “credibility” of the original budget planning process as instrument of sectorial public policy.

As is well known by the government, payment arrears constitute a non-transparent form of financing that has affected the quality of fiscal information, and has likely increased the cost of doing business with the state. The efforts made so far to reduce delayed payments could be complemented with the production of certain key information, such as the reconciliation between payable amounts reported in central government fiscal balance reports and in financial statements, and the preparation of auxiliary records with age profiles.

Comprehensiveness and transparency. Relevant characteristics of the Panamanian budgetary system are its ample coverage, the classifications used, and the quantity of information that is put in the public domain on a timely basis. The budget documentation could nevertheless be improved through the implementation of certain practices from the Fiscal Transparency Code, and the capacity to analyze the financial performance of the decentralized sector and the State’s shareholding participation in enterprises could be strengthened. These matters are important from the point of view of both “consolidation” of fiscal risks and revenue management.

Budget planning. Worth noting are the clarity and orderliness of the annual budget formulation process, the procedures for legislative scrutiny and approval, the transparency of the system for approving in-year modifications, and the recent initiatives to develop medium-term fiscal and budget frameworks and result indicators. The report suggests strengthening the “bottom-up” process (i.e. the strategic sectorial plans properly costed), enforcing compliance with the public investment programming procedures (including the quantification and evaluation of implications on recurrent expenditures), connecting the budget with procurement plans, and developing indicative ceilings for the discussion of sectorial budget projects.

Predictability and control – revenues.⁹ The continuing implementation of the Revenue Directorate’s strengthening project is critical and should help to, inter alia, make better use of the comprehensive tax information system in place (e-Tax). Special attention is needed on the audit and fraud investigation capacity (human resources, plans and methodologies), on the cleaning up of the taxpayer accounts to allow –among other things- the proper measurement and follow-up of tax arrears (and accordingly improve the correlated statistics), and on the institutional internal controls (including the information system’s security safeguards).

Predictability and control – cash and debt. Key features of the system, such as the centralization of central government revenues, regular preparation of cash flows, and adequate

⁹ The CFAA/CPAR covers only certain general aspects of tax administration.

public debt management and records, permit a good handle of the government's cash position. On the other hand, measures could be introduced to give Treasury more control over idle balances and to reduce the large fragmentation of payment bank accounts, as well as to attend to the timely and independent reconciliation of the principal account (Cuenta 210). Payment practices could also be modernized and unified, and the procedures to record and service debt could be simplified.

Predictability and control – expenditures. There are ample transactional controls in place, which seem particularly effective in the payroll system. For non-salary expenditures, however, the procurement and payment controls in general do not seem efficient and tend to dilute accountability. In that sense, the effort to develop tools that facilitate fiscal control (guidelines, checklists, IT systems) is commendable. Looking forward, a selective application of ex-ante controls, with the introduction of differentiated techniques based on risk assessments (at the level of entities and types of transactions), is advisable. As for the executing entities, it is recommended to conduct in-depth reviews of their internal administrative systems and procedures, to eliminate duplicative and/or unnecessary steps, as well as to enforce more effective follow-up to the internal control weaknesses reported by the external auditors.

Accounting, recording and reporting. Important advances have been made in terms of the timeliness, scope and publication of quarterly budget execution, fiscal balance, debt and payroll reports, as well as annual financial statements. Still, there is a need for an integral improvement of the quality of the financial statements (e.g., accounting standards, disclosures, and consolidation), and for the modernization of the managerial and accounting control of property, plant and equipment.

External audit. The timeliness and publication of financial audit reports are notable features, but not their coverage. Given the large spectrum of entities subject to external scrutiny, better application of risk management methodologies in the planning and execution of external audits could be pursued. Certain relevant entities, key revenue and expenditure lines, critical processes (e.g., application of procurement rules) and budget execution reports could then be covered explicitly. In more structural aspects, it is important to retake the dialogue and make decisions in the medium term about a possible separation of external audit functions from other incompatible tasks (endorsements, payments, and consolidation of financial statements).

Other general issues. The report suggests preparing and implementing information technology policies (at least for financial management), with the objective of setting certain limits and rules to the proliferation of separate and sometimes incompatible applications. This should help, along with other actions, to advance SIAFPA's integration and enhance its relevance as a tool for management.¹⁰ On the other hand, the government could consider the preparation of a financial management law, with the objectives of ordering the current

¹⁰ The MEF intends to improve system integration through the development of an improved, more flexible, web-based version of SIAFPA. On the other hand, the Presidential Secretariat of Governmental Innovation (SPIG) considers necessary to work jointly with the MEF and the CGR to develop a new system to plan and manage in real time governmental resources (iGRP), given SIAFPA's problems (technological infrastructure, lack of articulation and integration, coverage, and supporting staff).

institutional settings (which in some cases assign duplicate and/or conflicting functions) and of giving more stability to the budgetary norms that are currently applied on an annual basis.

Finally, the performance measurement indicators documented in this report could be used by the government as the baseline for a monitoring and evaluation system to assess impact of reforms over time.

Specific Conclusions and Recommendations – Procurement

Legal and Regulatory Framework. The legal framework for public sector procurement already includes the basic elements to support a transparent and competitive environment and a modern institutional framework based on the centralization of normative and policy functions and decentralization of operational functions. However, the legal framework should be improved by introducing greater clarity in some very important areas such as, for example, qualification and evaluation criteria, the total amount of the performance security, justification for direct contracting, and selection of consulting services, and by simplifying administrative requirements which currently contribute to delays, overlaps, and inefficiencies in the procurement process.

The most serious problem with the previous procurement law (Law 56, 1995) was its limited and fragmented application due, among other reasons, to a proliferation of differing interpretations and application practices and splitting of contracts to avoid the overly legalistic approval procedures and controls. It is estimated that, in practice, 80 percent of government procurement under the cited law applied only to the acquisition of small projects and the purchasing of common goods and services. Moreover, to partly bypass the current convoluted budget and administrative requirements, the Government has made extensive use of international financial agents to implement its key projects and large contracts. However, even within the simplified context of the “Facilitation Projects” administered by UNDP, it takes the Ministry of Public Works 180 days on average to complete award a contract following National Competitive Bidding procedures.

A major accomplishment in the area of the legal framework on procurement has been already taken. A new procurement law, (Law 22 of 2006¹¹), has been recently enacted. The Law, effective on December 29 2006, is anticipated to play a major role in transforming the government procurement system. The GOP has already developed an action plan for the implementation of the Law, including drafting regulation frameworks, developing an e-procurement strategy, etc, which will be financed under a World Bank Technical Assistance Operation under implementation.

Institutional Framework. The structure of the current institutional framework is appropriate and there is strong leadership and political support for the reform at the highest level of Government. The three key institutional stakeholders (the DCP, the CGR, and the Presidential Secretariat for Government Innovation) are cooperating very closely and share a

¹¹ Law 22 was approved by the National Congress on June 8, 2006, and ratified by the Executive Branch on June 27, 2006. (Gaceta Oficial No. 25,576 de 28 de Junio de 2006)

sound vision of the reform's objectives. The role and independence of the DCP would be further strengthened by the proposed new law.

These three institutions have launched several good initiatives, but have not yet developed a well articulated procurement policy and a strategy defining clear priorities and arrangements to ensure that the reform produces the desired impact in the short to medium term and is sustainable after the initial thrust.

For example, the DCP is in the process of developing a plan to implement framework contracts which can help achieve significant savings. However, other countries' experiences have shown that significant market analysis, a careful strategy, and an appropriate legal instrument are essential to avoid potential pitfalls such as market concentration and higher prices. In addition, it is important to point out that framework contracts address only one aspect of the reform (i.e. improving economies of scale) and cannot resolve by themselves all the inefficiencies which are affecting the system. In addition, this contractual approach is appropriate only for certain types of relatively simple goods and services. Currently, there is still little consolidation of procurement across government entities due to lack of planning, statistics, and controls on the overall demand, the fact that Panamacompras still does not include enough key functionalities to be used as procurement management tool, and other inefficiencies in the system.

The DCP should adopt as soon as possible a comprehensive strategy focusing on short and medium term actions to produce measurable results in the priority areas for the Government: (i) increase efficiency through simplification of processes; (ii) achieve better economies of scale and standardization; (iii) accelerate development and utilize more efficiently new technology and methodologies; and (iv) promote transparency and efficiency by increasing the use of competitive procurement. The strategy should include a national plan to build accountability and sustainable capacity in the procuring entities, the development of basic tools and methodologies, and detailed planning of the resources necessary to produce these tools and implement the DCP's mandate.

One of the most important initiatives to accelerate the modernization of the procurement system is the adoption of a strategic plan to complete the development and implementation of Panamacompra. The plan should define all management aspects of the system, the resources needed, technical details of its subsequent phases, and regulatory changes necessary to implement each of them ensuring a smooth transition to an electronic public procurement marketplace. Among other aspects, a unified goods catalogue, based on international standards, and a single database of suppliers are particularly important.

The overall procurement strategy should also include a risk map of all potential obstacles with a strategy to overcome them, a stakeholders' analysis to maximize the effectiveness of the relationships among public sector institutions and develop strategic alliances with the private sector and civil society, and a communication campaign to improve the image of the Government as business partner, which was damaged by chronic late payments and inefficiencies as noted previously.

The main implementing tools include standard bidding documents, manuals and guidelines on aspects such as planning and contract management, a procurement monitoring and evaluation system, and risk management tools developed and managed in partnership with the CGR.

The monitoring and evaluation system will be very important to ensure that the reform is implemented consistently throughout the public sector producing the desired impact in terms of increased efficiency, savings, perception of transparency and competitiveness, and that the system is updated on an ongoing basis after the reform is completed. The monitoring and evaluation system should be integrated with the risk management tool to ensure that, as noted previously, the intensity of the ex-ante control is commensurate to the capacity and quality of internal controls in the procuring entities (e.g. by raising thresholds for ex-ante review for the entities which perform better). Finally, the system should utilize the above mentioned benchmarking with the good practices found in the ACP and the CSS.

Market Operations and Practices. While ex-ante external control contributes to procurement delays, one of the most significant causes of administrative inefficiency lays in the internal bottlenecks of the procuring entities. For example, in the Ministry of Education, public bidding requires 20 distinct administrative processes divided in 84 practical steps, of which all but one process and 2 steps are internal requirements of the Ministry. Clearly, it is essential that these requirements be significantly streamlined eliminating unnecessary reviews and duplications.

Significant savings can be also achieved by introducing an integrated program which utilizes framework contracts, price benchmarking, and other cost reduction methodologies, provided that a careful overall strategy is developed, the right legal instrument utilized, and other complementary actions are taken to increase efficiency. For example, a project focusing on intense price benchmarking and consolidation of items with standard specifications procured on a regular basis in large quantities by several entities, can generate savings ranging from US\$44 to 68 million (equivalent to 8 to 12 percent of the annual procurement budget of the Government), depending on the items included in the program. The CSS, the first public sector institution after the ACP to utilize framework contracts, already achieved savings for approximately 18 million dollar and a significant reduction in the times required for ex-ante control since rolling out this approach a year ago.

The starting point to achieve an effective cost saving strategy is an in-depth analysis of the structure of the demand and the offer in the procurement market with the objectives of identifying the best opportunities for quick gains, designing an implementation program in phases (starting with items which are easier to consolidate and present an elevated saving potential), and defining other details of the strategy such capacity strengthening, technical assistance, and constituency building. Another example of potential cost reduction approaches is a greater use of international procurement for certain items. As the domestic market is dynamic and can meet adequately the demand of the Government, almost every goods and services are procurement locally. However, a high level assessment of this approach carried out during preparation of this report suggests that costs are not always below international market prices for all items procured.

Integrity of the system. The legal and institutional frameworks for transparency, anticorruption, and access to information in Panama have been already significantly modernized and can adequately support a sound financial management and procurement system. However, the integrity of the system could be further strengthened in significant ways by: (i) accelerating implementation of Panamacompra; (ii) establishing an independent protest review tribunal; (iii) publishing financial disclosure information of public officials; (iv) simplifying requirements for prosecution of embezzlement and corruption cases; and (v) and providing increased legal protection for whistleblowers.

I. COUNTRY BACKGROUND

Economical and Political Evolution

1. Panama is an upper middle-income developing country with a per-capita gross national income (GNI) of US\$4,450 in 2004. It has a population of around 3 million inhabitants, of which more than half (57 percent) resides in urban areas and 10 percent is of indigenous descent. In spite of Panama's relatively high per-capita income level, a surprisingly large share of the population (37 percent) continues to live below the national poverty line, and around 17 percent lives in extreme poverty. Most of human development indicators have failed to improve significantly during the last six years, in spite of positive economic growth and significant amounts of public social sector spending. Still, Panama's social indicators are generally better than the regional averages, and similar to those exhibited by other upper middle income countries.

2. Panama has been characterized as a dual economy, consisting of a dynamic service exports sector that is very competitive at the global level and a protected domestic market for agricultural and manufactured goods. The services sector accounts for 75 percent of Panama's GDP and over half of its total exports. The dominance of this sector is explained by the country's unique geographic location between North and South America and rests on four main pillars, comprising the operations of the Panama Canal, the Colon Free Zone, the International Banking Center, and the provision of flag-of-convenience services.

3. Another distinctive trait of the Panamanian economy is its monetary regime, which has been tied to the US Dollar as legal tender since the early 1900s. This regime has provided a stable anchor for the economy over the years, as manifested by low inflation rates, low interest rates and the absence of major currency crises. The adoption of a US Dollar-based regime also has meant the removal of active monetary and exchange rate policies from Panama's arsenal of macroeconomic policy instruments, forcing a greater reliance on fiscal and trade policies.

4. **The possible trade agreement with the United States.** In 2004, bilateral trade between the United States and Panama totaled \$2.1 billion, with U.S. exports accounting for \$1.8 billion of that amount. Between 2002 and 2003, U.S. exports to Panama grew over 30%. Nearly half of Panama's total imports come from the United States. U.S. foreign direct investment in Panama totals roughly \$25 billion. Panama currently enjoys broad access to the U.S. market. In 2002, over 90% of Panama's goods exports to the United States came in duty free under unilateral benefits programs like the Caribbean Basin Initiative (CBI) and the and the Generalized System of Preferences (GSP) or under 0% MFN tariffs.

5. Panama is currently negotiating a free trade agreement with the US with essentially the same objectives established for the CAFTA countries and which is expected to supersede domestic regulatory frameworks in several areas including procurement. All trade agreements recently negotiated by the US included detailed procurement rules and access to effective remedies for bidders who allege a violation of these rules.

6. **Political context.** Panama is a presidential democracy with a unicameral legislative assembly and an independent judicial system. In the previous administration (Moscoso, 1999-2004), the government's most important achievement was securing approval of a Fiscal Responsibility Law in 2002 that was seen to provide an adequate framework to institutionalize fiscal discipline and achieve medium-term fiscal sustainability. But the law was ineffective. Tax receipts over the five-year period remained almost stagnant, while current spending rose steadily to cover the swelling ranks of civil servants and growing interest payments. Public debt grew from 60 percent of GDP in 2000 to 66 percent of GDP in 2004. Little attention was given to program evaluation and there was a paucity of analysis on the efficacy and efficiency of public spending, despite pressing social needs and limited resources. Alleged corruption was a cause of widespread public dissatisfaction.

7. President Martín Torrijos was elected with a strong mandate in May 2004. His party also attained a majority in the National Assembly. The new administration is focusing its attention on Panama's most pressing challenges: fiscal and social security reforms. The fiscal deficit (excluding the Panama Canal Authority) reached 5% of GDP in 2004, but the new administration is taking measures to put the deficit on a declining path aimed at reducing it to 3.6% of GDP in 2005 and decreasing further to about 1 percent of GDP by 2007. A fiscal reform approved in February 2005 included measures to contain current expenditure and increase the efficiency of tax collections. The final goal of the reform is to generate savings, facilitate social investment programs and develop a solid economic base that stimulates growth and employment.

8. **The government's program.** In June 2005, the government made public an ambitious development plan for the five-year term of its administration: "Strategic Vision of Economic and Employment Development Toward 2009", which articulates the five pillars of the government's economic and social development policy: (i) reduction of poverty and improvement in income distribution; (ii) an economic growth policy to create employment; (iii) reform of public finance; (iv) development of human capital; and (v) reform and modernization of the State. The third and fifth pillars are of particular relevance to the CFAA/CPAR.

9. The government's program to regain fiscal stability is already underway. It consists, among other measures, of: (i) rationalization of current expenditures, including avoiding unnecessary expenses, with transparent, effective and efficient public procurement and contracting mechanisms; (ii) tax reform geared to capturing more resources through a fairer tax structure and a more efficient tax administration; (iii) improved management of the budgetary system geared to achieve more productive investments; (iv) establishment of responsible accounts payable management; and (v) provision of accurate information through transparent accounting standards.

10. The state reform and modernization area includes actions in various fronts, including: (i) ensuring transparency and eradicating corruption from the public sector; and (ii) redesigning the government's functions by getting rid of obsolete activities, simplifying and reducing bureaucratic dealings, and streamlining administration through improved staff professional training.

The Public Sector¹²

11. The national government accounts for the lion's share of total public spending, as local government spending represented around 2 percent of the total in 2005.¹³ At the national level, public sector consists of 17 central government entities, 24 decentralized institutions, 10 public enterprises, 7 financial institutions and the Panama Canal Administration (PCA). The central government accounts for about one-half of total spending while the decentralized institutions account for 25 percent. Excluding the financial sector and the operations of the Panama Canal Authority (ACP), total public spending at the national level has averaged around 31 percent of GDP over the last decade (Table 1). Including the operations of the ACP would add another 5 percent of GDP, raising the total to about 36 percent of GDP.

Table 1: Total Consolidated Non-Financial Public Expenditures
(by Institutional Grouping; on accrual basis, as percent of GDP)

	1996	1998	2000	2001	2002	2003	2004	2005	2006
	actual	budget	budget						
Central Government	18.5%	20.3%	20.0%	20.4%	19.3%	17.7%	19.8%	18.1%	19.3%
Decentralized Institutions	11.1%	12.2%	13.7%	12.0%	12.1%	11.5%	13.1%	13.9%	11.4%
Public Enterprises	9.1%	6.0%	3.0%	2.9%	3.1%	2.8%	2.9%	2.8%	3.2%
TOTAL	38.8%	38.5%	36.8%	35.4%	34.6%	31.9%	35.8%	34.9%	34.0%
less									
Inter-Institutional Transfers	-4.1%	-4.1%	-4.4%	-4.6%	-4.7%	-3.8%	-3.8%	-3.8%	-3.7%
TOTAL	34.7%	34.4%	32.4%	30.8%	29.9%	28.1%	32.0%	31.0%	30.3%

Source: PER, based on MEF.

Note: Total NFPS expenditures exclude the PCA and public financial institutions, and are calculated as total expenditures by institutional grouping minus amortization of debt and minus total inter-institutional transfers.

12. Although Panama's level of public expenditure as a share of GDP ranks among the highest in the region, its tax ratio is one of the lowest. This is explained by the unusually large inflow of non-tax revenues. The total revenue intake by the central government averaged 16.5 percent of GDP during 1993-2004, of which a full 6.5 percent of GDP (40 percent of the total) consists of non-tax revenues. This unusual composition of revenues is mainly explained by the Panama Canal and related activities.

13. The single largest expenditure item in the central government budget is the debt service. This reflects Panama's high level of public indebtedness, which reached around 66 percent of GDP in 2004. Total interest and amortization payments on the public sector's domestic and foreign debt accounted on average for 37 percent of total central government spending during the last decade. After public debt service, the most important spenders are (in declining order) the ministries of Education, Health, Justice and Governance, and Public Works, which together account for 44 percent of total central government spending.

14. The most important public financial institution is the National Bank of Panama (BNP), which operates as a commercial bank and also serves as the main financial intermediary for the national government, but without the power to issue money. Most of BNP's deposits come from other public sector institutions. It also administers the Fiduciary

¹² Abstracted from the Public Expenditure Review, PER (World Bank, 2006).

¹³ Central government transfers to municipalities account for barely 0.1 percent of the central government budget.

Development Fund (FFD), which was created in 1995 as a repository for the proceeds from the privatization of public enterprises and the sale or concession of Canal Zone assets, to be used for financing public development projects.

The CFAA/CPAR in the Country Context

15. Good PFM institutions allow governments to balance the three interrelated objectives of budgetary performance: aggregate fiscal discipline, efficient allocation of resources according to the Government's policy priorities, and operational efficiency in the use of resources (Schick, 1998). Institutions, understood as sets of formal and informal rules, influence behavior of public officials involved in the process of planning, allocating and spending public money aimed at implementing government policies and programs.

