

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

This Update to the Report on the Observance of Standards and Codes on Fiscal Transparency for **Honduras** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **July 14, 2005**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Honduras** or the Executive Board of the IMF.

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**International Monetary Fund  
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INTERNATIONAL MONETARY FUND

HONDURAS

**REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)  
FISCAL TRANSPARENCY MODULE—AN UPDATE**

July 14, 2005

**I. INTRODUCTION<sup>1</sup>**

1. The Report on the Observance of Standards and Codes (ROSC) in fiscal transparency in Honduras was first completed on January 29, 2002<sup>2</sup>. This note reports on key developments and progress made in the various areas of observance of fiscal transparency practices in Honduras with a view to updating practices described in the original ROSC. To obtain a complete description of current institutions and practices and IMF staff recommendations, this update should be read in conjunction with the original report. *The recommendations made in the 2002 ROSC are still relevant unless otherwise indicated below.*

2. The fiscal transparency module of the original ROSC presented the progress made by Honduras in recent years in improving fiscal transparency and management, and concluded that Honduras was compliant with some of the conditions of the Code of Good Practices on Fiscal Transparency. The report also pointed to the following areas that needed substantial improvement to meet all the requirements of the code: (i) clarification of the allocation of fiscal roles and responsibilities to the different branches of government, levels of government, and the different entities within the executive branch involved in fiscal management; (ii) public availability of fiscal information; (iii) improvement in the procedures for budget preparation, presentation, and audit; and (iv) strengthening of fiscal analysis systems and building the enforcement capacity of the internal and external audit bodies.

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<sup>1</sup> The consultations for performing this update were carried out in Tegucigalpa from September 18 to October 2, 2003, in the context of preparing a report on public expenditure management. The IMF mission comprised Mr. Julio Viñuela-Díaz (Mission Chief), Mrs. Sónia Muñoz (FAD) and Mr. Juan Ramón Ruiz (member of the FAD panel of experts).

<sup>2</sup> The original fiscal ROSC, entitled *Honduras: Report on the Observance of Standards and Codes-Fiscal Transparency Module* (IMF Country Report No. 02/16, February 2002), is available on the IMF Web site <http://www.imf.org/external/pubs/ft/scr/2002/cr0216.pdf>.

## II. DESCRIPTION OF PROGRESS

### A. Clarity of Roles and Responsibilities

#### Composition of the Public Sector

3. *The original Fiscal ROSC found that the public sector was distinguished from the private sector but that the boundary between central government and the rest of the public sector needed to be clearer.* The deconcentrated agencies were considered part of central government but not the 21 noncommercial decentralized entities. No consolidated data were provided on central government, general government, or the nonfinancial public sector. The exclusion of noncommercial decentralized entities from the definition of central government, in particular, was not in line with the *Government Finance Statistics Manual (GFSM)*.

4. The government of Honduras has made significant progress implementing the recommendation of the 2002 ROSC report on the definition of public sector. The New Organic Budget Law (OBL-Decree 83-2004) enacted in May 2004 defines general government and public sector in accordance with the *2001 GFSM*.<sup>3</sup> Consolidated information on the non-financial public sector under the revised definition has been available in the Secretariat of Finance (SEFIN) Annual Reports since 2003.<sup>4</sup>

5. *The original Fiscal ROSC suggested that the division of fiscal roles and responsibilities among the branches of government, levels of government, and among the different entities within the executive branch involved in fiscal management should be clarified.* The recently enacted OBL regulates—as recommended in the previous report—important aspects of fiscal management: budget, cash management, public credit, investment, and the Integrated Financial Management System (SIAFI). The OBL also mandates all public sector entities to establish mechanisms to facilitate information exchanges in electronic or hard-copy media. However, some gaps are remaining in particular with the provisions to govern public availability of information on in-year budget execution reports, government debt and financial assets, contingent liabilities and tax expenditures..

6. Great strides have been made in coordinating preparation of the budgets of the central government and the noncommercial decentralized entities and in timing their Congressional presentation and approval to coincide. The new OBL defines general guidelines for budget

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<sup>3</sup> Definitions in articles 1-2 of this law include: central government (comprising the central administration, deconcentrated entities, and noncommercial decentralized entities), general government (comprising central government and local governments) and nonfinancial public sector (comprising general government plus nonfinancial commercial decentralized entities or nonfinancial public enterprises).

<sup>4</sup> The Planning and Management Assessment Unit (UPEG) of the Finance Secretariat (SEFIN) began also providing detailed information on the nonfinancial public sector under the revised definitions though mainly for internal use.

preparation that are applied to both categories of entities. The 2003 and 2004 budgets of the central government (and decentralized entities) and the decentralized entities were delivered to the Congress simultaneously on the legally established dates. The breakdown of the budgets presented for the decentralized entities is now on a program-by-program basis identifying the specific purpose of central government transfers. The budgets of the decentralized entities, which were often approved after the end of the fiscal year, were approved for 2003 in a single legislative decree and before the start of the new fiscal year.

7. *The original fiscal ROSC observed a discretionary approach in the administration's application of regulations to the nonfinancial private sector.* Legislative Decree No. 255 of August 10, 2002 simplifies the procedures for creating new enterprises and sets maximum deadlines for various procedures.

### **B. Public Availability of Information**

8. *The original fiscal ROSC recommended that the budgets of the entire public sector and the budget execution and settlement reports be published.* The 2004 budget, presented to the Congress in September 2003, includes for the first time disaggregated financial information on all the decentralized entities, whereas previously such information had been limited to the transfers they received from the central government.

9. The SEFIN has considerably increased the amount of information available on the Internet: (i) the Budget Technical Directorate publishes the Annual General Budget of the Republic and the quarterly budget execution reports; (ii) the General Directorate of Decentralized Entities publishes its budgets annually as well as half-yearly reports on execution and quarterly reports on personnel information; (iii) the Public Credit Directorate publishes the report on