16. **Objectives.** With the view of strengthening the performance of Panamanian PFM institutions at the three cited levels,¹⁴ the overall objectives of the CFAA/CPAR are to: (i) document and update analytical knowledge on the legal and institutional framework and systems for budget planning and execution, procurement and contracting, fiscal reporting and external oversight; and (ii) accordingly propose a set of recommendations, thereby helping the Government in the design or implementation of capacity-building programs under its ongoing public sector modernization agenda. Emphasis is put on *fundamental actions* that could enhance operational efficiency.¹⁵

17. To that effect, Chapter II describes the PFM legal and institutional framework, including the integrity of the system, Chapter III looks into key cross-cutting issues, Chapter IV examines thoroughly the budget cycle, and Chapter V discusses procurement operations and market practices. The ultimate goal is to contribute to the government program's strategic pillars cited earlier, particularly on reform of public finance and modernization of the State.

¹⁴ The Public Expenditure Review (World Bank, 2006) analyzes other aspects (fiscal reform, quality of sectoral expenditure planning and allocation) that have a significant impact on the three levels of budgetary performance.

¹⁵ The *fundamental actions* found throughout the report respond primarily to the results of the application of the PFM Performance Measurement Framework (Annex 2).

II. LEGAL AND INSTITUTIONAL FRAMEWORK

Financial Management Framework

18. The PFM legal instruments are contained in various laws and regulations listed in Box 1. There is no financial management law per se, as the relevant rules are found in organic legislation and in a large section of each annual budget law dealing with budget administration procedures.

Box 1: Main Laws and Regulations Governing Public Financial Management

- Articles 267-278 of the Constitution regulate the general state budget. Articles 279-280 regulate the functions of the Office of the Controller General of the Republic (CGR).
- The Organic Law of the Ministry of Economy and Finance (Law 97, 1998) and its Regulations (Decree 52, 1999) establish MEF's leadership in public sector budget administration and financial management.
- Each annual Law of the General State Budget lays out the Budget Administration General Norms.
- The Public Contracting Law (Law 56, 1995) and its Regulations (Decree 18, 1996) norm public procurement.
- The regime for ex-ante control (*fiscalización*) and ex-post audits (*examen de cuentas*) is established in the Organic Law of the CGR (Law 32, 1984).
- The Tax Code and other specific legislation, such as recent tax reforms (Law 61, 2002 and Law 6, 2005) provide the framework for tax administration functions.
- The Fiscal Responsibility Law (Law 20, 2002) sets certain fiscal deficit and debt targets.
- The Law on Transparency (Law 6, 2002) establishes rules for the improvement of transparency in public management and grants individuals the right to access public information.
- The MEF has issued various manuals related to budget classification, formulation and execution, as well as user guides for the Integrated Financial Management System (SIAF).
- The CGR has issued the public sector accounting and auditing standards.

19. **Main institutional arrangements.** The Ministry of Economy and Finance (MEF) is responsible, inter alia, for the direction of public sector budgetary administration and of public finances. Accordingly, it houses typical financial management regulatory directorates: National Budget, Investment Programming, Revenues, Public Credit, Procurement, Treasury, Accounting, and Integrated Financial Management System (SIAFPA), among others.

20. The Office of the Controller General of the Republic¹⁶ (CGR) is an independent constitutional body with the authority to exercise fiscal oversight on (*fiscalizar*) all management of funds and other public goods, through ex-ante or ex-post controls.¹⁷ Other functions of the CGR include, inter alia, setting public accounting methods, reporting the financial situation of the public administration to the legislature and the executive, and maintaining national accounts. For the purposes of this report, three directorates are relevant: Fiscal Control (*Fiscalización*), Methods and Systems of Accounting, and General Audit.

¹⁶ The National Assembly elects the Controller General for a term equal to that of the President of the Republic (five years). The Controller can only be removed by the Supreme Court of Justice if justified under the law.

¹⁷ In accordance with the Constitution, the CGR determines the cases in which it will exercise both ex-ante and ex-post control, or only ex-post control. The latter, however, has rarely been put into practice.

21. The National Assembly approves the annual budget and possesses other budgetary attributes (see Chapter IV), but it cannot authorize expenditure items and programs that are not contemplated in the budget.

22. As will be noted in ensuing chapters, there are four main areas in which the institutional settings seem subject to improvements: (i) payment operations are fractioned, with CGR handling payroll and debt service, and MEF the other payments; (ii) similarly, public debt databases are maintained by both the MEF and the CGR; (iii) MEF's organic law (Law 97) grants it the function of keeping the integrated government accounting and preparing the consolidated financial statements of the public sector, a function that is still performed by the CGR; and (iv) CGR's external audit responsibilities seem incompatible with its ex-ante control and administrative-type tasks.

23. **Financial management systems.** The development and consolidation of an integrated financial management system (SIAFPA) is a central feature of the government's Program to Strengthen and Modernize Economic and Fiscal Management, financed by IDB and currently in its second phase (Box 2).

24. SIAFPA is the official government system for financial and budgetary records. Under the basic premise of operational decentralization and normative centralization, it follows two structures: (i) in executing entities, *SIAFPA institucional* contains modules for budget, procurement, treasury, accounting, fixed assets and inventories, and fiscal control; and (ii) at the central level, *SIAFPA consolidado* contains normative modules for budget, treasury, public debt, and accounting.

25. SIAFPA operates in 23 NFPS entities (including the whole central government), while other entities use an earlier budget execution system (SRPG) or other information systems. Even though the expansion of SIAFPA has gradually contributed to standardization, the abundance of disconnected IT applications for financial management is still tangible.¹⁸

¹⁸ For example: SIAFPA, SRPG and other systems are used for recording budget execution and accounting transactions. EPD is used for management of most, but not all, government payrolls. The budget formulation system, the public investment system (SINIP), the debt management system (DMFAS/SIGADE), and the fixed assets registry, to name a few, are not directly interfaced on-line to SIAFPA. The MEF intends to improve system integration through the development of an improved, more flexible, web-based version of SIAFPA. On the other hand, the Presidential Secretariat of Governmental Innovation (SPIG) considers necessary to work jointly with the MEF and the CGR to develop a new system to plan and manage in real time governmental resources (iGRP), given SIAFPA's problems (technological infrastructure, lack of articulation and integration, coverage, and supporting staff).

Box 2: Program to Strengthen and Modernize Economic and Fiscal Management

The main objective of the 2nd phase of the program is to increase public sector efficiency and effectiveness in the economic and fiscal spheres. The objectives of the Loan have been recently reviewed with the government, following the change of administration. The review of the project components has slightly modified the original calendar for disbursement, and the agreed goals have been defined as follows: (i) enhance the MEF's planning capacity; (ii) strengthen financial management; (iii) make tax collection more efficient and effective; (iv) improve the quality of public investment; (v) expand the management and oversight capacity of the customs administration; and (vi) strengthen the institutions of the land-registry system.

Strengthening of financial management

a. Budget Directorate (DIPRENA). To improve budget management and make it more expeditious, accurate, and transparent, the following activities are planned: (i) design a methodology to review the programming structure of the national budget, and introduce a multi year budget programming; (ii) conduct a diagnostic study of the current programming structure; (iii) define and implement a new programming structure aimed at making the budget a means for administering public management and assessing its performance in physical and financial terms; (iv) incorporate the interface with the public revenue subsystem into the budget cycle; and (v) train its staff in the new methodologies adopted.

b. General Treasury Directorate (DGT). Plans are to reduce the government's current financing expenditures by: (i) consolidating efforts within the operation of the Treasury, reducing the time for payment to service providers from 120 to 30 days; and (ii) carrying out the program to implement an integrated account system in the Treasury, cutting the daily average balance from US\$500 million to US\$150 million, with a respective decrease in interest costs.

c. Public Debt Directorate (DCP). Improving external and internal debt management will reduce the costs of managing the public debt. The following activities will be carried out: (i) finalize the transfer of debt registration and payment functions between the MEF and CGR; (ii) support streamlining of the debt registration and payment process; and (iii) design and adopt a quality control methodology for data entered in the SIAFPA and reports on public debt management.

d. National Accounting Directorate (DNC). The following activities will be carried out: (i) formulate procedures to verify the quality of accounting information; (ii) define the methodology for consolidating the public sector's financial statements; (iii) design methodologies for financial and economic analysis of consolidated financial statements; and (iv) support implementation of the DNC training plan.

e. SIAFPA. The following activities are proposed: (i) fine-tune and extend SIAFPA to the decentralized public sector and local governments selected by the Government of Panama; (ii) define a standardization plan for SIAFPA; (iii) incorporate into SIAFPA interfaces with other related systems, e.g., revenue, investment, and the integrated account of the Treasury; and (iv) design back-up and contingency plans. Full implementation of SIAFPA throughout the public sector is expected to bring an increase in the sector's productivity, a decrease in public procurement costs, and greater transparency and control in execution of the budget.

Modernization of the public investment system

The general objective of this component is to strengthen the planning, programming, and control of the public investment budget so the public sector can pursue investment options that yield the highest returns and are the most consistent with the government's macroeconomic targets. The key element of this strengthening is the "control tower"—an information system built on a Web application coupled with Intranet-based communication as a core component of the SINIP—that will provide information on the public sector's investment project portfolio to the entire country.

The Directorate of Investment Programming (DPI) undertakes a number of activities to strengthen the SINIP, as follows:

- Institutional strengthening through a scheme that takes into account three components: (i) training and technical assistance, (ii) methodologies, standards and procedures; and (iii) the integrated project portfolio system (*banco integrado de proyectos*).
- Structuring of the Inter-institutional Technical Committee to foster project feasibility.
- New design of the system to manage investment initiatives.
- Execution of an action plan to contract a consulting firm to undertake the development and implementation of the integrated project portfolio system, with a view of satisfying the needs of users and the improvement of the defined methodology.
- DPI's plans include the review of methodology for the formulation, monitoring and management of project initiatives, which will serve as basis for the new system.

DPI actions also include the development of a training program to strengthen the process of formulation and monitoring of project initiatives, as well as the use of the information system. The new system concept takes into account the development of functionality for the identification of training needs in executing entities. On the other hand, the contracting of an international consultant to coordinate the formulation of a medium-term sectorial public investment plan (2006-2010) is underway.

Strengthening of the tax system

- a. With the objective of implementing procedures for institutional planning and management control: (i) studies will be conducted on evasion and on key economic sectors to provide input for the institutional plans; (ii) the single taxpayer registry will be evaluated and courses of action will be proposed to give the General Revenue Directorate (DGI) better knowledge and more information on the units administered; (iii) management control and planning methodologies will be established for all areas; and (iv) the organizational structure of the action programs adopted will be reviewed and adapted.
- b. To implement effective controls and combat tax evasion: (i) capacity will be created for investigating and detecting tax evasion; (ii) new computer systems will be set up to support inspections; (iii) the implementation of structural measures to prevent evasion will be assessed; (iv) specific audit techniques will be developed by economic sector; and (v) auditors will be provided with computer-based means for their field work.
- c. Strengthening of IT resources: (i) the DGI will receive support to consolidate its IT independence within the framework of policies defined by the MEF and the exchange of information that must necessarily occur with other areas of the government; (ii) support will be provided to develop and administer its own systems; and (iii) infrastructure will be reinforced and updated to manage electronic data systems.
- d. Establishment of institutional communication policies: (i) policies will be established to foster better compliance with tax obligations by taxpayers; and (ii) large-scale, permanent channels of information on the tax system will be put in place, aimed both at the community and at the system internally.
- e. To promote training and improvement in the services offered by tax administration personnel and boost operational capacity, support will be provided for: (i) creation of a unit to coordinate staff training and management; (ii) implementation of specific procedures for the selection, hiring, evaluation, and promotion of employees under the current Administrative Career Act; (iii) design and implementation of training plans, with emphasis on the areas of tax control and inspection; and (iv) application of management procedures that allow the DGI to administer more expeditiously the physical and financial resources assigned to it.
- f. With regard to internal control, the program will promote the formalization of procedures by means of guidelines or manuals and will establish internal control procedures.

Source: IDB (2002, slightly updated in 2006)

Public Procurement Framework

26. **Overview of the legal framework.** Law 56 of 1995 and its implementing regulations, included in Decree No. 18, 1996, constitute the basic regulatory framework for public sector procurement in Panama. Strengths and weaknesses of the law are addressed in detail in the 2001 CPAR. However, an inter-institutional committee of the Government prepared a new draft procurement law which was endorsed by the full Cabinet and will be submitted to Congress shortly. This document is discussed separately below.

27. Law 56 and regulations set forth all the basic principles which are required to support a competitive and transparent procurement system including the foundation for a sound institutional framework for policy development and implementation. The most important shortcomings included insufficient clarity in important aspects such as bidders' qualification, evaluation, and the amount of performance security (up to 100 percent of the contract value at the discretion of the procuring entity), excessive and vague justifications for direct contracting, lack of appropriate rules for selection of consultants, and overly legalistic provisions which introduce some rigidity in the process (e.g. excessive formality and multiple

documentary requirements). The latter problem, in particular, is compounded by the ex-ante control rules set forth in CGR's enabling statute, and various layers of internal approvals established by agency-level rules. Among the justification for direct contracting, one of the most frequently abused is "obvious urgency" which is too broadly defined. Another case where excessive latitude and lack of clarity may lead to abuses is the procuring entity prerogative to award the contract directly when two consecutive processes have been voided for lack of participants.¹⁹

28. The most serious problem with the Law 56 of 1995 is its limited and high degree of fragmented application due, among other reasons, to a proliferation of differing interpretations and application practices and splitting of contracts to avoid the overly legalistic approval procedures and controls. It is estimated that, in practice, 80 percent of government procurement under the current law applies only to the acquisition of small projects and the purchasing of common goods and services.

29. Another consequence of the burdensome budgetary and procurement processes has been the extensive use of external financial agents such as UNDP and IICA to execute projects and large contracts managed by central government agencies.

30. **New Procurement Law.** A major accomplishment in the area of the legal framework on procurement has been already taken. A new procurement law, (Law 22 of 2006), published in the Gaceta Oficial on Jun 28, 2006. The Law, scheduled to be effective on December 29 2006, is anticipated to play a major role in transforming the government procurement system.

31. The new Law constitutes a step in the right direction in reforming the regulatory framework as it addresses, in part, several of the weakness previously identified, strengthens the independence and mandate of the DGCP, and facilitates the transition to an electronic procurement system. The GOP has already developed an action plan for the implementation of the Law, including drafting regulation frameworks, developing an e-procurement strategy, etc, which will be financed under a World Bank Technical Assistance Operation under implementation.

32. **Examples of Parallel Regulatory Systems.** While several autonomous bodies follow their own rules in addition to the law, the ACP utilizes a completely independent procurement system²⁰. There are many factors in addition to a sound set of rules which contribute to the efficiency of the ACP's procurement system. However, some of these factors are rooted, at least in part, in its regulatory framework which is well designed and incorporates modern principles and approaches in Government contracting laying the basis for streamlined procurement processes and controls. While the latter are strong and innovative, the main thrust of the ACP's rules is the cost efficiency and quality of the procurement outputs, and the most favorable conditions for disposition of obsolete goods and the

¹⁹ The language of Art. 46 and 58 of the Law 56, allows, but not mandates that the procuring entity award the contract to the only participant. However, the entity may, at its discretion, award the contract directly to a different party who had not participated in the bidding.

²⁰ Based on Art 312, Title XIV of Panama's Political Constitution, Articles 52-59 of the Enabling Law of the ACP, the ACP Contracting Regulations, and further internal rules addressing procedural details.

concessions granted by the ACP. ACP's regulatory framework recasts the procurement cycle as a process of supply management, involving a full range of management decisions in addition to the selection process. Principles found in the ACP's system of rules go much beyond the basic value of open and transparent competition, also present in the Public Procurement Law, to provide clear guidance on many key aspects of an efficient system including, inter alia, ensuring fair and equitable treatment of bidders and contractors, the use performance-based specifications, delegation of contracting authority, procurement planning to increase efficiency through appropriate consolidation, access to procurement information by prospective bidders and contractors, bid protests, and evaluation of contractors' past performance. The control system includes, inter alia, ex-post audits, clear rules of ethics and financial disclosure, and an efficient procurement information management system which automatically flags suspicious activities such as contract fractioning and collusive practices. The ACP procurement rules also sets forth detailed provisions on contract administration, including prompt payment to contractors and computation of interest in case of late payment, maintenance of records and internal audit, and clear ethics and code of conduct measures and sanctions. For control purposes, the Same Contracting Officer is prohibited from performing more than two of the following tasks: approval, receipt acknowledgement, and payment authorization.

33. Another important example of the "parallel procurement regimes" existing in Panama is the Social Security Administration (CSS). In addition to Law 56, detailed procurement provisions are included in its recently reformed enabling law²¹ and the Law on Drugs and Other Health Sector Goods²². These sets of rules are complemented by detailed procedures on the procurement process which were fully revised in 2005²³ and standard bidding documents which set the basis for transparent competitive processes and equitable contractual relationships. The CSS parallel regime sets forth a more comprehensive and modern regulatory framework than the Public Procurement Law, particularly with respect to the use of framework contracts. Many details are appropriately included within lower level, flexible sources (i.e. internal procedures and bidding documents). However, the recent success of the CSS in improving procurement efficiency and transparency can be credited more to its organizational reform, the efficient use of technology and new contracting approaches, and the leadership of its Director than legal reform.

34. **Overview of the Institutional Framework and Management Capacity.** The key institutional stakeholders include the MEF, in particular, its Public Procurement Directorate (DCP), the CGR, and the Presidential Secretariat for Government Innovation (SPIG).

35. The DCP is the primary regulator and, by law, it is required to actively participate in the system's oversight together with the CGR (e.g. by approving direct contracting, an activity which historically has absorbed a significant portion of its resources).

36. The current Government has placed strong emphasis on procurement reform as a way to streamline public administration and increase the efficiency of public spending. As a

²¹ Law 51 of 2005.

²² Law 1 of 2001.

²³ Various internal rules such as the "Procedures for the Purchase of Goods Utilizing Framework Contracts" (N. 260-05) and the "Procedures to Address Breaches of Contracts in Framework Contracts" (178-05).

result, the DCP received a stronger mandate and full political support to revive the reform process. Currently, the DCP has effective leadership, is developing a sound vision for its strengthened role, and is beginning to coordinate well with other key Government stakeholders, in particular the CGR and the SPIG. In addition to those allocated by the Government, adequate resources to support the initial phase of the reform are available through the World Bank's Public Policy Reform Technical Assistance Project which has a specific component for this purpose (Box 3).

Box 3: Public Policy Reform Technical Assistance Project

The objective of the project is to consolidate and deepen the reforms needed to accelerate growth and reduce poverty, by strengthening the government's economic monitoring and planning, policy formulation and execution capacity. The project promotes the achievement of this objective by assisting the government in the implementation of selected commitments and policies, the design of selected new reforms and the improvement of its capacity to carry out poverty and economic monitoring, and analytical evaluations. More specifically, the objectives of the project include the following: (i) promoting trade reform and liberalization; (ii) contributing to fiscal sustainability and public sector efficiency by strengthening the overall capacity of the government to monitor economic data and improve macroeconomic policy formulation and implementation; (iii) improving the quality of poverty data and information on social expenditures so as to increase the relevance, efficiency and targeting of social programs; and (iv) improving the efficiency and transparency in public procurement.

Strengthening the public procurement system

1. Improving the public procurement legal framework. This sub-component supports an overall review of existing procurement and related regulations, and the drafting and processing of an amendment to Law 56, and comprehensive regulatory decree, using a participatory mechanism (workshops) to involve all stakeholders. The amendment to the Public Procurement Law would aim at strengthening the lead policy, regulatory and institution building role of the DCP, closing existing loopholes, and removing inconsistencies.

2. Building institutional capacity for handling procurement. The government believes that it is necessary to strengthen the capacity for handling public procurement and this sub-component supports the strengthening of the DCP and the government agencies' procurement units to provide them with the resources to carry out their duties and to undertake a phased program aimed at: (i) developing standard procedures and bidding documents of general application nationwide; (ii) reviewing and adjusting procedures; (iii) developing and implementing a human resources policy; (iv) carrying out an assessment of available human resources; and (v) designing and implementing a training program for procurement officials.

3. Developing a public procurement system. This sub-component supports the establishment of a Public Procurement Information System and setting the basis for Electronic Government Procurement (EGP). The project finances technical assistance, training and equipment for the development of this system.

The government has recently refocused the procurement sub-component as part of the policy dialogue carried out during preparation of this report, including some of its recommendations. For example, selection processes are underway to retain consultants who will help the DCP develop an overall reform strategy, prepare baseline indicators utilizing the OECD-DAC Procurement Joint Venture BIS tool, reviewing administrative processes to identify inefficiencies and bottlenecks, and carry out transparency perception surveys.

Source: World Bank (2001, slightly updated in 2006)

37. During 2005, the DCP has been restructured to provide technical assistance to procuring entities on the interpretation and application of the regulatory framework, supervise the consistent implementation of the system as a complement to the CGR's control function, develop tools such as bidding documents, build capacity in procuring entities, and manage the e-procurement system. The new leadership and restructuring have resulted in more efficient workflows (from 90 to 30 days average to respond for approximately 70% of the processes) and launched an outreach campaign to begin collaborating more effectively with the private sector and civil society organizations (e.g. with the local chapter of Transparency International). The latter will require a significant effort as the DCP will need to overcome a negative image of the public procurement system and the state as a business partner for the private sector²⁴. In addition, during preparation of this report, the DCP began cooperating more closely with the Public Policy Technical Unit responsible for implementing the World

²⁴ Several private sector representatives interviewed by the mission indicated that many reputable Panamanian companies either do not contract with the Government or, by corporate policy, rely only on the procurement market only for a limited share of their business.

Bank project and refocused the procurement plan to address some of the emerging needs of the DCP, as identified by its leadership and preliminarily confirmed by this CPAR update.

38. The CGR is also in the process of reviewing its control methodology with the objective of improving its own efficiency, as addressed in Chapter IV. To this end, for example, the CGR has initiated the development of e-procurement before transferring this responsibility to the DCP and has been an early sponsor of legal reform to modernize the system.

39. The SPIG plays a central role in promoting the development of technology designed to promote transparency and efficiency in the public administration and establishing an environment which is conducive to its utilization. In particular, the SPIG took the leadership in the development of the e-procurement strategy (PanamaCompra) and it is a key partner for the DCP in its implementation.

The Integrity of the System

40. **Ethics and Anti-Corruption Measures.** The Government's agenda for state modernization included in the 2005 strategy for economic and social development identifies ethics, anticorruption, and a competitive procurement system as important priorities.

41. Law 6 of 2002 constitutes the legal framework for transparency in the public administration. As required by the law, on December 15, 2004, the Executive Branch issued regulations²⁵ establishing general principles for the standardization of codes of ethics within the central government. All public entities have already issued and disseminated their codes of ethics and some have posted their code online.

42. The transparency and anticorruption framework is implemented by several horizontal and vertical institutions.

43. The Offices of the CGR and the Attorney General are the agencies primarily responsible for enforcement of anti-corruption provisions within their respective areas of jurisdiction.

44. *The CGR*²⁶ has recently implemented several actions supporting transparency and good governance, such as starting to develop indicators to assess the fiduciary capacity of public entities and adjust the thresholds for ex-ante reviews accordingly. The CGR Office also established a financial disclosure program for public sector employees, as required by Law 59 of December 29, 1999. According to the CGR, as of December 25, 2005, 87.3% compliance had been achieved.

²⁵ Cabinet Decree 246 of December 15, 2004.

²⁶ Two offices reporting to the Controller General investigate administrative corruption: (1) The National Directory for Special Investigations (CGR's Resolution 204 of July 1995), which oversees reports on alleged irregularities in administration of public funds. This entity has an online system to report cases of misuse of public funds; and, (2) The Financial Liability Directorate (Dirección de Responsabilidad Patrimonial) Cabinet Decree 36 of February 10, 1990); an entity responsible for undertaking preliminary administrative steps to determine if public funds have been misused. The Dirección is also entrusted to issue administrative decisions on financial liability.

45. *The Attorney General's*²⁷ has implemented the following initiatives within the past year:

- Strengthening of the anti-corruption prosecutorial team by appointing a new specialized senior prosecutor.
- Creation of an “internal affairs” office responsible for investigating cases of misconduct involving staff at the Attorney General’s Office.
- Adoption of an anticorruption agenda at national and international level.
- Sponsoring of a bill to expedite investigation and prosecution of cases of corruption cases.

46. The *National Anticorruption Council*²⁸ was created as an advisory body to the Executive Branch on public sector strategies related to good governance, transparency, ethics and anticorruption. The Council, whose membership includes NGOs, religious groups and the media, is responsible, for disclosing the standard code of ethics among public officials, creating ethics units within public sector institutions, and advising the Executive Branch on anti-corruption and ethics.

47. As discussed, the *Presidential Secretariat For Government Innovation (SPIG)*²⁹ is responsible for promoting transparency and efficiency in public administration through the use of new technology.

48. *Civil Society*. Law 6 of January 22, 2002³⁰ includes mechanisms to encourage active civil society participation in monitoring public administration and Cabinet Decree No. 179 specifically requires the National Anticorruption Council to facilitate this participation with respect to the Government’s anticorruption efforts. Among other civil society organizations, the local chapter of Transparency International³¹, Fundacion para la Libertad Ciudadana³² and the Comision Justicia y Paz³³, have been very active and outspoken on issues related to transparency, ethics and anticorruption.

²⁷ According to Article 217 of the Constitution, the Public Ministry (under the Attorney General) is responsible for defending the interest of the State and or municipalities; enforcing laws; overseeing the official conduct of public servants and ensuring they fulfill their duties; investigating and prosecuting crimes and infringements of the Constitutions and laws; etc

²⁸ Cabinet Decree 179 of October 27, 2004.

²⁹ Cabinet Decree 102 of September 1, 2004.

³⁰ Law 6 of January 22, 2002.

³¹ Transparency International organized a workshop on Law 56, 1995, with the participation of members of public and private sectors, and civil society. The workshop produced a Map of Risk (Mapa de Riesgos), which identified the following key issues: discretionary powers given to the public official responsible for the implementation of bids; excessive use of sole source; restrictive provisions for qualification of bidders, limited time for preparation of proposals, and others findings also identified by the CPAR 2001.

³² *Fundacion para la Libertad Ciudadana* has conducted anti-corruption assessments covering issues related to politics, public contracting; judicial system, access to information. Among the most relevant reports issued by the Fundacion are: Global Integrity Report, Global Corruption Report, and assessments (diagnostic) of the public administration. The Fundacion has also participated in educational programs focused on anticorruption, such as

49. **Access to Information.** The right to access information is grounded on Article 41 of the Constitution and is also guaranteed under Law 6, which established the principles of public access and publicity. In the line with the Government's commitment to transparency, the Executive Branch issued a decree in September 2004 further expanding and defining the public's right to information³⁴. Consequently, anyone can exercise this right with respect to any matter of social or private interest³⁵ and public officials are required to issue a prompt response under penalties defined in the law, which also establishes a judicial mechanism for enforcing this right. Citizens whose requests for information have been denied or not addressed in accordance with the law, can request enforcement through a "habeas data", or a court order directed to the public entity to produce the information.

50. Law 6 also requires public entities to periodically publish certain documents (on policy, strategy, internal procedures, etc) on their internet sites and to keep printed copies of such documents and policies available to the public. However, public entities are not required to establish an office or department to manage this function. Additionally, access to all procurement files, reports and actions is specifically guaranteed by both Law 56 and Law 6.

51. The exercise of the right to access information has been further facilitated by the launch in October, 2005 of the first phase of the new e-procurement system, *PanamaCompra* whose enabling decree³⁶ emphasizes the importance of e-procurement in promoting transparency and competition, and supporting good governance. All central government institutions and autonomous entities are required to post online all public procurement information, contracts opportunities and awards and municipal and other local entities are also expected to eventually begin utilizing *PanamaCompra*.

52. **Access to Appeal Mechanisms.** Bid protests constitute an important watchdog for the system which is widely resorted to by bidders in Panama, but the regulatory framework does not establish an efficient system for review. A Resolution which sets forth procedural formalities to submit a protest has been issued by the DCP six years after the procurement law entered into effectiveness³⁷. The DCP's decisions are enforceable only if issued prior to contract award, there is no timeframe for PPO's review and decision, and the protests' outcome is not disseminated.

53. While only registered bidders are allowed to submit a protest, in the present regulatory framework there is no instruction on what constitute an acceptable protest or on

the design and implementation of public campaigns ("corruption stains") for awareness of the negative costs and consequences of corrupt activities.

³³ *Comision Justicia y Paz* has played a key role overseeing activities by the Judicial Branch, and advising the other branches on initiatives for strengthening judicial independence.

³⁴ Cabinet Decree 124 of May 21, 2002. Decree 124, limited the application of Law 6 to those "interested people", who have a direct personal interest in the information requested. However the new regulation has broader the application of Law 6 allowing "any person" to request information.

³⁵ Information concerning the compensation of public servants (on contracting, appointment, payrolls, representations, per diem, etc) is also subjected to public scrutiny under the current legislation. This information has been posted in websites by several government institutions.

³⁶ Cabinet Decree 98 of September 2, 2005.

³⁷ Resolution 109 of October 15, 2001 complementing Law 56 of 1995.

how to handle unfounded complains. As a result, the system is often abused by some bidders who submit frivolous protests simply to disrupt the process. Among the regulatory changes recently adopted by the Social Security Administration (CSS) to improve its procurement efficiency, as discussed below, a 15 percent security was introduced as a condition to submit a protest which is executed if the protest is not resolved in favor of the bidder by the Supreme Court which, in accordance with Panamanian law, carries out an independent review in the second instance through its specialized “Third Chamber”³⁸. The ACP regulations include a similar requirement for contracts above US\$10,000, but the amount of the guarantee is 5% and the guarantee is executed only if the protest is found to be frivolous and has caused additional expenses to the ACP. However, in the ACP’s system, protests alleging irregularities in the bidding documents and disqualification do not require posting the guarantee. In addition, determinations on protests must be made within 30 days.

Conclusions and Recommendations

54. **Financial management framework.** In general, there is a large legal and regulatory framework that covers each relevant area of budget management. Nevertheless, the practice of subjecting general budget administration norms of a “permanent” nature to annual issuance and approval could risk bringing instability to the system. Although not a priority, the government could therefore consider the preparation of a financial management law, leaving the annual budget laws to deal solely with the specifics of each fiscal year.

55. On the other hand, the distribution of fiscal functions is clear, yet not always adequate. Noting that in some cases there are legal and even constitutional implications, a *fundamental action* could be to get policy dialogue underway with the relevant stakeholders to look into mid-term solutions to optimize the distribution of institutional responsibilities, particularly with respect to payment operations (e.g., payroll and debt service), debt records, administration of accounting systems and preparation of consolidated fiscal reports, and external audits.

56. The ongoing implementation of an integrated financial management system (SIAFPA), with the correlated standardization of procedures, has contributed to the production of timely and seemingly reliable (though not yet complete) information on government spending. In that sense, SIAFPA contributes largely to the MEF’s capacity to control aggregate spending.

57. Recognizing the ambitious plans underway to upgrade SIAFPA’s technological platform to an internet based architecture,³⁹ a thorough review of the intricate administrative procedures in place (see Chapters IV and V), and of the system’s own recording methods (e.g. lack of a single accounting/budgetary entry applied throughout the process), could have

³⁸ Article 72, Law 51 of December 27, 2005.

³⁹ Among other advantages, an Internet-based architecture can reduce costs associated with dedicated links, communication systems, maintenance, and upgrades, and thus can significantly ease expansion of coverage. At the same time, it has to be supported by strong security safeguards.

preceded the plans. The prospective linkage between SIAFPA and *Panamacompras* (see Chapter V) is a step in the right direction.

58. More broadly, the government could develop an IT policy (at least for applications related to financial management) that lays out basic standards for development of software applications, database management, equipment, and integrity safeguards. Among other advantages, such a policy could help avoid the proliferation of different (and sometimes incompatible) applications and databases, not only across different executing entities, but even within MEF.

59. Looking forward, the public financial management performance measurement indicators documented in this report, could be used by the government as the baseline for a monitoring and evaluation system to assess impact of reforms over time.

60. **Procurement legal framework.** There was ample consensus among public and private sector stakeholders that Law 56 on Public Procurement should be modernized to streamline procurement processes and create an environment more conducive to the implementation of e-procurement, and that the present political climate was conducive to legal reform.

61. *The draft law.* Adoption of the new law will support the further implementation and sustainability of the reform, but the draft could be improved as discussed above.

62. The most serious problem before implementation of the new law is the fragmentation in the system which makes it very difficult to ensure a consistent compliance across the public sector and the latitude that each procuring entity seems to have in adopting its own requirements for bidding and contracting. For example, this latitude could create potential obstacles to foreign bidders' participation and complicate implementation of the possible trade agreement with the U.S. Indeed, Panama's institutional and organizational capacity to interpret and implement the treaty consistently across the public sector represents the main challenge. It is important to ensure that efforts to improve the regulatory framework are accompanied by equal emphasis on actions aimed at improving compliance and outcomes of the system in terms of efficiency and transparency, as discussed in the following chapters.

63. **Procurement institutional framework and management.** Due to the magnitude of the reform task and the legitimate desire to produce quick results, the DCP has launched many good initiatives, but is yet to develop a comprehensive strategy clarifying its priorities, defining tools and methodologies, and ensuring the sustainability of the reform effort after the initial thrust. The DCP has selected a consultant to help identify and prioritize short and medium term actions (e.g. which tools should be developed and how), and resources needed for these specific projects as well as for its ongoing activities. The strategy should also include a stakeholder analysis of the main interlocutors to maximize the effectiveness of the interaction and develop partnerships, and a map of potential obstacles to the DCP's effectiveness with options for overcoming them.

64. The DCP has also selected a qualified consultant to apply the baseline indicators system (BIS) developed by the OECD-DAC/World Bank Roundtable on Strengthening Procurement Capacity in Developing Countries to broadly assess the key elements of a well

functioning procurement system⁴⁰. The BIS will constitute the basis for a monitoring system to continue measure progress and identify areas where additional emphasis is required. A similar exercise was carried out jointly with the ACP Contracting Department for the limited purpose of assessing the quality of the ACP procurement system utilizing an objective methodology which could help derive lessons and guidance in reforming the rest of the public sector.

65. The design of any M&E system, particularly one focusing on public procurement where experience is limited, is very complex and there is no single solution. The DCP should consider a broad spectrum of M&E methodologies including regular collection of information, impact evaluations, and surveys focusing on the supply (i.e. DCP and the CGR's oversight role) as well as the demand side (i.e. ensuring that findings are the outcome of participatory evaluations and information is owned and utilized as much as possible by all stakeholders, including procuring entities and civil society). The BIS should be complemented by a methodology and indicators to measure the performance of procuring entities in terms of compliance with the rules, and impact in terms of the system's ability to produce value for money as well as improve the private sector's perception of the system's transparency. The latter aspect is also being addressed by a consulting assignment which is underway and could serve as a dynamic tool for periodic assessments. Ideally, these assessments would be carried out under a transparency agreement with a leading CSO which would provide a sort of independent "score card" for the government's transparency facilitating the task and adding credibility to its results. To operate the system, the DCP should select competitively external evaluators and train them on the application of the indicators. Each finding should be accompanied by a specific recommendation (agreed with the entity) to address the shortcoming identified in the process (specific to procurement and/or financial management) or organization (management, control, human resources). High level ownership and use of system (i.e. all the line Ministers) is essential for its effectiveness and sharing/publication of results (including recognition and/or awards/incentives) is important to generate healthy competition among public entities to improve their performance. Finally, there should be clear criteria for incorporating finding at the decision-making level and derive generalized policy implications which guide further reform.

66. Due to limited exercise of the policy oversight functions by the Ministry of Finance until recently and a traditionally weak internal control function throughout the public sector, the CGR has become over the years a key player in the procurement process to the point of being perceived almost a co-administrator. The pervasive ex-ante control and resulting overload adds considerable time to the procurement processes compounding the delays caused by the procuring entities' internal inefficiencies (see Chapters IV and V for further details). However, the CGR shares the Government's vision for stronger accountability and more efficient processes coupled with better capacity and use of technology in the procuring entities in order to justify a more selective scope for ex-ante control. As recommended in Chapter IV, the CGR could consider developing a comprehensive risk management tool based on

⁴⁰ This tool has been developed in a highly consultative manner by most donors, a large group of developing country governments, and implementing agencies and organizations. The system of indicators is based on benchmarks, objectives, and features of what is generally considered as an acceptable system as agreed upon by the participants in the Roundtable, the results of which (the "Johannesburg Declaration") fed into the High Level Forum on Aid Effectiveness held in Paris in 2004.

information jointly developed and shared with the DCP to regularly assess the capacity and procurement risk posed by different entities and determine thresholds for prior review which could be raised as the risk decreases. The tool could be eventually fully linked to the DCP's M&E system.

Integrity of the system

67. **Access to Information.** The current legal framework is adequate and enforceable. Further development of the e-procurement system, specifically address later in this report, is considered a major element to continue modernize the state and enhance the effectiveness of the transparency framework.

68. **Protests.** The solution adopted by the CSS with respect to protests has been effective in reducing the number of frivolous protests, but poses an excessive risk and a significant barrier to the exercise of this important right for bidders which may have legitimate grounds for seeking review. The ACP has adopted a more balanced approach which could be introduced throughout the public sector. In addition, it would be very useful to better regulate the role provided by Law 56 for the DCP by establishing an efficient and independent intermediate level of administrative review and defining more clearly in the regulations critical aspects of the protest such as standing, scope of protestable matters, content and procedures for filing, timing of protest, time for decision, rules of evidence, rapid interim measures, and standard for review.

69. **Ethics, Transparency and Anticorruption.** The regulatory and institutional frameworks are sound, but further cooperation with civil society is desirable to enhance its capacity to hold the state accountable and to cooperate in policy development, particularly in the area of procurement. Relevant initiatives would include holding regular consultations and establishing monitoring mechanisms as triggers for civil society action, and enhance civil society organizations' advocacy capacity. Over the past decade, the Republic of Panama has significantly improved its regulatory framework in compliance with the international conventions on anticorruption to which it is a party.⁴¹ Further improvements would include subjecting senior public employees' financial disclosure to public scrutiny and further simplifying requirements for investigating public officials. In addition, specific legislation for whistleblowers protection is required. A bill on this aspect is currently being considered by the legislature.

⁴¹The Republic of Panama ratified the Inter-American Convention against Corruption, Law 42 of July 1, 1998; and, the United Nations Convention against Corruption, Law 15 of May 10, 2005. In addition, Panama signed the Declaration on the Mechanisms for Follow-up of the implementation of the Inter-American Convention against Corruption.

III. KEY CROSS-CUTTING ISSUES

Public Financial Management Out-Turns

70. Selective budget execution ratios can indicate whether the budget is sufficiently realistic and is implemented as intended. To that effect, this section focuses on four indicators: (i) aggregate revenue out-turn, (ii) aggregate expenditure out-turn, (iii) composition of expenditure out-turn, and (iv) stock of expenditure payment arrears.

71. **Revenues.** Firstly, a comparison of budgeted and actual revenue can provide an overall indication of the quality of revenue forecasting, a critical factor since budgeted expenditure allocations and underlying policy priorities are based upon it. As shown in Table 2, the recent track record in that aspect has been reasonable: central government's domestic revenue collection has fallen below 94 percent of the originally budgeted estimates in only one of the last three years.⁴² Current revenue execution ratios from the rest of the NFPS have also been reasonably close to the budget.

Table 2: Aggregate Revenue Execution
(in percent of budgeted revenue)

	2003	2004	2005
Central Government			
Domestic Revenue	94.5	87.5	108.8
Current Revenue	98.4	90.1	110.6
Tax Revenue	101.4	97.6	110.8
Non-Tax Revenue	94.4	80.1	110.3
Decentralized Institutions			
Current Revenue	94.6	100.7	
Public Enterprises			
Current Revenue	93.2	101.9	

Source: Own calculations using CGR/MEF data.

72. **Expenditures.** The ability to implement budgeted expenditures is an important factor in supporting the government's ability to deliver planned public services for the year. As shown in Table 3, recent performance has been good: in only one of the last three years the variance between the actual central government primary expenditure and the budget has exceeded five percent. Looking at its composition, however, it is evident that over-execution of current expenditures has had to be compensated by slowing down capital expenditures.⁴³ As in the case of revenues, the rest of the NFPS executes aggregate expenditures reasonably close to the budget.

⁴² In 2004, the 80 percent execution ratio of non-tax revenue was due in large part to the new administration's decision to eliminate the practice of advancing dividend payments from the National Bank of Panama (BNP). Conversely, in 2005 the tax reform and an unanticipated amount of dividends from participation in enterprises boosted up, respectively, the tax and non-tax collections.

⁴³ The new administration has made an effort to address expenditures in arrears, resulting in increases to the original budget, which explain partially the over-execution of current expenditures in 2004 and 2005.

Table 3: Variance in Aggregate Primary Expenditure Execution
(in percent of budgeted expenditure)

	2003	2004	2005
Central Government	(12.8)	4.8	3.0
Current	(5.8)	9.0	8.3
Capital	(36.9)	(7.4)	(14.9)
Decentralized Institutions	(8.2)	(7.0)	
Public Enterprises	(6.3)	4.5	

Source: Own calculations using CGR/MEF data.

73. **Expenditure composition.** The credibility of the budget can also be measured by the extent to which budget entities receive the resources initially planned: where the composition of expenditure varies regularly from the original budget, the latter will not be a useful statement of intent. As shown in Table 4, in two of the last three years the variance in central government primary expenditure composition⁴⁴ has exceeded the overall deviation (Table 4) by more than five percent. Given that this situation reflects largely key budgetary decisions taken during the first year of the new administration, it is expected that the government will be in better position to control allocational volatility in upcoming years.

Table 4: Variance in Primary Expenditure Composition
(in percent of budgeted expenditure)

	2003	2004	2005
Central Government			
Absolute overall deviation (Table 3)	12.8	4.8	3.0
Absolute variance in composition	13.8	15.3	8.9
Difference	1.0	10.5	5.9

Source: Own calculations using CGR/MEF data.

74. **Payment arrears.** The identification and control of expenditure payment arrears is of critical importance, as they can constitute a form of non-transparent financing that affects the credibility of budget data (and the cost of doing business with the government, as stressed in Chapter V). Since the end of 2004, the government has undertaken a commendable effort to deal with accounts payable exceeding 90 days, and has since reduced the age of known accounts payable to 30-60 days. An outcome of this ad hoc exercise was, however, the awareness that many accrued expenditures were not recorded, while the accrued expenditures that were accounted for were not necessarily monitored. Moreover, the balance of accounts payable in fiscal reports and financial statements is not reconciled and age profiles are not available in either.⁴⁵ Therefore, as of the date of this report the available data on payables (and the share of those that may be in arrears) cannot be considered reliable and complete.

Comprehensiveness and Transparency

75. This section addresses the comprehensiveness of budget and fiscal risk oversight, and the public accessibility to fiscal and budget information.

⁴⁴ Variance in primary expenditure composition is calculated as the absolute weighted average deviation between actual and originally budgeted expenditure, as a percent of budgeted expenditure on the basis of administrative classification (18 budget entities).

⁴⁵ As of December 31, 2005 the CGR's fiscal balance report puts the accounts payable balance at \$164.2 million, while the consolidated central government financial statements report \$284.5 for a similar concept.

76. **Budget classification.** For meaningful tracking of expenditures to take place, a robust classification system is required. In this dimension, Panama's system for formulation, execution and reporting relies on four main budgetary classifications: administrative (*institucional*), by funding source, economical (*objeto de gasto*), and programmatic.⁴⁶ While the classification system is not based on international standards, it can produce information roughly consistent with those standards, e.g. the programs are similar to functional groups under GFS/COFOG.⁴⁷

77. **Budget documentation.** For the legislature to undertake its scrutiny and approval functions, the budget documentation should allow a complete picture of central government fiscal forecasts, budget proposals and out-turn of previous years. Currently, the annual budget documentation that is made available to the National Assembly on a systematic basis consists of:

- a purpose statement (*exposición de motivos*) through which the Minister of Finance presents the draft General Budget of the State Law to the National Assembly;
- a presentation summarizing the macroeconomic scenario, the budget policy and certain fiscal and budget aggregates;
- the draft General Budget of the State Law, which provides ceilings on major budgetary lines (under economical classification), entities, and programs. It also includes the general norms of budget management; and
- supplementary data, such as the detailed composition of revenues, expenditures and investments by entity, and the results indicators by entity.

78. In addition to the detailed information on revenues and expenditures, selected features of the mentioned budget documentation are described below:⁴⁸

- the macro-economic assumptions include estimates of aggregate growth and other indicators to support the revenue projections, but not the inflation rate;
- the fiscal deficit presentation improved in 2005, with estimates under both cash and accrual basis;
- the deficit financing describes its anticipated composition, but no information is provided on debt stock and financial assets;
- summarized budget data are presented for both revenue and expenditure according to the main classifications used, including prior year's budget outturn and current

⁴⁶ The classifiers also provide for functional, sectorial and regional sorting, but these are not used for regular detailed fiscal reporting.

⁴⁷ For the purposes of this report, the international standard for classification systems is the IMF's Government Finance Statistics (GFS), which incorporates the UN-supported Classification of Functions of Government (COFOG).

⁴⁸ The list refers to the budget documentation per se, not to the information that the MEF uses for budget preparation.

year's revised budget and estimated outturn. However, the same comparators are not produced to the same detail as the budget proposal.

- new policy initiatives are mentioned, but the correlated estimates of budgetary impact are not clearly explained.

79. **Coverage of government operations.** Fiscal reports in Panama (i.e., annual budget estimates, in-year execution reports and year-end financial statements) are characterized by their comprehensive coverage of the central government public sector, which allows a complete picture across all categories.

80. In accordance with the Constitution, the budget of the Panama Canal Authority (ACP) is approved by the National Assembly but not as part of the general state budget. The government has further decided to exclude the ACP from the public sector accounts as means to safeguard its financial autonomy.⁴⁹ While separate, ACP operations are reported on a timely basis and made public.

81. **Oversight of aggregate fiscal risk.** The cited comprehensiveness in financial reporting could facilitate the monitoring of fiscal risk arising from activities of decentralized institutions, public enterprises and financial agencies. These entities provide budget execution reports on a quarterly basis that are consolidated by the CGR, which since 2005 has also made public the NFPS fiscal balance statement quarterly. Furthermore, the entities' annual financial statements (un-audited) are combined in a report published by the CGR. All in all, however, there is no evidence that fiscal risk oversight is performed on a systematic basis.

82. **Public access to fiscal information.** As noted in the preceding chapter, the Transparency Law (Law No. 6, 2002) grants individuals the right of access to public information, except of a confidential or limited access nature, at no more than printing cost. In that regard, selected aspects of the accessibility to fiscal information are explained below:

- annual budget documentation (as described previously in this chapter) can be obtained by the public through appropriate means, including the internet;⁵⁰
- monthly budget execution data by entity can be accessed through the internet;⁵¹
- quarterly budget execution reports are routinely made available to the public through appropriate means upon issuance;⁵²
- year-end financial statements and external audit reports are made available to the public through appropriate means upon issuance;⁵³

⁴⁹ An agreement was reached with the IMF to present both the government's definition of the fiscal balance (excluding the ACP) and the more comprehensive measure including the PCA as part of the public sector (IMF, 2006).

⁵⁰ <http://www.mef.gob.pa>

⁵¹ idem

⁵² <http://www.contraloria.gob.pa>

⁵³ idem

- information on public bids is posted in the e-procurement transparency system (*Panamacompras*), as described in the previous chapter.

Conclusions and Recommendations

83. **PFM out-turns.** *In order for the budget to be a tool for policy implementation, it is necessary that it is realistic and implemented as passed.*

84. The methodologies used in Panama for analysis and monitoring of budgeted revenues and expenditures, and the coordinated application of these methodologies, have increased the ability of the government to maintain aggregate fiscal discipline as planned in the budget. However, the level of inter-institutional variances in execution evidences that there is still room to increase the credibility of the initial expenditure budget as an instrument for strategic allocation of public resources (see recommendations in next chapter).

85. As the government is well aware of, the credibility of fiscal and budget documentation can also be affected by incomplete recording of accrued expenditures and identification of payment arrears. The efforts already underway to clean up payables should continue, complemented with ***fundamental actions*** to enforce proper recording of commitments and accruals, reconcile balances of accounts payable between fiscal reports and financial statements, and develop subsidiary records with age profile classifications.

86. **Comprehensiveness and transparency.** *Comprehensiveness of the budget is necessary to ensure that all activities and operations of governments are taking place within the government fiscal policy framework and are subject to adequate budget management and reporting arrangements. Transparency is an important institutional value that enables external scrutiny of government policies and programs and their implementation.*

87. To start with, fiscal reporting in Panama has a comprehensive coverage, with minimal unreported government operations. Moreover, a robust budget classification system in terms of administrative, economic and programmatic items is in place. Finally, a wealth of fiscal and budget information is put in the public domain on a timely basis.⁵⁴ These are strong pillars to support further enhancements in two particular areas.

88. In terms of content, a ***fundamental action*** to enhance budget documentation would be the gradual introduction of international good disclosure practice. Drawing from IMF's Fiscal Transparency Code (IMF, 2001), key aspects that could be brought in are: (i) improved and more comprehensive information on the quantitative macroeconomic framework, on fiscal policy, risk and sustainability, and on the impact of new policy initiatives; (ii) details of debt stock and financial assets; and (iii) more detailed comparators between the budget and the ongoing and preceding years.

⁵⁴ The Executive Secretariat of the National Committee for Transparency against Corruption (CNTCC) has recommended the creation of a "Financial Transparency Portal", an informational platform to facilitate free access to any user in real time to financial and budgetary information, using simple formats accessible to the average citizen.

89. Other items that could be introduced are the three-year aggregate projections with underlying macroeconomic assumptions, statements describing the nature and fiscal significance of contingent liabilities, and estimates of tax expenditures.

90. In terms of fiscal oversight, a *fundamental action* would be the strengthening of capacity in MEF and CGR to assess and monitor financial performance and fiscal risks associated with decentralized institutions, public enterprises and shareholding in private companies. Fiscal risk issues could then be consolidated into a report at least annually. This action is also critical from the revenue management point of view, considering the large share of non-tax revenues (around 40 percent) that characterizes the composition of central government revenues in Panama.

IV. BUDGET CYCLE

Budget planning

91. This section looks at the budget formulation process against four principles: (i) because of their multi-year implications, expenditure policy decisions should be aligned with the medium-term availability of resources and the sectorial strategies; (ii) for that to happen, the quality of public investment programming is key; (iii) effective and orderly participation in the formulation process by executing entities and political leadership impacts the extent to which the budget will reflect macro-economic, fiscal and sector policies; and (iv) legislative power to authorize the executive to spend public funds should be underpinned by rigorous examination and debate of the budget law.

92. **Multi-year perspective.** The MEF prepares medium-term (five-year) projections of the fiscal balance. These high level aggregates inform decisions on the budget envelope, but there is not yet a multi-annual budget per se, i.e. ceilings on the basis of economic and programmatic classifications that are produced systematically, made easily available, and taken into consideration in the discussion of annual allocations to sectors and programs. At the time of preparation of this report, however, the MEF was conducting initial exercises leading in that direction.

93. As part of the mentioned recent efforts, the MEF undertook a debt sustainability analysis to calculate the future primary budget balance needed to stabilize the debt-to-GDP ratio. An experimental specific methodology (considering the characteristics of Panamanian fully dollarized economy) was built and existing software was adapted to that end. While the analysis is not as yet officially applied and approved, this is by itself a good advancement.

94. The challenges at the sectorial level are far more considerable. With some exceptions, there is general lack of fully costed medium-term sectoral and programmatic strategies. As a result, the linkages between investment budgets and forward expenditure estimates are weak, as is the public investment system itself.⁵⁵

95. **National public investment system (SINIP).** While the pervasive weak capacity for medium-term planning is the main issue affecting the quality of investment programs, the system itself has a number of shortcomings. Firstly, SINIP was created by decree and is normed, but compliance and enforcement are limited. For example, the fact that certain projects have been incorporated into the budget without following SINIP's appraisal and recording process does not send a good signal to the executing entities (although it should be

⁵⁵ In accordance with comments from MEF's Directorate of Investment Programming (DPI), in the absence of a legal framework for the national public investment system (SINIP), efforts in this area will have limited results, with a weak SINIP that is not legally enforced. Thus, the annual efforts or achievements could be diluted the following year or when a change in administration takes place.

noted that this is no longer a common practice). Moreover, there are inconsistent approaches to the classification of project expenditures under the capital or current budget.⁵⁶

96. On the other hand, of those projects that were incorporated into the system, economic return analyses are available only for projects financed by international entities. Finally, the programming process is highly centralized, although the government has recently instituted territorial consultative councils as means to involve citizens in the identification of investment needs.⁵⁷

97. **Annual budget formulation.** The MEF prepares a clear annual budget calendar that is generally adhered to (the budget period is the calendar year). Accordingly, the MEF distributes the budget policy circular to the executing entities almost six weeks before these are required to present their detailed proposals to the MEF on July 31.⁵⁸ The circular contains general information about the macroeconomic and fiscal scenario and guidelines on revenues, expenditures and investments that apply across the board. No sectoral specifics, such as indicative ceilings, are provided.

98. The August-early September period is dedicated to MEF's review of the proposals and bilateral discussions with the entities.⁵⁹ The Minister of Finance presents the consolidated budget to the Cabinet for approval in mid-September. In practice, the Cabinet basically endorses MEF's proposal and the budget documentation is then presented to the National Assembly by the end of September.⁶⁰

99. A significant recent development was the production of results indicators by the budget entities, which have been documented for the first time as an annex to the 2006 budget documentation. As is normal in the introduction of this type of instruments, the first set of indicators deal fundamentally with figures on coverage and are subject to further refinement over time.

⁵⁶ An informal estimate by the MEF indicates that about 40 percent of the capital budget is composed of current expenditure-type programs.

⁵⁷ The Executive Secretariat of the National Committee for Transparency against Corruption (CNTCC) has recommended the creation of a Citizen Unit of Budget Transparency, which would have among its responsibilities: the coordination of social audits for the evaluation of quality and social return of investments, as well as performance audits to assess the results of investments in high-risk investment projects; the evaluation of impact in zones of poverty and extreme poverty; and coordination with the Directorates of Budget and Investment Programming of the monitoring of public policy implementation.

⁵⁸ The MEF as well as the executing entities begin preparing informal estimates before the budget policy circular is released.

⁵⁹ Evidently, there is more room for discussion of options for capital than for current spending. The MEF has calculated that inflexible expenditures account for about 71% of the consolidated public sector budget, with remunerations and debt service representing 24.2% and 25.6% of the budget respectively. Earmarked revenues do not seem to be a major issue, the most important being, in percent of central government current revenues: interests of the development fiduciary fund (around 3.5%), the constitutional minimum budget of the judiciary (2%), and the payroll tax for education insurance (*seguro educativo*, around 1.7%).

⁶⁰ The Constitution stipulates that the draft budget must be presented by the President to the National Assembly within the first month of the first period of ordinary legislative sessions. These start on September 1, but in accordance with recent constitutional amendments, from 2009 the first sessions will start on July 1.

100. **Legislative approval.** The National Assembly has the constitutional power to approve (with or without modifications) or reject the budget proposed by the executive.⁶¹ It can eliminate or reduce expenditures, with the exception of debt service, contractual obligations and previously approved public investments. It cannot incorporate or increase expenditures without Cabinet's approval, or revenues without CGR's approval. In either case (reduction of expenditures or increase of revenues), any proposed allocation of resulting funds is subject to Cabinet's approval.

101. In order to exercise the described constitutional rights, the Assembly's Budget Commission dedicates about five weeks for ample discussions (*vistas presupuestarias*) with the MEF and executing entities before approving in the first instance the budget law, which is then subject to plenary approval in two more instances. During the last three years, the Assembly has approved the budget a month in advance of the beginning of the fiscal year, thus allowing orderly starts of budget execution.

102. **Budget modifications.** Three types of budget modifications can take place during the fiscal year:

- intra-budgetary transfers (*traslados de partida*) are approved by the MEF after consultation with the CGR about the availability of balances. Over a threshold of US\$300,000, each transfer is submitted to the National Assembly's Budget Commission for approval;⁶² below that threshold, the documentation is submitted to the Commission for information. There are certain limits: (i) certain operational expenditure balances can only be transferred if corresponding to proved savings;⁶³ (ii) allocations for investments cannot be transferred to current expenses; and (iii) transfers cannot increase budget lines classified under "global allocations", with the exception of foreign service.⁶⁴
- additional credits are budget modifications resulting in an increase of the overall budget total that can be issued only if revenue budget surpluses are available, and if the CGR issues a favorable opinion on their "financial viability and convenience". These credits are approved by the Assembly's Budget Commission upon request from the Cabinet or the National Economic Council (CENA).⁶⁵

⁶¹ If by the start of the fiscal year the budget law has not been voted, the executive's proposal comes into effect. Conversely, if the National Assembly rejects the proposal, the budget in effect from the previous year is put again into effect, with the exception of debt service, contractual obligations and previously approved public investments, which are incorporated as proposed by the executive.

⁶² The Commission has eight working days to pronounce itself; otherwise, the transfer is considered approved.

⁶³ These operational expenditures are salaries, basic services, contributions to international organizations, social security obligations, and debt service.

⁶⁴ *Asignaciones globales* are non-targeted expenditures, such as for national emergencies and other contingencies, and make about 1.5 percent of the central government primary expenditure budget.

⁶⁵ Before submittal to the Assembly, additional credits that do not exceed US\$2 million are approved by CENA; over that threshold, by the Cabinet after CENA's favorable opinion. CENA is responsible for financial affairs of the central government and decentralized institutions and, among its functions, issues opinions on public finance matters that require Cabinet approval. It is presided by the Minister of Economy and Finance, and additionally conformed by the Minister of Commerce and Industry, a Presidential designate to represent the social area (currently the Minister of Public Works), the General Manager of BNP, and the Controller General.

- in the case of substantiated revenue shortfalls, the MEF can prepare a plan to curtail public expenditure for approval by the Cabinet and the Assembly's Budget Commission, resulting in a modification to the budget.

Revenues: Predictability and Controls

103. This section examines selective aspects of tax administration performance from the point of view of their contribution to an orderly and predictable budget implementation. The focus is on MEF's General Revenue Directorate (DGI), which in 2005 collected around 73% of tax revenues.⁶⁶ Worth noting is DGI's comprehensive tax information system (e-Tax), which facilitates several functions, such as maintenance of the taxpayer registry (RUC), electronic filing of declarations and payments to third-parties (PAT), processing of collections data, and maintenance of the unified taxpayer account (*cuenta corriente*), among others.

104. **Transparency of taxpayer obligations and liabilities.** Taxpayer compliance can be facilitated by, inter alia, the clarity and accessibility of legislation and administrative procedures, and the ability to contest administrative rulings. In Panama, there is a large set of tax laws and regulations, which are made available to the public through various means, including the internet for most major taxes. Access is also given to opinions from DGI's legal department, but these opinions do not create jurisprudence.

105. There are two administrative instances of appeal against DGI resolutions. First, a reconsideration recourse can be presented before the public official who issued the resolution (the regional administrator) for clarification, modification or revocation. Second, an appeal recourse can be presented before the mentioned official's superior (the DGI, through its Appeals Commission).⁶⁷ Once the administrative channel (which seems obviously biased towards the DGI) has been exhausted, the resolutions can be appealed before a judicial court.

106. **Registration and assessment.** Effectiveness in tax assessment depends on various factors, but two key pillars are an enforced registration of taxpayers and a correct assessment of their liabilities. In this regard, the picture in Panama is mixed.

107. The procedures for assignment of taxpayer identification numbers and registration in the unified database (RUC) are well documented. The RUC records the basic information of corporations, individuals and properties, allowing linkages to other government systems, such as the public registry (however, data cross checks are not made). With the 2005 tax reform, sanctions for noncompliance with tax legislation were increased.⁶⁸

⁶⁶ The main taxes administered by DGI, in percent of 2005 tax collections, are income tax (42%), value added tax (ITMBS, 10%), and selective consumption taxes (10%). The General Customs Directorate (DGA) administers the duties and ITBMS on imports (26%).

⁶⁷ The appeal recourse can be presented in subsidiary form to the reconsideration recourse, or directly (thus renouncing the reconsideration recourse).

⁶⁸ The sanction for non-filers of tax declarations is between US\$100 and US\$1,000. The interest rate for late payments is of two percentage points over the rate of reference for commercial loans. After 60 days in arrears, the taxpayer incurs in tax fraud, sanctioned with a penalty between five and ten times the defrauded amount, or two to five years of arrest. Other sanctions apply to different instances of noncompliance.

108. As for the audit function (*fiscalización*), the use of certain methodologies for data cross-checks (e.g., with payments to third parties -PTA-) is worth mentioning. However, tax audits are undertaken mostly on an ad hoc basis, evidencing lack of audit planning and use of risk-based methodologies, all in large part to the constrained human resource capacity. The ability to conduct fraud investigations and prosecute criminal cases is similarly weak.

109. **Collections.** The management of tax receipts and arrears is a critical factor in the ability of revenue agencies to fund the treasury. In Panama, actual collections are made under contractual arrangements with the banking system and by DGI's own receipt facilities (characterized as "chaotic" on payment deadline dates), and are deposited into the single treasury account (Account 210) maintained by MEF's Treasury Department in the BNP.⁶⁹ While on one hand these banking arrangements are reasonably effective, on the other the procedures for recording revenues are complex, resulting in delays in the reconciliation of revenue data.⁷⁰

110. The major issue in this area is, however, the lack of reliable data on tax arrears. Unified (i.e., excluding customs) taxpayer accounts are in operation, but their contents are subject to major clean up resulting from amnesties, prescriptions, and tardy or inadequate entries and adjustments, all of which in turn affect the calculation of interests. Hence, it is difficult to accurately assess DGI's performance on the collection of outstanding debt.

Cash and Debt Management

111. **Treasury operations.** Planning, monitoring and management of cash flows and balances are key elements to support budget execution and avoid unnecessary borrowing and interest costs. As noted earlier, Panama's central government revenue is centralized in a treasury single account (Account 210) managed by MEF's Treasury Department and maintained in the BNP, the government's financial agent. In general, the management of idle cash is passive, as government deposit accounts in BNP are interest free.⁷¹

112. Once the budget has been approved, the Treasury prepares a yearly cash flow forecast based on historical patterns, debt service projections (input from MEF's Public Credit Department -DCP-) and revenue projections. During the year, the Treasury also prepares monthly and daily forecasts, partly based on daily information it receives from the BNP on the movements and balance of Account 210.⁷² Given market conditions, and taking into

⁶⁹ Receipts by DGI and BNP are deposited into the Treasury account within 24 hours; receipts by private banks are deposited within 72 hours (depending on the contracts).

⁷⁰ Part of the problem relies on the operation of different systems that are not (properly, or at all) inter-connected: DGI records collections in e-Tax, DGA in SICE, DGT operates the single treasury account system (CUT) with aggregate data received from BNP, and the CGR makes the accounting/budgetary recording in SIAFPA.

⁷¹ An exception is the Development Fiduciary Fund (FFD), which has asset management agreements with international firms under regulated risk parameters. At the end of 2004, FFD's net worth was of US\$1.4 billion and its annual net income was of US\$67.6 million. The use of income generated by the FFD is earmarked by law to sectorial public investments, but channeled through the budget and Account 210. FFD's financial statements are audited on an annual basis and made public by MEF.

⁷² The balance and information on the bulk of the payments is sent by BNP the next day, while the specific information on the payments is sent after three days.

account the Treasury's cash flow requirements, the DCP issues short-term debt in accordance with an auctions calendar.

113. The bulk of expenditures financed by internal sources are paid directly by the Treasury to providers of goods and services and by the CGR to civil servants (in both cases using checks), or transferred to decentralized entities.⁷³ Payments not exceeding US\$1,000 can be made by the ministries using a system of institutional funds authorized by the CGR. The BNP provides the Treasury with data on the balances of accounts opened by other public sector entities, but otherwise Treasury has no control over them.⁷⁴ Neither does it have it on special accounts required by international agreements to fund project activities, which are managed directly by implementing units or specialized agencies (notably UNDP).

114. At the time of preparation of this report, the bank reconciliations of Account 210 were being finalized within three-four months after each month, contrasting significantly with the internal control best practice of daily reconciliations. The process is conducted by the Treasury itself, who communicated that there are no major outstanding items. No aggregate information is available on the status of other bank account reconciliations.

115. **Debt management.** The recent Public Expenditure Review (PER) contains an analysis on debt management concluding that in general, and particularly in comparison with other developing countries, Panama's debt management capacity is high.⁷⁵ For the purposes of this report, two features are worth noting: the quality of debt data recording and reporting (which is critical for ensuring accurate debt service budgeting, timely service payments and well planned debt roll-over) and the systems for contracting loans and issuing guarantees.

116. Main debt management responsibilities lie with MEF's Public Credit Department (*Crédito Público*), which maintains the public debt database in UNCTAD's Debt Management and Financial Analysis System (DMFAS/SIGADE). A large amount of information on domestic and external debt is made public by *Crédito Público*.⁷⁶ However, the CGR is responsible for official records and accounting of debt, making use of SIAFPA to that effect.⁷⁷ CGR publishes the public debt statements on a quarterly and annual basis as part of its fiscal reporting.

117. The CGR is also responsible for debt servicing, for which it provides the Treasury a monthly report with the programming of the incoming month's payments, as well as individual check requests for each payment.⁷⁸ The checks are delivered by the CGR to the

⁷³ The Treasury releases payments largely on a first-come first-served basis, but this is an ad hoc policy rather than a formal rule. The extensive use of payment by checks (as opposed to electronic transfers) contrasts with the sophistication of Panama's banking system. And, the lack of an electronic register of providers (i.e., for payment purposes) prevents useful cross-checks with DGI for tax administration objectives and other controls.

⁷⁴ Around 2,700 public sector bank accounts have been identified by the BNP.

⁷⁵ World Bank. 2006.

⁷⁶ A complete set of statistics are uploaded to MEF's webpage, for domestic as well as external debt. Regarding domestic debt, there is also a yield curve, the auctions calendar and the outcomes of the latest auctions.

⁷⁷ DFMAS and SIAFPA are not interfaced, but the data is reconciled on a monthly basis.

⁷⁸ An agreement between CGR and MEF dated July 11, 2003 states that all payment functions and budget execution of public debt would be shifted to DCP, but it has not been put into effect.

BNP with the relevant payment instructions. Confirmations are then submitted by BNP to the CGR and *Crédito Público* so that both SIAFPA and DMFAS are updated.

118. The governance framework for contracting loans is well defined. Under the budget approved by the legislature, the political and fiscal decisions to contract loans are taken by CENA and made operational by *Crédito Público*. The latter are also responsible for authorizing guarantees, of which currently there are very few (for the international airport and the electricity company), are documented, and pay a risk premium for the service.

Expenditures: Predictability and Controls

119. This section addresses key characteristics of the expenditure cycle from an internal control and operational efficiency perspective. Because of its specifics, procurement management is analyzed separately in Chapter V.

120. **Availability of funds for expenditures.** Reliable information on the availability of funds to incur expenditures is necessary for the executing entities to implement their work plans. In connection to this principle, the first parameter is the annual budget approved by the National Assembly, which imposes maximum limits to each entity to commit expenditures under its capital and operational programs. Expenditures cannot be committed or paid in absence of available credit balances.

121. The use of budget allocations by executing entities is restricted by a monthly commitment program proposed by each entity and approved by the MEF. To the entities' advantage, the remaining balance from each month is rolled over to the next, and the program can be modified during the year, subject to MEF's approval. On the other hand, the program does not impose an obligation on the MEF to release funds, which is fully linked to cash availability. The commitment program's reliability as an instrument to enhance predictability of funding is therefore dependent on the actual revenue collections.⁷⁹

122. Budget execution programming is also affected by significant modifications to the original budget taking place throughout the year, e.g. 1,534 intra-budgetary transfers and 109 additional credits were made in 2005 (granted, most of them requested by the executing entities themselves). The central government primary expenditure budget was increased in 13.3 percent as a result. As shown in Table 5, the modifications changed the individual original budgets of executing entities by 16.7 percent on average, with a standard deviation of 25.4 percent. The volatility resulting from budget modifications is particularly marked in capital expenditures.

⁷⁹ In 2005, predictability of funding was not an issue, given the extraordinary performance in revenue collections. At certain points in previous years, however, cash shortcomings had a direct effect on the expenditure side, leading executing entities to incur in payment arrears.

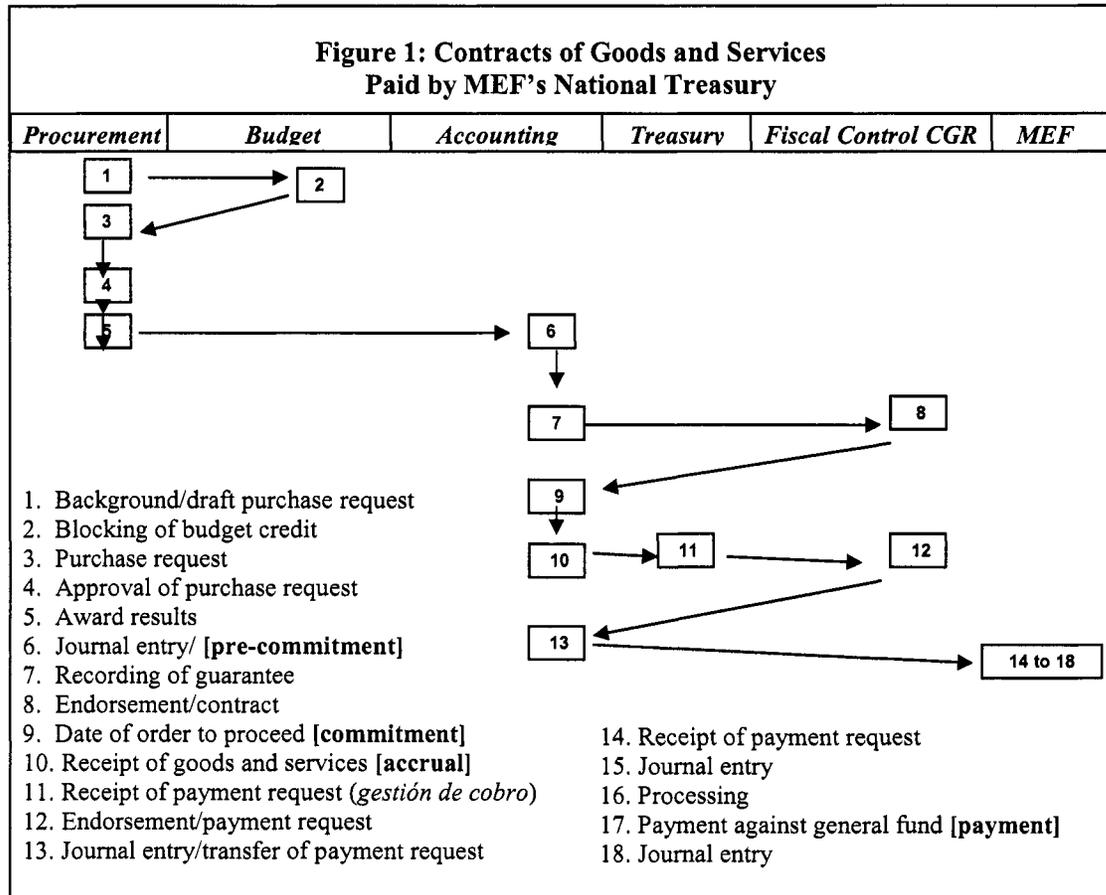
Table 5: Budget Modifications to Primary Expenditure
(in percent of originally budgeted expenditure)

	2003	2004	2005
Central Government (net aggregate)	9.6	17.0	13.3
Central Government (absolute average)	13.6	18.1	16.7
Central Government (std. deviation)	14.3	32.0	25.4
Current (absolute average)	4.7	14.1	20.6
Current (std. deviation)	4.8	43.2	52.6
Capital (absolute average)	116.6	67.6	107.4
Capital (std. deviation)	267.9	77.3	222.8

Source: Own calculations using CGR/MEF data.

123. **Internal controls for expenditures on goods and services.** An effective internal control system should be relevant, comprehensive yet cost effective, widely understood and complied with. Looking specifically at the steps and units involved in a normal contract of goods and services (depicted in Figure 1), it is clear that the set of controls is comprehensive. At the heart of the compliance system is the institutional figure of ex-ante fiscal control, an endorsement (*refrendo*) process undertaken by the CGR.⁸⁰

⁸⁰ Ex-ante control is performed by CGR fiscal control officers (*fiscalizadores*) located in public sector entities, for purchase orders, contracts (and amendments) and payments under US\$10,000. Above those thresholds, the endorsements (*refrendos*) are processed centrally by the fiscal control department of the CGR. In 2005, 5.8 million documents (including 4.8 million checks) were endorsed by the CGR. The thresholds and the ex-ante control requirement itself can be modified by the CGR, but that is rarely done.



Source: MEF

124. In principle, the relevance of the fiscal control figure lies on its potential as deterrent for noncompliance with budget regulations. The flip side, however, is that it could be conducive to a culture of poor accountability in the executing entities, as the burden of regulatory compliance can be perceived to be on the CGR. In any case, the application of ex-ante controls across the board, as done in Panama, reflects lack of risk assessment approaches characteristic of international good practice in internal controls.⁸¹

125. It is rather difficult, if not impossible, to quantify the cost effectiveness and compliance rates of the internal control procedures. There are indications, however, of important issues in both areas. First, as mentioned above, 100 percent ex-ante external review of transactions is not usually cost-effective from a risk management perspective. Second, the resulting overload on fiscal control officers, plus the other steps included in the process (noting that physical files travel from one unit to another as each step is completed), have traditionally produced significant delays in the contracting and payment process. As discussed

⁸¹ The one clear and major exception is the ACP, which is constitutionally exempt from ex-ante fiscal control.

in further detail in Chapter V, the number and type of internal procedures are not only ample, but can vary significantly from one entity to another.⁸²

126. Third, in the past some entities circumvented the commitment restrictions by delaying accrual recording and/or payment until funding became available, generating significant arrears (as noted earlier, this is less of an issue now). Finally, as explained later in this chapter, the fact that most individual financial audit reports issued by CGR's Audit Department contain opinions other than "clean" may point to the existence of problems in the effectiveness of the internal control framework.

127. The government is aware of these issues and is accordingly taking relevant actions, such as the efforts to pay overdue accounts. From the CGR side, it is worth noting the recent issuance of fiscal control guidelines and verification checklists, which aim at an orderly and consistent application of the ex-ante reviews. The integrated correspondence system (SICO) will help with the measurement of transaction times, eventually enhancing accountability and performance. And, the project of electronic endorsements (e-Fiscaliza) will help reduce the times related to the physical transfer of documentation.

128. **Payroll controls.** The CGR executes the personnel payroll for 39 entities, including the central government, representing around 68 percent of the public sector payroll. For that purpose, information provided by the executing entities is entered into a database management system named EPD ("Structure-Payroll-Deductions"). While subject to improvements, EPD seems to work fairly well. Additions and modifications to the database are entered by the CGR after a review of the relevant documentation and cross checks with other registries (e.g., public registry, social security).

129. The individual payrolls are prepared by the executing entities themselves, following EPD parameters. The CGR endorses those payrolls and, once consolidated in EPD, issues the payments (after coordination with the Treasury for the account funding). As part of its fiscal control, the CGR undertakes database testing to detect duplications, which is a significant step towards implementation of systematic payroll audits. Aggregate payroll statistics are made public by the CGR as part of its quarterly fiscal reporting.

130. **Donor practices.** Even though the 2005 budget execution norms require that disbursements of external funds for projects pass through the Treasury, in practice those funds are to a large extent deposited directly into special accounts managed by project implementation units (PIUs) or into accounts of specialized agencies (such as UNDP), and managed in accordance with project-specific procedures. This situation responds partially to an attempt to avoid the complexities of contracting and payment procedures described

⁸² A sample of 2,590 purchase orders recorded in SIAFPA by three entities noted an average of 52 days between the blocking of the budget credit and the receipt of goods. A separate sample of 8,830 payments made by Treasury noted an average of 131 days (standard deviation of 252 days) between the date of the provider's invoice date and the date of payment. Source: SIAFPA.

earlier.⁸³ Even though these separate funds are in-budget, their execution is normally recorded only at the end of the year, thus limiting the coverage of quarterly reports.

131. **Internal audit.** An effective internal audit function should provide regular and adequate feedback to management on the performance of internal control systems. In Panama, the internal control standards issued by the CGR regulate the internal audit function, but do not mandate it. The internal auditor is appointed and removed by the head of each entity.

132. Internal audit units in central government entities seem to have been generally constituted without technical studies or objective criteria to justify their size or budget. They usually suffer from limitations in human, technical and technological resources, which may be a symptom of the predominance given to the ex-ante control figure. The internal audit reviews do not seem to be performed under risk-based approaches, and no statements on the overall assessment of the entities' internal control systems are produced.

133. The CGR receives the internal audit annual plans and has the authority to evaluate internal audit units, but there is no system under which evaluations are formally and systematically reported back to the internal auditors. Even though internal auditors are required to follow up on internal control issues reported by the external auditors, this may not be done effectively, given the recurrent nature of some of the internal control weaknesses reported by the CGR.

Accounting, Recording and Reporting

134. This section looks at the adequacy of record keeping and release of financial information for management and scrutiny purposes.

135. **In-year reporting.** Timely and regular information on actual budget execution is needed for the entities in charge of fiscal oversight to monitor performance, and for the executing entities to manage their budget. In this respect, the Panamanian framework is appropriate: Executing entities are required to produce monthly budget execution reports to be submitted to the MEF, the CGR and the National Assembly's Budget Commission within ten days after each month, and quarterly financial statements within 15 days after each quarter.⁸⁴ To a large extent, electronic media is used to facilitate recording and reporting,⁸⁵ and aggregate figures are uploaded on a monthly basis to MEF's webpage.

136. The MEF and the CGR present to the President and to the Assembly's Budget Commission a quarterly consolidated analytic report of the public sector budget execution, within 45 days after each quarter. The report does not allow a direct comparison at the same level of the original budget (e.g., it misses execution by program), and the notes seem insufficient to help the reader understand the numerical data. It should be noted, however, that

⁸³ In fact, there is a project (*Dinamización del Sector Público*) whose main actual function is to execute other projects, by establishing a liaison office with UNDP.

⁸⁴ However, as noted earlier, an important shortcoming is that information of execution by special agencies (such as those implementing investment projects) is not incorporated during the year to the official accounting records.

⁸⁵ Of the 51 NFPS entities, 19 (including the whole central government) record and report on SIAFPA, 19 on SRPG, and the remaining 13 using other systems. As noted earlier, the CGR records revenue and debt operations.

the report does form part of a larger document produced by the CGR including additional data, such as statements of fiscal balance, debt and payroll.

137. **Annual reporting.** The annual Report of the Controller General, presented to the President and the Assembly on the first of March following the year reported, contains inter alia the annual budget execution report (with the same presentational features as the quarterly reports), the audited financial statements of individual executing entities (see next section), and the un-audited financial statements “integrated” by main public sector groupings, i.e. central government, decentralized entities, public enterprises and financial agencies. The integration is a sum of the individual financial statements, not a consolidation per se.⁸⁶

138. The accounting standards applicable to the NFPS have been issued by the CGR, in line with its constitutional mandate.⁸⁷ While comprehensive, the standards have a number of characteristics that are not consistent with international standards, if the International Public Sector Accounting Standards (IPSAS) are used as reference.⁸⁸

139. In terms of the NFPS financial statements presented, these are fairly complete, with the evident exception in 2005 of the social security institute (CSS, the largest decentralized entity). Their quality, on the other hand, is a concern. First, as will be noted later, most audits contain qualified or adverse opinions on the financial statements (for various reasons, such as lack of reconciliations between balances and subsidiary ledgers, differences arising from physical inventories, land without titling, certain unrecorded transactions). Moreover, the disclosure of information through notes to the financial statements is generally weak and, as mentioned before, a consolidation is not yet possible.⁸⁹

140. **Fixed assets.** MEF’s Directorate of Cadastre and Patrimonial Assets collects and consolidates registries of property, plant and equipment on the basis of data provided by the holding entities. This information, however, is considered largely incomplete and/or improperly valued. Moreover, the registry is neither reconciled against physical inventories nor used for accounting purposes (e.g., depreciation recording).

⁸⁶ The budget execution report does contain a public sector consolidated statement with elimination of reciprocal transfers.

⁸⁷ The basis is accrual accounting, per the relevant documents: Government Accounting Standards (Decree 234), Government Accounting General Manual (Decree 113), and Financial Information Regulations (Decree 4 for decentralized entities, Decree 355 for public enterprises).

⁸⁸ For example: (i) the individual standards are not part of a broad conceptual framework documenting items such as measurement bases and elements of financial statements; (ii) disclosure requirements for the notes to financial statements are limited; (iii) some features of budgetary and financial accounting (with different recognition approaches) are combined; (iv) the coverage is incomplete (e.g., trust funds, detailed aspects of cash flow statements, leases, financial instruments, investment property, related party disclosures, provisions, accounting changes, assets held for sale); (v) some technical aspects of classification and disclosure contradict international practice (particularly the income statement, “other assets” and “other accounts payable”, and the treatment of public assets); (vi) some standards establish alternative treatments that would difficult prospective consolidations; and (vii) non-accounting elements (e.g., administrative and control practices) are included.

⁸⁹ Other issues with the quality of financial statements are: (i) incomplete data on certain departments from the ministries of education and health; (ii) certain cash flow statements missing; and (iii) incorporation by individual entities of certain accounting policies that are inconsistent with the CGR norms. The method (cost) in use to account for shareholding investments could be evaluated.

141. **Contingent liabilities.** Other than records of guaranteed debt, no information is consistently compiled and reported on contingent liabilities.

External Audits

142. This section analyzes the arrangements for scrutiny of public finances, with an emphasis on the key elements of the external audit function, i.e. the scope and coverage of the audit, its adherence to appropriate standards, focus on significant and systemic issues in its reports, and performance of the full range of financial audit.

143. **Audits.** As noted before, the Constitution grants the CGR the power to exercise fiscal oversight on all management of funds and other public goods, through ex-ante (analyzed earlier) or ex-post controls. Its Organic Law (Law 32, 1984) establishes its responsibility to “examine accounts”, and MEF’s Organic Law (Law 97, 1998) notes that the financial statements audited by the CGR constitute the official source of information on the financial situation of the public sector.

144. In accordance with its mandate, the CGR issues annual audit opinions on the individual financial statements of public sector entities.⁹⁰ Because of the large spectrum under purview (51 NFPS entities, 7 financial agents, the ACP, and 86 local governments), CGR’s audit plans cover between 25 and 30 financial audits per year. However, these are not rolling plans, as the same reported entities are usually repeated from year to year.

145. The 2004 audit opinions included in the Report of the Controller General covered financial statements of 22 NFPS entities, with certain large institutions left out (e.g., the judiciary and the CSS). The scope is further limited by the lack of audit opinions on the financing sources (revenues and debt), budget execution reports, and notes to the financial statements.⁹¹ Only a small number of audit opinions were unqualified (“clean”).⁹²

146. Internal control and compliance observations are reported to each executing entity, but are not part of the annual Report or otherwise aggregated for public use. Entities are required to provide formal responses to the audit findings, but their repetitive nature points to the need for better monitoring and enforcement systems and capacity building.

147. CGR’s Government Auditing Norms are consistent with standards by the International Organization of Supreme Audit Institutions (INTOSAI), with the actual practice more focused on transaction level testing. While the audits are performed by a specific General Audit Department (DGA), there is an inherent independence conflict with other functions cited earlier that fall under the CGR, e.g. the issuance of endorsements, the payment and recording of debt and payroll, and the consolidation of financial statements.

⁹⁰ Certain entities (e.g. the ACP) and externally-financed investment projects are audited by private firms, but there is not a formal approach in practice to the use of private sector auditors.

⁹¹ Some of these items, e.g. opinions covering the whole set of financial statements and notes for certain entities, can be found in some CGR reports but not in the official annual report.

⁹² Of the 22 audit opinions issued on financial statements of NFPS entities, 2 were unqualified (“clean”), 10 were qualified, and 10 were adverse.

148. **Legislative oversight.** A way in which the legislature can scrutinize the execution of the budget is through legislative bodies that examine the external audit reports and question responsible parties about the findings of the reports. The National Assembly In Panama, contrasting with its active role in the discussion and approval of the budget, does not exercise a formal function with respect to the examination of year-end budget execution reports and audited financial statements.

Conclusions and Recommendations

149. **Budget planning.** *A policy-based budgeting process enables the government to plan the use of resources in line with its fiscal policy and national strategy. Effective scrutiny by the legislature helps keep the executive accountable for its policies.*

150. The government is taking important steps towards developing a medium term fiscal and budgetary framework, including the preparation of macro projections and a first debt sustainability exercise.⁹³ It is understood that a gradual approach is necessary to validate and sustain what is by nature a long-term endeavour.

151. The available multi-year fiscal targets is a good base to implement certain ***fundamental actions***: (i) in key sectors, costed strategic plans could be developed as the catalytic documents for policy assessment and reconciliation of the top-down and bottom-up multi-year budget planning; (ii) the public investment and procurement programs should be based on those plans, with due assessment of recurrent cost implications;⁹⁴ and (iii) indicative ceilings for the selected sectors, broken down to the main economical and programmatic categories, could be developed and referred to in the formulation of annual budgets. These actions could lead to more meaningful discussions over operational efficiency in the use of resources, an orderly review of budgetary implications of existing and new policies, and better planning of the recurrent costs of investment decisions.

152. SINIP's potential as a tool to support policy-based and cost-effective investments could be augmented through certain actions, taking into account the importance of its strengthening as pillar for the process of investment planning and evaluation. In terms of its institutional framework, a public investment policy could be designed, delineating aspects such as private participation in public investments, co-financing arrangements in investments with private returns, competitive mechanisms to access investment funding, and arrangements for maintenance plans. The MEF could restrict incorporation of projects into the capital budget to those that have undergone due technical SINIP review and registration. Also, thresholds could be established for pre-investment and feasibility studies. All of this needs to be properly valued, documented and regulated, under a clear plan of action.

⁹³ The government could consider opening the discussion of macroeconomic assumptions that underpin the budget to selected non-governmental experts (e.g., research centers, universities) as means to validate the process. It could also consider conducting the debt sustainability analyses on an annual basis.

⁹⁴ MEF's DPI intends to contract international consultant services to coordinate formulation of a Sectorial Public Investment Plan and to prepare a methodology of the sectorial médium-term investment plans for the 2006-2010 period.

153. To facilitate monitoring of financial and physical progress, better use could be made of interfaces between SINIP and SIAFPA, and SINIP's reports could be enhanced and made easily available for public scrutiny. Finally, training programs on the methodologies for preparation, appraisal, administration, monitoring, and ex-post evaluation of projects could be implemented.

154. In terms of budget formulation, the MEF commands a process that follows an established procedural framework in an orderly and timely manner. As more emphasis is put on medium-term frameworks and results (see below), the government could enhance the process by allowing earlier Cabinet involvement in the setting of aggregate allocations, which in turn would facilitate the incorporation of indicative budgetary ceilings (considered international good practice) into the process. As for legislative participation, the Panamanian system largely follows recognized good practices in terms of procedures for scrutiny, debate, approval and modifications.

155. The recently introduced results indicators by program could progressively reach an appropriate, yet manageable, mix of dimensions (e.g., effectiveness, efficiency, economy, quality) and ambits (e.g., process, outputs, outcomes).⁹⁵ Similarly, the sophistication of cost accounting systems to calculate unit standards and measure the marginal cost of changes in performance could be gradually built. Credibility of the new practices should rely on a formal program assessment process that informs budget ceilings and allocations for upcoming years, on higher degrees of flexibility to entities in the execution of their budgets and, in the longer term, on introduction of incentives documented in performance agreements.

156. As is expected from such a significant overhaul of the budgetary system, there are capacity gaps in executing entities and in the MEF that need to be addressed. In a system that will necessarily imply more devolution to executing entities, the MEF should shift its transactional focus, and thus develop capacity, to assess the fiscal and budgetary impact of policy changes and programmatic trade-offs, and to maintain a system of budgetary accountability (e.g., standardizing reporting formats, assisting executing entities to measure productivity and output, and evaluating results).⁹⁶

157. **Revenue collection.** *Predictable and controlled revenue administration is necessary to fund policy and program implementation.*

158. Tax administration in Panama has been substantially modernized since 1998, primarily with the operation of information systems that allow massive data processing, thus facilitating taxpayer compliance and assessment. This report does not intend to evaluate overall revenue management capacity, but looks at selective areas considered critical to the prompt and complete funding of the treasury. In that sense, a significant start is the effective system in place to ensure that collections are promptly deposited into the treasury single account. However, a number of other areas could be improved.

159. **Fundamental actions** recommended to improve effectiveness of assessment and collection functions, and transparency of tax data, are: (i) to strengthen the human resource

⁹⁵ This classification is based on the Chilean experience. Guzmán (2005).

⁹⁶ See treatment of the subject in Schick (2001).

base of the audit department, develop audit plans and methodologies based on risk assessments, and the forensic capacity to investigate and prosecute tax fraud; (ii) to undertake a comprehensive exercise to clear up the taxpayer account database, including accurate identification of outstanding debt;⁹⁷ (iii) to aggregate that information so as to enable better reporting on declared and assessed taxes, including well-classified and reconciled data on arrears (e.g., age profile, amounts in dispute, bad debts); and (iv) to review the integrity of the system itself, developing safeguards against and audit trails of tampering attempts.

160. In terms of its internal operation, the DGI could develop a strategic plan and enhance its performance monitoring system and indicators. It could also strengthen its internal control department with the capacity to investigate allegations and presumptions of corruption, and coordinate with the DGA, the public registry and the property registry for data cross-checks. The actions underway to create a large taxpayer unit, develop a plan for control of stop-filers, and strengthen enforced collections should continue. Finally, and noting that legal changes would be required, the administrative instances of the appeals system could be made more independent from the DGI.

161. **Cash and debt management.** *Efficient management of financial assets and liabilities is critical to reduce debt service costs and fiscal risk.*

162. The MEF exercises good management and control of the government's cash position, on the basis of a single treasury account that captures central government revenues, regular cash flow programming, and use of effective debt instruments to deal with temporary cash shortages. However, a number of funds operate out of the common fund payment system (small but numerous rotating funds, transfers to some decentralized and autonomous entities of a noncommercial nature, and projects funded by external loans and grants).

163. Such a system can produce idle funds, increase transaction costs, and reduce transparency. Attention should also be paid to the backlog in the bank reconciliation of the Treasury accounts, a basic internal control task. Two recommended *fundamental actions* are therefore to introduce measures that grant the Treasury further control of public sector bank account balances and their consolidation, and to ensure bank reconciliations are completed shortly after each month (and eventually on a daily basis) by a separate unit.

164. Other improvements to treasury operations could be gradually introduced: (i) to formalize a policy (supported by system restrictions) on the sequencing of payment releases; (ii) to make further use of electronic deposits into bank accounts; (iii) to link payments to RUC identification numbers (thus allowing tax administration cross-checks); and (iv) to transfer payment operations for debt service and payroll to the Treasury.

165. The quality of debt management and records is high but the correlated procedures are cumbersome. The current assignment of responsibilities for debt recording and payment could be evaluated to avoid duplications and seemingly unnecessary steps. The interface between DMFAS/SIGADE and SIAFPA could be approached, but only after the

⁹⁷ Among others, the taxpayer account should differentiate between the non-filing status (not showing any amount in this case, but indicating lack of compliance), the debt that is not in arrears status (a debt that has been declared or assessed for which payment is not yet due), and the arrears status (an overdue debt).

administrative procedures are revised. The MEF could also consider documenting its debt management strategy in a formal mid-term document approved by Cabinet, containing among others, the quantification of debt costs and risks under different scenarios.

166. **Expenditure controls.** *Predictable and controlled budget execution is necessary to enable effective management of policy and program implementation*

167. The procedures to modify the approved budget during the fiscal year are well regulated, conducted in a transparent manner, and give certain flexibility to execution. However, the materiality and frequency of in-year adjustments is a concern in the sense that they reduce the credibility of the budget formulation process. While this situation depends on a number of factors, it could be more closely monitored as a means to avoid shifts across expenditure categories that could affect operational efficiency of service delivery.

168. There is a comprehensive set of internal controls, which seem particularly effective in payroll management. The picture for non-salary expenditures is different. The significant delays in contracting and payment, which have traditionally characterized public sector financial management in Panama, have probably increased the aggregate cost of works, goods and services in different ways as noted in the following chapter. And the all-encompassing ex-ante fiscal control is not an incentive to regulatory accountability on the executing entities' side. Furthermore, the untimely and inefficient use of resources by service delivery units can be a significant obstacle to the recent introduction of results in the budgeting process.

169. CGR's recent development of tools to facilitate fiscal control (guidelines, checklists, and information systems) is commendable and should continue. Two additional *fundamental actions* could be: (i) to apply ex-ante procurement and payment controls more selectively, with the introduction of differentiated fiscal control techniques based on risk assessments (applicable at different levels, e.g. entity/program and type of transaction); and (ii) to review carefully the perceived fragmentation and complication in internal administrative systems and procedures within executing entities, so as to eliminate duplications and unnecessary steps.

170. The effective implementation of risk-based approaches to internal control systems necessarily requires increased strengthening of these systems. While this depends on many factors, two *fundamental actions* could be: (i) to enforce and monitor the prompt and comprehensive actions by executing entities in response to audit findings; and (ii) to strengthen internal audit capacity, gearing the function towards significant systemic issues of reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets, and compliance with laws, regulations, and contracts.

171. **Donor practices.** External financing is largely incorporated into the budget, but its execution is not reported on a timely basis and is usually performed under parallel administration arrangements. While the "outsourcing" approach to project administration seems justified in light of the issues described above, in the short term in-year reporting could be enforced to allow for comprehensive analyses of budget execution. In the short to medium term, the modernization of public financial management and procurement practices should serve as basis to increase the amounts of external cooperation that are managed through the government's own systems, supporting a consolidated approach to budget implementation.

172. **Accounting, recording and reporting.** *Timely, relevant and reliable financial information is required to support fiscal and budget management and decision-making.*

173. The government accounting function in Panama has been institutionalized and shows important advances, such as the accrual base of recording, the timely issuance of in-year and annual budget reports and financial statements (complemented with information on debt and payroll), and the availability of information through the internet. Still, the official budget execution reports could be improved with annexes that allow a direct comparison at the same level of the original budget (e.g., execution by program), and with enhanced narrative explanations to assist users in assessing the entities' performance, their stewardship of assets, and the allocation of resources.

174. The major concern in this area lies, though, on the reliability of the financial statements. There are a number of circumstances (affecting accounting standards, records, and reports) that could limit a comprehensive and effective oversight of the use of funds, and could provide the opportunity for operational efficiency breaches and increased fiscal risks.

175. Accordingly, **fundamental actions** could encompass: (i) firm follow up to the issues that have prevented the external auditors from issuing unqualified opinions on the financial statements; (ii) improvements in the notes that provide narrative descriptions or more detailed schedules of figures in the financial statements; (iii) a thorough short-term revision of the government accounting standards, with a view of reaching convergence with international practice in the medium to long term; and (iv) enforcement of the consistent application of the standards to permit, among others, adequate consolidation practices. Efforts could also be made to begin disclosing known contingent liabilities.

176. Procedures for asset management and control could be documented in a modernized property, plant and equipment manual, setting uniform standards to control, record and report costs, revaluations, depreciation, movements, sales and disposals, custodial responsibilities, registries, physical inventories and reconciliations. Additionally, interfaces could be built between the databases in use and SIAFPA's accounting module.

177. **External audits.** *Effective scrutiny through external audit, complemented by legislative oversight, is an enabling factor in the government being held to account for its fiscal and expenditures policies and their implementation.*

178. Based on legislation that provides it with adequate room to exercise its external audit function, the CGR has made commendable efforts to perform its audits and issue the respective reports on a timely basis. There are issues, however, in terms of audit coverage, approach, follow-up and independence that should be taken into consideration as the function is further modernized.

179. **Fundamental actions** could be taken to: (i) make better use of risk assessment techniques to develop the annual (and multi-annual) audit work plan and to plan individual audits, so as to adhere in practice to international standards and focus better on significant and systemic issues; (ii) in line with the plans, ensure adequate coverage and disclosure of relevant entities (such as the CSS), items (such as revenue and debt), processes (such as application of procurement rules), and information (such as budget execution); and (iii)

analyze carefully and make decisions with respect to the possible separation of the external audit function from other ex-ante control and administrative-type tasks performed by the CGR. By enhancing external scrutiny, these actions could increase accountability for efficient and rule-based management of resources.

180. As a means to broaden coverage, the CGR could formalize the use of the work of private auditors for certain entities or programs, under an efficient quality control framework. On other hand, as normative body of the internal control framework, the CGR could implement better systems to monitor and support the implementation of actions to address the repeatedly reported internal control weaknesses.

181. CGR's project to enhance the forensic capacity of the audit department should continue. The initiative to undertake performance audits is also valid, but in terms of sequencing it may be prudent to address the financial audit issues first.

182. On the legislative front, building upon the extensive role played by the Assembly in the scrutiny, debate and approval of the budget, instances for formal review, hearings and follow-up to annual audit reports could be implemented.

V. PROCUREMENT OPERATIONS AND MARKET PRACTICES

Efficiency of Procurement Operations and Practices

183. The 2001 CPAR identified serious weakness in the main entities' procurement capacity due to the lack of standard documents and other tools, poor planning and internal control, limited capacity of staff which have often inadequate professional qualifications and almost no training and suffers high turnover. Consequences identified by the CPAR included a high degree of discretionality in interpreting the law, limited use of open competition and frequent abuses of direct contracting (with as much of 75% of procurement carried out by shopping and direct contracting), frequent contract fractioning, long delays in contract evaluation and award, late payment to contractors, and generally inefficient procedures. While preparing this CPAR update, the team carried out in-depth assessments of the Ministry of Works, Education, and Health to validate or update the 2001 findings. In addition, comprehensive evaluations were carried out for the CSS and the ACP to be able to compare the findings in line ministries with other public sector entities generally considered as successful. With the understanding that special conditions apply to these entities, the objective of this exercise has been to identify good practices which could be replicated and utilize them as internal benchmark for procurement excellence.

184. Generally, procurement of goods and works in line ministries is managed by departments established within the Administration Directorate, several steps down in the organizational structure from the head of the agency. However, procurement responsibilities are fairly dispersed within the institutions⁹⁸.

185. In addition to confirming the findings of the 2001 report, the assessment of the three line ministries provided some insight on the internal bottlenecks which contribute to delays and inefficiencies. For example, in the Ministry of Education, contracting requires 20 administrative processes divided in 84 practical steps, of which all but one process and 2 steps are internal requirements of the Ministry. The average time for a simple shopping process is six months⁹⁹. In the Ministry of Health, contracting requires 18 administrative processes divided in 69 practical steps, of which all but one process and 2 steps are internal requirements of the Ministry. Typically, 246 days are required by MOP to complete a process under Law 56 and 180 within the "facilitation project" which utilizes UNDP as financial agent for most MOP contracts. Even within this simplified context, MOP needs to implement 38 steps before allowing a contractor to mobilize.

186. Overall, the limited use of open competition remains a serious problem and is the consequence of both poor planning capacity and, in some cases, intentional fractioning of contracts to avoid the time consuming approval procedures. However, open competitive

⁹⁸ For example seven additional departments participate in the procurement process within the Ministry of Education. The Engineering Directorate typically participates in drafting specifications and evaluating bids.

⁹⁹ Indeed, from January to September 2005 when the mission took place, 130 procurement processes had been initiated by the Ministry of which only 21 had been completed.

bidding, when used (i.e. for contracts above 250,000 dollar), is generally perceived as sufficiently transparent.

187. As noted in Chapter IV, one of the most serious problems has traditionally been the delay in paying suppliers and contractors. These delays add significant cost (a surcharge estimated at between 10 and 20% percent of the value of the contract in addition to the cost of the time overruns) and discourage participation in the procurement market. However, as mentioned previously the current Government is making significant efforts to clear these arrears and notwithstanding the delays, most public works are generally completed.

188. Some initiatives to increase efficiency have already been launched by line ministries. For example, the Ministry of Education developed new bidding documents, eliminated unnecessary documentary requirements, and began to allow submission of missing documents and information within a specified time instead of outright rejecting bids, when these requirements are purely legalistic and omissions do not represent a material deviation from the key qualifications.

Supply Management and Strategic Planning

189. The DCP has just begun developing a policy to implement framework contracts in order to achieve savings through consolidation of appropriate items (e.g. stationary and office equipment, telecommunication services, and gasoline). However, a well designed approach applicable throughout the public sector is still missing. It is very important that the introduction of framework contracts be based on a careful strategy and an appropriate legal instrument to avoid potential pitfalls such as market concentration and higher prices. Other countries' experiences have shown that without proper planning, this contractual approach can be become discredited by unintended results and its important potential for savings be lost. In addition, it is important to point out that framework contracts address only one aspect of the reform (i.e. improving economies of scale) and should be part of a well coordinated, multi-pronged approach addressing the different causes of inefficiency which affect the system (e.g. convoluted internal administrative procedures, excessive external control, and lack of consistency). In addition, this contractual approach is appropriate only for certain types of relatively simple goods and services. In-depth market studies have not been carried out to support strategic choices and planning methodologies and tools have not been developed to implement the strategy. The planning capacity of the procuring entities also requires significant strengthening, as discussed above.

190. Currently, with the exception of the ACP and the CSS, there is almost no consolidation across the public sector or within institutions. This is largely due to the lack of annual planning, limited data and oversight on demand which leads to inefficiency as well as potential lack of transparency in the utilization of public resources. These problems are compounded by the fact that the goods catalogue is still under development and e-procurement is still incipient and does not include yet key functionalities to implement an efficient consolidation strategy through e-tendering. Additional problems affecting purchasing efficiency include: (i) overspecification; (ii) limited standardization (except for computers); lack of price benchmarks for goods and services; (iii) limited incentives for suppliers; (iv) lack of substitute products strategies (e.g. with respect to computer clones); (v)

and little attention to potential savings and efficiency resulting from wider international competition for certain items (the vast majority of purchases are made locally because, as discussed above, there is a well developed market).

E-Procurement

191. The team carried out a comprehensive assessment of the e-procurement readiness of the Government jointly with key public and private sector stakeholders and utilizing the standard methodology developed by the multilateral banks.¹⁰⁰ The analysis confirmed that the basic conditions for a successful transition to a fully electronic procurement system exist. However, important management and functional aspects which are required to ensure the system's sustainability and to obtain the desired impact in terms of increased transparency and efficiency are still not fully in place. The system's strong features include:

- A clear vision, very high level political support, strong technical and policy leadership, and close cooperation between the two key actors (i.e. the DCP and the Presidential Secretariat for Government Innovation).
- A procurement regulatory framework which requires some improvements, but does not impede the establishment of e-procurement
- Regulatory frameworks for electronic commerce, access to information, and transparency which adequately support e-procurement.
- A solid portal (Panamacompras) building on the previous experience led by the CGR which facilitates identification of key success factors and allows to incorporate lessons learned.
- The examples of well developed systems established within the ACP and the CSS which successfully demonstrated the impact of e-procurement.

192. Aspects which require further strengthening include:

- A strategic plan which includes aspects such as management, planned development and detailed implementation of subsequent phases of the system, financing, and human resources.
- A more comprehensive policy for public procurement including the systems' overall priorities, oversight mechanisms, overall strategic procurement planning (as discussed above), contract management, and relationship with the market.
- A wider mandate and increased resources for the DCP.
- Lower level regulatory instruments which define more in detail aspects related to e-procurement, and introduce modern controls based on the system's performance to enable an assessment of the system ability to generate value for money, in addition to the current legal and accounting controls.
- A single catalogue of goods and services based on international standards and mandatory for all public sector entities, and a single database of providers.
- A simplification of the procurement processes, as discussed elsewhere in the report, and, in particular and simplification of the external control process.

¹⁰⁰ See Annex III.

193. The DCP is currently working on the second phase of the e-procurement system, including a link with the financial system and electronic management of bidding processes. These activities are to be financed, in part, by the World Bank Public Policy Reform Technical Assistance Project.¹⁰¹ The launching of Panamacompras has resulted in an average increase of 30-40 percent in bidder participation per process and the system includes features that are expected to facilitate payment, such as an interactive system which allows contractors to track the administrative process. A full interface with the financial management system is also planned.

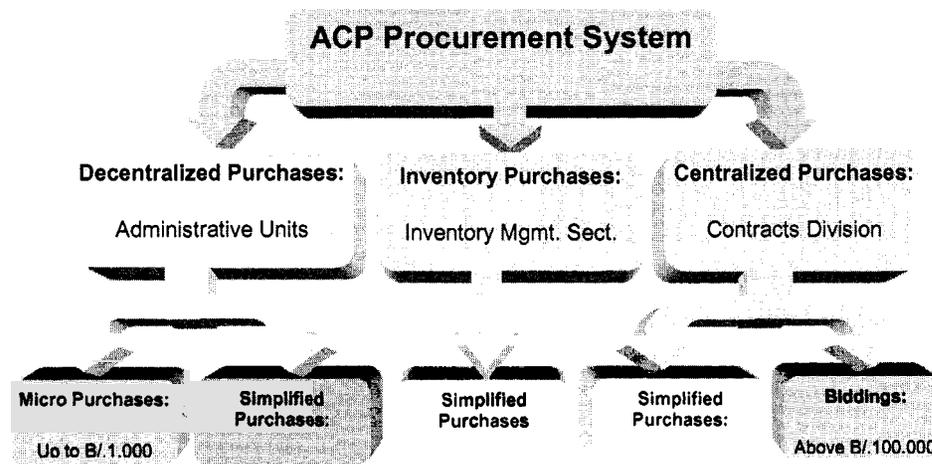
Examples of Parallel Organizational Systems and Practices

194. Several steps were undertaken by the CSS which reflect good practice worldwide in reforming high impact procurement agencies in countries spanning the entire spectrum of development. First of all, the CSS conducted a thorough review of its contracting practices identifying specific problems and bottlenecks. Reforms included important organizational changes which elevated the importance of procurement within the institution. The procurement department of the CSS is a Directorate with greater decision-making and budgetary independence than the procurement departments found in other public sector agencies, and this is credited by CSS management as a factor in the recent success. Next, the CSS streamlined purchasing processes simplifying administrative steps and requirements. Regulatory changes were introduced through the revised CSS enabling law, standard documents were adopted, and other tools and procedural changes implemented (e.g. e-tendering, a catalogue of goods and services, and the use of framework contracts). According to CSS' management, the team's own empirical observations, and feed back from other stakeholders, the new approach generated initial savings amounting to 18 million dollar, reduced significantly the time required for ex-ante control (from several months to approximately a week), especially for the goods procured through framework contracts, improved stock control, enhanced transparency, shortened payment times, and had a very positive impact on budgeting and financial management.

195. The ACP has long successfully mainstreamed its procurement system within the overall financial management system and does not treat procurement as an isolated technical process, but an integral part of the decision making process for the management of the ACP assets and resources. Contracting authority is delegated down from the ACP Administrator to the to the Manager of the Contracting Division and to the Contracting Officers who have full authority within the delegated powers thereby setting up an efficient system requiring few approval steps. The Contracting Division has a strong organization, adequate resources and significant independence to exercise its responsibilities.

¹⁰¹ Panama, Public Policy Reform Technical Assistance Project, Loan number 4635.

Figure 2: Structure of the ACP Procurement System



196. All acquisitions are planned in a coordinated manner across units according to set procedures, and standard bidding documents have been long in use. Upon contract completion, the contractor's performance is assessed and a record of this assessment is shared with the contractor and maintained in a central database. All procurement transactions are recorded and monitored through an integrated financial management system with a complete set of financial, purchasing and inventory functions and including a module on the contractors' past performance. This system is capable of generating a wide range of relevant procurement statistics and interfaces with the Contract Information System (SIC) which manages risk and raises red flags for Contracting Officers and managers on various potential illegal practices such as collusion as contract fractioning as well as inefficient procurement planning. The alert system triggers further investigation. The ACP comprehensive approach to procurement is complemented by a first rate training program tailored to different duties and levels of delegation and a quality assurance system which includes the only ISO 9001 certification within the public sector in Panama. As in all modern procurement systems, the ACP established a process to continuously update procurement tools and methodology and incorporate new efficiencies. This effort is led by a special task force designated by the Contracting Department with the clear objective of seek further simplification of procedures while maintaining the desired level of control.

Indicator	Benchmark	Results (average value during period)
Client satisfaction	80%	89%
Cancelled bidding processes	No more than 5% of total bidding process	Indicator not met during period
Time for award in public bidding for goods and services	80% resulting in award within 35 days or less	98%
Time for award in public bidding for works, negotiated contracts, and framework contracts.	80 resulting in award within 65 days or less	93%
Protests	No more than 3% of protests resolved in favor of the contractor	None during period

197. When an indicator is not met, the reasons are investigated. For example, the indicator on cancelled bidding processes allowed the ACP to focus greater attention on the need to improve budgets' realism, market surveys, and commercial conditions.

Functionality of the Public Procurement Market

198. The 2005 public procurement budget of the Government of Panama (not including the ACP) for projects and recurrent costs was approximately 1,100 million (a 9% decrease from 2004) including goods, works, and services and was executed by 60 institutions with the following composition:

Type	Percentage
Central Government	46
Decentralized institutions	21
Public Companies	20
Financial intermediaries	11
Municipal Governments	2

199. Procurement of goods and services can be broken down as follows:

Category	Total (\$ mill/year)
Consulting services	30.4
Other services	321.8
Materials and supplies	189.1
Equipment	12.4
TOTAL	553.7

200. In Panama there are more than 34,000 commercial enterprises with total annual sales in the order of 15,000 million. By and large, the local market is capable to satisfy the government's demand for commonly needed goods and services both in terms of quantity and quality. One of the reasons of the domestic market's dynamism is the free trade area of Colon where approximately 10,000 dollar worth of goods is traded annually.

201. Approximately 60% of the procurement of goods and services is concentrated in 8 institutions with the CSS being the largest buyer (more than 150 million per year). The other main spenders include: the Ministry of Public Works (MOP), the National Water and Sewer Institute (IDDAN), the Ministry of Education, the Savings Institute, the National Bank of Panama, the intl. Airport "Tocumen", and the office of the President. In order of magnitude of their procurement budgets, follow: the ministry of Finance, the National Lottery, the Ministry of Agriculture, the Ministry of Health, the Ministry of Justice, and the municipal governments. During the year 2005, 2,646 suppliers did business with the Government with 80 taking the largest share of the procurement market (i.e. the majority of payments were made to these suppliers).

202. Average annual public investment in infrastructure projects during the years 2001-2003 amounted to approximately 260 million including civil works, roads, bridges and water projects. The largest players in the area of public works are MOP and IDDAN¹⁰².

Table 7: Procurement of Works (\$ million)

Public Entity	2000	2001	2002	2003	Annual Average 2000-2003	Relative share 2000-2003
Ministerio de Obras Publicas (MOP)	106	51	177	177	128	49%
Instituto de Acueductos y Alcantarillados Nacionales (IDAAN)	3	27	25	115	43	16%
Empresa de Transmisión Eléctrica (ETESA)	3	7	84	5	25	9%
Ministerio de Salud (MINSa)	5	69	3	4	20	8%
Fondo de Inversión Social (FIS)	3	7	22	19	13	5%
Ministerio de Educación (MEDUC)	1	3	8	5	4	2%
Ministerio de Economía y Finanzas (MEF)	0	10	5	0	4	1%
Ministerio de Vivienda (MIVI)	8	5	0	2	4	1%
Caja de Seguro Social (CSS)	4	1	4	2	3	1%
Municipal Governments	1	3	2	2	2	1%
Other institutions	12	20	23	11	17	6%
Total	158	222	371	350	262	100%

Source: CGR

203. The public sector commissions numerous multi-million construction projects each year¹⁰³. Domestic firms have successfully performed contracts up to 30 million, although only a few firms have adequate capacity for contracts of this magnitude. The majority of contracts between 10 and 20 million are performed by joint ventures between a Panamanian and a foreign firm, while there is adequate competition among domestic firms capable to perform contracts up to 10 million. There are several firms with significant turnovers and capacity of implementing multiple large projects¹⁰⁴. Many foreign firms have established local offices, but other international firms also typically bid for and are awarded large projects and the market for large works is generally considered as sufficiently open and competitive.

204. In large projects, commercial banks are often willing to engage in an operation similar to “factoring” whereby they advance up to 80 percent of the payment by the Government to the contractor effectively purchasing the government’s debt. The remaining 20 percent is retained as collateral to guarantee the Bank’s commissions. Access to credit is generally good and there are no particular obstacles for either large or small companies. While late payment may discourage competition and adds costs at all levels of the market, SMEs are particularly affected because of their limited ability to pre-finance contracts and continue construction when cash flow is very slow.

Conclusions and Recommendations

205. **Benchmarking with Domestic Best Practices.** Clearly, the efficiency of the ACP’s and CSS’ procurement systems is the result of the combination of multiple factors. These

¹⁰² The ACP which is the single largest spender in both goods and works is not included as it operates under a completely separate budget and system.

¹⁰³ With largest during the last three years being respectively 48.8, 38.3, and 29.7 million.

¹⁰⁴ More than 100 million in the case of the largest.

factors include sound rules, streamlined processes, prompt payment to and equitable treatment of suppliers and contractors, appropriate use of technology, highly professional and adequately trained and paid workforce, and an environment which is conducive to control and enforcement. These factors are consistent with international best practices, but not all of them can be necessarily replicated throughout the public sector. Nevertheless, these successful experiences represent sources of good practices and innovative approaches which are uniquely relevant to Panama because they are implemented within very similar sets of rules and legal traditions and by institution which draw from essentially the same pool of human resources. ACP staff enjoys greater job stability and better salaries and career opportunities than their counterparts in other parts of the Government ¹⁰⁵. However, the CSS follows the same salary scale as the rest of the Government. While higher salaries may be a factor, it is not the only one, or necessarily the determining one, in the context of Panama, in improving administrative efficiency.

206. A necessary starting point to determine what and how successful practices can be replicated is to further develop the DPC's monitoring and evaluation capacity, as discussed above. Indeed, the ACP itself makes decisions on upgrading its system by continuously assessing it through baseline and performance indicators. By harmonizing its performance indicators with those utilized by the ACP and comparing the result of baseline indicators exercise for the whole public sector with those applied to ACP by the CPAR team and the Contracting Division, the DPC would be able to clearly identify which practices can be replicated given potential political, institutional, legal or financial constraints and constantly benchmark its progress vis a vis a well know, credible system which not only can offer examples, but also technical assistance (e.g. on the design of bidding documents, training courses, certification program, and career paths), already developed tools (e.g. red flag system), capacity building, and use of the ACP's world class training facility at conditions to be agreed between the DPC and the Contracting Division. The following table provides an example of practices which are likely to be major factors' in ACP's and, in some case, the CSS' procurement efficiency and could be replicated throughout the public sector:

Practice	Impact
Decentralized delegation of authority	Contributes to streamlining processes, create a culture of accountability, and an incentive to build capacity
Use of standard documents	Improves consistency, helps filling procedural gaps in regulations with a flexible tool, reduces mistakes, and enhances transparency
Use of framework contracts	Achieves savings through consolidation
Ex-post audits	Reduce delays and encourage internal control, accountability, and capacity building
Limited number of steps required to	Avoids duplication and unnecessary delays

¹⁰⁵ Panama adopted an Administrative Career Law in 1994 (Law No. 9), which is not fully implemented due to the lack of regulations and a suspension order in 1999.

contract	
Strict enforcement of ethics code	Better compliance and culture of accountability
Extensive use of e-procurement	Transparent and expeditious processes and well organized data which are available for better planning as well as control
Good interface with comprehensive financial management system	Complete records, quick and accurate transactions, faster payments, better monitoring and compliance
Quick award and payment procedures, automatic interest paid on delays, fair and prompt resolution of protests and claims	High level of bidders' participation and lower prices.
Quality Assurance System and benchmarking	Better monitoring and compliance and good basis for capacity building
Red flag system	Tighter controls, more accountability, better risk management
Ongoing training for staff	Better compliance, stronger professional ethics, more objective basis for delegation of higher level functions
Record of contractors' past performance	More accurate evaluation of qualifications, greater incentives for good performance

207. **Quick Saving Program.** The CPAR update team carried out a high level assessment of the supply strategy focusing on 10 categories of consumables goods for recurring needs, with simple specifications, required by all government entities, and currently purchased independently by each one of them, such as telecommunications, gasoline, computer equipment and printing services.¹⁰⁶ The study also looked at the potential for better consolidation of consulting and professional services and identified the potential for savings in each one of the categories assessed which would translate in total potential savings ranging from 44 to 68 million per year (equivalent to 8 to 12 percent of the total government procurement bill). The following table relates the savings identified to the overall 2005 procurement budget for goods and services.

Table 8: Potential Savings

Category	Total	Conservative %	Aggressive %	Conservative \$ Million	Aggressive \$ Million
Consulting and professional services	30.4	5	8	1.5	2.4
Other services	321.8	10	15	32.2	48.3
Materials and supplies	189.1	5	8	9.5	15.1
Equipment	12.4	10	15	1.2	1.9
Total	553.7	8	12	44.4	67.7

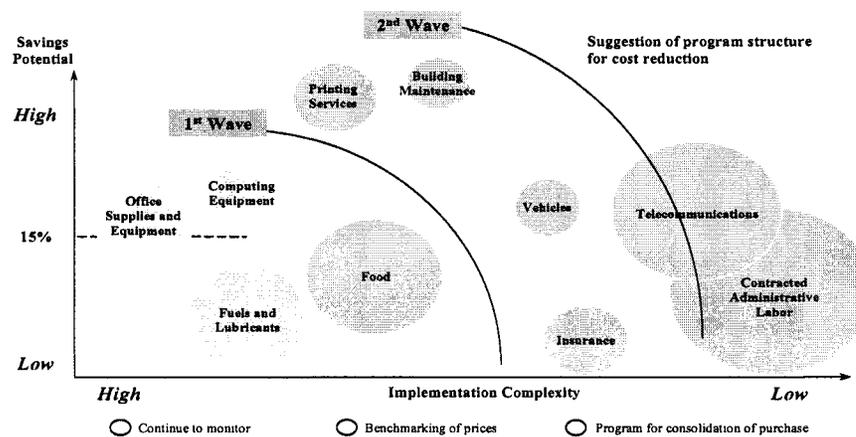
¹⁰⁶ The assessment details are included in Annex IV.

208. The DCP should carry out a full diagnosis of the current supply strategy with the objective of prioritizing opportunities and developing details of the cost savings strategy. To succeed, the program should be highly visible within the government and be strongly supported by the highest level. It should also be closely coordinated between the Ministry of Finance and the CGR close, but efficient control and enforcement of remedies, as appropriate. Technical assistance will be required to carry out the study and facilitate implementation of the recommendations.

209. The basic features of the program should include:

- A complete expenditures profile and generating primary data on
 - Expenses by expenditure category (e.g. salaries, debt payments, mandatory tax revenue transfers, investments, procurement, etc.)
 - Expenses by government agency
 - Expenses by procurement item group (e.g. civil works, hospital/medical services, IT equipment, administrative support staff, vehicles, fuel, etc.)
- A benchmarking exercise to homogenize prices for high volume products.
- A ranking of procurement item groups according to the size of procurement expenditures.
- Identification of participating units;
- Demand and venter market structures
- Potential approaches to improve procurement, starting with the largest groups looking at both 'moderate' and 'aggressive' measures. Based upon this analysis, potential savings will be estimated for each item group from revising procurement contract arrangements. The selection of the alternative approaches will be based upon internal and external factors such as: risks and opportunities, time, length of activities, ease of implementation, available technologies.
- Prioritized group opportunities according to magnitude and ease of realizing savings potential.
- Design of contractual vehicle (framework contract) and Standard/model bidding documents incorporating cost-reduction measures (eg. consolidation, e-procurement, standardization, etc.)
- Identification of the unit which would manage the framework contracts.
- Design of subsequent phases according to savings potential and implementation complexity starting with items such as office paper and gasoline
- Launch of first and subsequent phases
- A mechanism for systematic feedback
- Training for the unit managing the contracts, participating units across the public sector and private sector participants

Figure 3: Progressive Implementation of Quick Savings Programs



210. **Continue development of E-procurement** The key actions required to support the establishment of a sustainable e-procurement system include a comprehensive procurement policy which includes strategic planning, the strengthening of the DCP, the establishment of common standards, improvement to the regulatory framework, and the identification of the lessons learned from the pilot experience.

211. The DCP should have the resources to continuously develop procurement policy and strategies, monitor the system's performance, quickly introduce new technologies and efficiencies, coordinate capacity building and manage communications to ensure ample information and build support.

212. The strategic plan should address specific objectives and timeframes at the central government and local level, a participatory approach to e-procurement development which includes the private sector and civil society.

213. The revamped procurement policy should be clearly linked to the Government's overall socio-economic objectives, as defined in the five pillars of the "Strategic Vision for Economic Development and Employment until 2009". Specifically, procurement policy should support the key objectives of industrial development, regional development, of small and medium enterprises, access to information and communication technologies, and electronic commerce. The policy should include quantitative indicators to be monitored independently and the results should be disseminated.

214. A series of executive decrees could address specific procedural aspects consistent with the electronic commerce law and incorporating international standards (e.g., as reflected in the multilateral banks' e-procurement guidelines and the electronic communication criteria included in the UNCITRAL convention currently being drafted).

Recent Achievement on the Procurement Reform.

1. The current Government has placed strong emphasis on procurement reform as a way to streamline public administration and increase the efficiency of public spending. As a result, the Public Procurement Directorate (DCP) in MEF received a stronger mandate and full political support to revive the reform process. Currently, the DCP has effective leadership, is developing a sound vision for its strengthened role, and is beginning to coordinate well with other key Government stakeholders, in particular the Comptroller General of the Republic (CGR) and the Presidential Secretariat for Government Innovation (SPIG). In addition to those allocated by the Government, adequate resources to support the initial phase of the reform are available through the World Bank's Public Policy Reform Technical Assistance Project, which has a specific component for this purpose.
2. During 2005, the DCP was restructured to provide technical assistance to procurement entities on the interpretation and application of the regulatory framework, supervise the consistent implementation of the system as a complement to the CGR's control function, develop bidding documents, build capacity in procuring entities, and manage the e-procurement system. Under the its new structure, the following improvements have been observed in the performance of the DCP:
 - Cost reduction strategies. The DCP has implemented public procurement processes for the provision of key services and goods for the central government that used to be procured in a fragmented manner by each public entity. According to informal estimates by the DCP, the cost reduction strategy already has produced cost savings of up to 34 percent for the central government, while increasing competition, promoting greater transparency and increasing the quality of the products/services procured in key areas, such as telecommunication and office supplies. The DCP plans to apply this strategy to other key services and goods in the near future.
 - More effective workflow system. Preliminary estimates based on approximately 70 percent of the procurement processes analyzed by the DCP, indicate that the average response time period fell from 90 days in August 2005 to 30 days as of May 2006.
 - Improved skills mix. The DCP has strengthened its skill-mix, increasing the number of professionals from 2 to 13, while keeping the overall number of employees at the same level. The structure of the DCP also has been redesigned to effectively support and address the areas of legal advice, e-procurement system, policy and management of the public procurement system, and special projects.
 - Improved outreach. An outreach campaign was launched to collaborate more effectively with the private sector and civil society organizations (e.g. with the local chapter of Transparency International).
3. A major accomplishment in the area of procurement has been the development of the new e-procurement system, PanamaCompra, which is capable of performing many sophisticated functions, such as business opportunities notifications, on-line status notifications of payments for providers. An important indicator of the progress made in implementing this new system is that 90 percent of all public procurement processes in the

central government is currently taking place through PanamaCompra.¹⁰⁷ More than 100,000 visitors and 1100 registered subscribers have visited the web-site since the beginning of February 2006. The new e-system provides subscribers automatic information regarding ongoing procurement processes of activities that they may be interested. Furthermore, a module that allows contractors/providers to find out the status of their requests for payments has been created and another module has been designed to provide CGR with a monitoring tool.

4. The DCP also has made progress in developing a comprehensive procurement reform strategy, preparing surveys to determine perceptions on the effectiveness of public procurement systems, applying baseline indicator systems to assess procurement performance, and designing training programs to improve public procurement capacities.
 - The consultant retained for the purpose developing a comprehensive procurement reform strategy has finished the consultative phase with the authorities, with a final report produced in June 2006. Moreover, a consultant has been hired to analyze and redesign the process of purchases and payments in key government agencies.
 - Consultant services have been contracted to develop a methodology and conduct surveys to determine private and public perceptions of the public procurement system.
 - The DCP is in the process of applying the baseline indicators system (BIS) developed by the OECD-DAC/World Bank Roundtable on Strengthening Procurement Capacity in Developing Countries to broadly assess the key elements of a well functioning procurement system.¹⁰⁸ The BIS will constitute the basis for a monitoring system to continue measure progress and identify areas where additional emphasis is required.
 - Finally, the DCA is designing a consulting activity aimed at (i) assessing technical capacities and skills of public staff responsible for carrying out procurement processes; and (ii) developing a comprehensive training and capacity building programs for the procurement agencies.

5. A new procurement law (*Ley 22*) approved by the National Congress on June 8, 2006: (i) eliminates parallel frameworks, applicable to several agencies (with exception of the CSS, the Panama Canal Authority and municipal entities), that have hampered the application of a consistent public procurement system; (ii) creates an autonomous DCP, as an entity responsible for the interpretation of the law; and, (iii) establishes several procedures/systems promoting efficiency, economy and transparency; such as: a) establishing a framework for cost reduction strategies (e.g., price benchmarking, consolidation for economies of scale), b) creating an independent administrative tribunal to review/decide

¹⁰⁷ Cabinet Decree 98 of September 2, 2005, requires all central government institutions and autonomous entities to post online all public procurement information, contract opportunities and awards. Municipal and other local entities are expected (but not compelled) to eventually begin using PanamaCompra. (www.panamacompra.gob.pa) The Decree emphasizes the importance of e-procurement in promoting transparency and competition, and supporting good governance. (Gaceta Oficial 25,378, September 5, 2005).

¹⁰⁸ The BLIs are intended to provide a standardized instrument for developing countries and donors to assess the quality and effectiveness of national procurement systems. The BLIs address four aspects of a country public procurement system: (i) the existing legal framework that regulates procurement in the country; (ii) the institutional architecture of the system; (iii) the competitiveness of the national market; and (iv) the integrity of the procurement system.

procurement related protests/complains, and c) establishing a sound framework for the implementation of an e-procurement system. Under the TA operation, the World Bank provide financial and technical support to GOP's actions aimed at implementing the new procurement law, including, among others: a) drafting regulation frameworks and procedures; b) developing an e-procurement strategy; c) and providing office and IT equipment and capacity building to the new autonomous DCP.

6. The CGR is in the process of reviewing its control methods with the objective of improving its operating efficiency and the SPIG (www.innovacion.gob.pa) continues to play a central role in promoting the development of technology designed to promote transparency and efficiency in the public administration. Proof of this is given by the PanamaTramita (www.panamatramita.gob.pa) and PanamaCompra projects. In the case of PanamaCompra, the next version includes functionalities that will help SPIG in auditing technology acquisition by all government entities.
7. Summary Assessment. The current Government has given priority to procurement reform to streamline public administration and increase the efficiency and transparency of public spending (i.e. providing a stronger mandate to the DCP, passing a new procurement law, supporting e-procurement system). The actions taken to date already appear to have had a considerable impact (para.46) and should become even more apparent over time. Implementing the new legal framework and building up consistent practices among procurement agencies will be as or more important than the changes to the legal framework *per se*.

ANEXXES

Annex I Action Plan

For discussion purposes, the fundamental recommendations of the report are presented in **draft** action plan format here.

Item	Actions	Respon- sibility	Basis ¹⁰⁹	Timing ¹¹⁰	TA Needed? ¹¹¹
	FINANCIAL MANAGEMENT				
1.	<p>FM institutional framework</p> <ul style="list-style-type: none"> Organize technical working groups and high-level discussion tables to look into solutions to optimize the distribution of institutional responsibilities, particularly with respect to: (i) payment operations (e.g., payroll and debt service), (ii) maintenance of debt records, (iii) administration of accounting systems and preparation of consolidated fiscal reports and financial statements, and (iv) independence of external audits. As needed, propose legal changes. 	MEF, CGR and relevant stakeholders	ADM LEG	S M	KS Y
2.	<p>Transparency of expenditure payment arrears</p> <ul style="list-style-type: none"> Continue cleaning up the recording of commitments and accruals Reconciliate balances of accounts payable between fiscal reports and financial statements Develop subsidiary records with age profile classifications 	MEF, CGR and executing entities	ADM	S S-M M	N N Y
3.	<p>Quality of budget documentation</p> <ul style="list-style-type: none"> Prepare action plan to fill gaps from IMF's Fiscal Transparency Code. Incorporate into budget documentation: (i) improved and more comprehensive information on the quantitative macroeconomic framework, on fiscal policy, risk and sustainability, and on the impact of new policy initiatives; (ii) details of debt stock and financial assets; and (iii) more detailed comparators between the budget and the ongoing and preceding years 	MEF	ADM	S S-M	Y Y

¹⁰⁹ ADM = Administrative action. LEG = Action that would involve changes to legislation.

¹¹⁰ S = Short term (could be substantially implemented within 12 months). M = Medium term (could be implemented within 1 to 5 years). S-M = Short-to-medium term (some aspects, but not all, could be implemented within 12 months).

¹¹¹ N = No additional technical assistance (TA) would be needed (could be implemented with installed capacity). KS = Could be implemented with installed capacity, complemented with international knowledge sharing (KS). Y = Additional TA may be needed.

Item	Actions	Respon- sibility	Basis ¹⁰⁹	Timing ¹¹⁰	TA Needed? ¹¹¹
4.	<p>Oversight of fiscal risk</p> <ul style="list-style-type: none"> • Prepare and implement program to enhance capacity in MEF and CGR to assess and monitor financial performance and fiscal risks associated with decentralized institutions, public enterprises and shareholding in private companies. • Consolidate fiscal risk issues into a report at least annually. 	MEF, CGR	ADM	M	Y
5.	<p>Budget planning</p> <ul style="list-style-type: none"> • On a pilot basis in key sectors, start the preparation of costed strategic plans for policy assessment and reconciliation of the top-down and bottom-up multi-year budget planning. • Ensure that the public investment programs are based on those plans, with due assessment of recurrent cost implications • Prepare indicative ceilings for the selected sectors, broken down to the main economical and programmatic categories, and incorporate them in the formulation of annual budgets 	MEF, executing entities	ADM	S-M	Y
6.	<p>Tax administration</p> <ul style="list-style-type: none"> • As part of the modernization project, strengthen the human resource capacity of the tax audit, investigation and internal control functions. • Develop tax audit plans and methodologies based on risk assessments. • Undertake a comprehensive exercise to clear up the taxpayer account database, including accurate identification of outstanding debt. • Aggregate that information so as to enable better reporting on declared and assessed taxes, including well-classified and reconciled data on arrears (e.g., age profile, amounts in dispute, bad debts). • Review the integrity of the system itself, developing safeguards against and audit trails of tampering attempts. 	MEF	ADM	S-M	N
				S-M	KS
				S-M	N
				M	KS
				S-M	Y

Item	Actions	Respon- sibility	Basis ¹⁰⁹	Timing ¹¹⁰	TA Needed? ¹¹¹
7.	<p>Cash management</p> <ul style="list-style-type: none"> • Analyze the legal aspects and accordingly introduce measures to grant the Treasury control of public sector bank account balances and their consolidation. • Ensure bank reconciliations of Account 210 are completed shortly after each month by an independent unit. • Ensure bank reconciliations of Account 210 are made on a daily basis, using better technological linkages with BNP. 	MEF/CGR MEF MEF/BNP	LEG ADM ADM	S-M S M	Y N Y
8.	<p>Internal controls on expenditures</p> <ul style="list-style-type: none"> • Introduce differentiated fiscal control techniques based on risk assessments (applicable at different levels, e.g. entity/program and/or type of transaction), and accordingly begin to apply ex-ante controls more selectively. • Review the internal administrative systems and procedures within executing entities, so as to eliminate duplications and unnecessary steps. • Introduce system to monitor the prompt and comprehensive actions by executing entities in response to audit findings on internal controls and financial statements. Apply sanctions as needed. • Introduce training and awareness programs to modernize internal audit, gearing the function towards significant systemic issues. 	CGR Ex. entities CGR CGR	ADM ADM Ad/Leg ADM	S-M S-M S-M M	Y Y KS Y
9.	<p>Financial statements</p> <ul style="list-style-type: none"> • Improve the quality of the notes that provide narrative descriptions or more detailed schedules of figures in the financial statements. • Perform a thorough revision of the government accounting standards, with a view of reaching convergence with international practice in the medium to long term. • Prepare consolidated central government (and eventually public sector) financial statements. 	MEF/CGR	ADM	S-M S-M M	Y Y KS

Item	Actions	Respon- sibility	Basis ¹⁰⁹	Timing ¹¹⁰	TA Needed? ¹¹¹
10.	<p>External audits</p> <ul style="list-style-type: none"> Assess and improve use of risk assessment techniques to develop the annual (and multi-annual) audit work plan and to plan individual audits, so as to adhere in practice to international standards and focus better on significant and systemic issues. In line with the plans, ensure adequate external audit coverage and disclosure of relevant entities (such as the CSS), items (such as revenue and debt), and information (such as budget execution). 	CGR	ADM	S-M	Y
					Y
	PROCUREMENT				
11.	Development and adoption of a comprehensive procurement reform strategy.	DCP	ADM	S	Y
12.	Development of a cost reduction strategy including price benchmarking, better consolidation for economy of scale and more efficient procurement procedures.	DCP	ADM	S	Y
13.	Development of basic tools such a suite of standard documents for the main types of procurement, manuals and guidelines on key aspects such as procurement planning and contract management.	DCP	ADM	S	Y
14.	Development of a comprehensive M&E for procurement including a baseline for assessing systemic quality (based on the OECD indicators which they already agreed to use), and performance indicators to assess consistency in implementation through the public sector, value for money, and perception of transparency and efficiency.	DCP	ADM	S	Y
15.	Development of a risk management strategy to focus external control on agencies with less capacity and more risk (i.e. by raising thresholds for ex ante review for agencies assessed as having better capacity and internal controls - this is linked to the previous)	DCP and CGR	ADM	S	Y
16.	Development of a comprehensive e-procurement strategy	DCP and SPIG	ADM	S	Y
17.	Carry out comprehensive training and capacity building programs for the procuring entities	DCP	ADM	M	Y
18.	Implementation of the cost reduction strategy in phases	DCP	ADM	M	N
19.	Implement the protest review tribunal	DCP	AMD	S	Y
20.	Drafting regulation frameworks and procedures for the implementation of Law 22, 2006.	DCP	AMD	S	Y

Item	Actions	Respon- sibility	Basis ¹⁰⁹	Timing ¹¹⁰	TA Needed? ¹¹¹
21.	Publish Financial Disclosure information	CGR and Congress	LEG	M	N
22.	Simplify requirements for investigating public officials for corruption	Attorney General	LEG	M	N
23.	Draft Whistleblower Protection Legislation	Attorney General	LEG	M	N

Annex II Public Financial Management Performance Measurement Indicators

See attachment.

Annex III Electronic Government Procurement Assessment

See attachment.

Annex IV Government Procurement Strategy Assessment

See attachment.

Annex V Background Papers and Persons Interviewed

List of Background Papers

Budinich, Emma (2005). Panama: Notes on Public Investment System.

Cosío-Pascal, Enrique (2005). Panama: Notes on Public Debt Records.

Fanta, Enrique (2005). Panama: Notes on Tax Administration.

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List of Persons Interviewed

NAME	POSITION	ENTITY
Abrego, Merino	Secretario Técnico de Asuntos Económicos	Asamblea Legislativa
Adames, Luis M.	Funcionario	Dirección de Catastro y Bienes Patrimoniales, MEF
Aleman Zubieta, Alberto	Administrador General	Autoridad del Canal de Panamá
Alexander, Héctor	Viceministro de Economía	Ministerio de Economía y Finanzas
Amaya, Benigno	Director Nacional de Finanzas	Caja del Seguro Social CSS
Aparicio, Luis	Analista Desarrollador	SIAFPA, Ministerio de Economía y Finanzas
Arias, María Teresa	Jefa del Departamento Legal	Autoridad del Canal de Panamá
Barrios Ng, Jose	Director de Departamento de Finanzas	Autoridad del Canal de Panamá
Barrios, Leska	Jefe de Departamento	Departamento de Programación, Ministerio de Economía y Finanzas
Barrios, Soila	Programador analista	Proyecto CUT, Dirección General de Tesorería
Batista Domínguez, Abilio	Secretario de Asuntos Legales	Procuraduría General de la Nación
Beiner, Francisco	Gerente regional de operaciones	Centro Interamericano de Administraciones Tributarias
Bernal, Marisela	Asesora Legal en Adquisiciones	Ministerio de Economía y Finanzas
Brocan, Eli	Directora	Sistemas y Métodos, CGR
Caballero, Noel	Jefe Unidad	DGI, Asesoría Jurídica
Candanedo, Amael	Analista de Programa	UNDP
Cano, Melina	Administradora Provincial de Ingresos de Panamá	Dirección General de Ingresos, Ministerio de Economía y Finanzas
Carrera, José A.	Sub Director y Jefe	Dirección de Auditoría, CGR
Castillo, Elias	Presidente de la Asamblea Nacional	Asamblea Legislativa
Castillo, Magali		Alianza Pro-Justicia
Castillo, Rogelio	Jefe	Departamento de Deuda Pública, Contraloría General de la República
Chamorro, Félix	Jefe Unidad	DGI, Fiscalización
Chen P., Denia N.	Directora General	Dirección General de Tesorería, Ministerio de Economía y Finanzas
Chen, Eva	Gerente	Contabilidad y Finanzas, Autoridad del Canal de Panamá
Chung, Mirna	Consultora Coordinadora Tesorería	Dirección General de Tesorería,
Coronado, Gerardo	Programador analista	Proyecto CUT, Dirección General de Tesorería
Cosulich Ayala, Jorge	Secretario Ejecutivo	Centro Interamericano de Administraciones Tributarias
de Cárdenas, Evelyne	Jefe de Area	Fiscalización de Personal y Planillas, Dirección Nacional de Informática, Contraloría General de la República
De Freitas, Miguel	Director Nacional	SIAFPA, Ministerio de Economía y Finanzas
de la Cruz, Jonel	Jefe	Dirección de Auditoría, CGR
De León, Rubén	Presidente de la Comisión de Presupuestos	Asamblea Legislativa
De Mathos, Lisbeth	Jefe Unidad	DGI. Cobranzas

de Velarde, Dense	Jefe de Deuda Externa	Dirección de Crédito Público, Ministerio de Economía y Finanzas
Domínguez, Dámaso	Director nacional de Administración de Contratos	Ministerio de Obras Públicas
Echevers, Marissa	Sub-directora de Contrataciones Públicas	Ministerio de Economía y Finanzas
Echevers, Nestor	Coordinador Nacional del Programa de Dinamización de la Ejecución del Presupuesto de Inversión en Instituciones Prioritarias del Sector Público	Ministerio de Economía y Finanzas
Eguren, Jose	Coordinador Residente	UNDP
Espino, Osvaldo	Jefe de Unidad	Auditoría Interna, Ministerio de Obras Públicas
Fernández, Dagoberto	Director Nacional de Ingeniería y Arquitectura	Ministerio de Educación
Fernández, Maria	Jefa de Operaciones de Ejecución Nacional	UNDP
Fistonic, Lutzia	Directora de Fiscalización General	Contraloría General de la República
Galvez, Roberto	Deputy Resident Representative	UNDP
Garay, Erick	Consultor de Infraestructura	Proyecto CUT, Dirección General de Tesorería
García, Ricardo	Jefe de Unidad	Contador, Ministerio de Obras Públicas
Gómez, Ana Matilde	Procuradora General de la Nación	Procuraduría General de la Nación
Gómez, Edwin	Funcionario	Dirección de Catastro y Bienes Patrimoniales, MEF
González, Carlos	Director de Presupuesto de la Nación	Ministerio de Economía y Finanzas
González, Rigoberto	Secretario General	Procuraduría General de la Nación
Gutiérrez, Nelson	Director de Operaciones	Centro Interamericano de Administraciones Tributarias
Halphen, León	Jefe Legal de la Dirección Nacional de Administración de Contratos	Ministerio de Obras Públicas
Herrera, Eduardo	Consultor analista	Proyecto CUT, Dirección General de Tesorería
Kuzniecky, Dani	Contralor	Contraloría General de la República
Lay, Jacob	Consultor analista	Proyecto CUT, Dirección General de Tesorería
López, Elis	Jefe de Unidad	Ministerio de Educación
Lugo, Roberto	Sub Director de Presupuesto de la Nación	Ministerio de Economía y Finanzas
Madrid, Ildelfonso	Analista Financiero	Operaciones Financieras, UNDP
Marín, Jaime	Jefe de Operaciones, conciliación bancaria	Departamento de Operación, Ministerio de Economía y Finanzas
Martínez, Víctor	Funcionario	Sistemas y Métodos, CGR
Maytín, Angélica	Presidente Ejecutiva del Capítulo Panameño de Transparencia Internacional	Fundación para el Desarrollo de la Libertad Ciudadana
Meana, Daniel	Director Nacional	Dirección Nacional de Informática, Contraloría General de la República

Medrano, Rogelio	Jefe, Soporte de Sistemas	Dirección de Crédito Público, Ministerio de Economía y Finanzas
Méndez, Aracelly	Director Crédito Público	Dirección de Crédito Público, Ministerio de Economía y Finanzas
Milwood, Mateo	Coordinador del Sector Fiscal	Ministerio de Economía y Finanzas
Mitre G., Elsie N.	Jefa de Control de Entidades Recaudadoras	Dirección General de Ingresos, Ministerio de Economía y Finanzas
Molina, Jaime	Coordinador del Sector Servicios	Ministerio de Economía y Finanzas
Montenegro de Fletcher, Alma		Consejo Nacional de Transparencia contra la Corrucción
Morales, Francisco	Director	Dirección Nacional de Contabilidad
Muñón, Vielka	Director	Dirección de Planificación y Presupuesto, Ministerio de Obras Públicas
Noriega, Francisco	Jefe del Departamento de Compras y Proveeduría	Ministerio de Salud
O'Meally, Amanda	Gerente	Contabilidad y Finanzas, Autoridad del Canal de Panamá
Ordas de Rodríguez, Beatriz	Directora de Programación de Inversiones	Ministerio de Economía y Finanzas
Ordás, Beatriz	Directora de Programación de Inversiones	Ministerio de Economía y Finanzas
Ospino, Aliro	Jefe Unidad	DGI, Incentivos Fiscales
Peña, Lino	Funcionario	Sistemas y Métodos, CGR
Peñaloza, Jorge	Jefe de Unidad	Unidad Coordinadora Programa BID- BIRF-CAF, Ministerio de Obras Públicas
Pérez, Rodolfo	Técnico, Soporte de Sistemas	Dirección de Crédito Público, Ministerio de Economía y Finanzas
Previa, Edgardo	Funcionario	Dirección de Catastro y Bienes Patrimoniales, MEF
Quijada, Orencio	Dirección de Métodos y Sistemas de Contabilidad	Dirección Nacional de Informática, Contraloría General de la República
Revira, José Javier	Vicepresidente	Cámara de Industria y Comercio
Reyes, Santiago	Consultor	SIAFPA, Ministerio de Economía y Finanzas
Richa, Susana	Secretaria de la Comisión de Presupuesto	Asamblea Legislativa
Rodríguez, Francisco	Director Nacional de Asesoría Fiscal	Contraloría General de la República
Rodríguez, Gyrelia	Encargada de la consolidación de información	Sistemas y Métodos, CGR
Ruiz Miro, Edilberto	Director de Contrataciones Públicas	Ministerio de Economía y Finanzas
Ruiz, Jorge	Director Nacional de Finanzas y Desarrollo Institucional	Ministerio de Educación
Said, David	Director de Unidad Técnica de Políticas Públicas	Ministerio de Economía y Finanzas
Sánchez, Enrique	Gerente de División de Contratos	Autoridad del Canal de Panamá
Santos, Ulises	Sub-director de Compras y Abastos	Caja de Seguro Social
Silgado, Carlos	Consultor analista	Proyecto CUT, Dirección General de Tesorería
Simona, August	Presidente	Cámara de Comercio
Smith, Walter	Jefe Unidad	DGI, Estadísticas
Soto, Beatriz	Jefe de Deuda Externa	Dirección de Crédito Público, Ministerio de Economía y Finanzas

Tarte, Gaspar	Secretario Presidencial	Secretaria Presidencial de Innovación Gubernamental
Tuñón, Vielka	Directora de Planificación y Presupuesto	Ministerio de Obras Públicas
Valdes, Ricardo	Jefe de Unidad	Unidad Coordinadora Programa BID-BIRF-CAF, Ministerio de Obras Públicas
Vasquez, Ricaurte	Ministro	Ministerio de Economía y Finanzas
Wong, Jacinto	Secretario Presidencial Adjunto	Secretaria Presidencial de Innovación Gubernamental
Ysasa, Florencio	Presidente	Cámara de Industria y Comercio
Zuleta, Alexis	Director Nacional de Compras y Abastos	Caja de Seguro Social

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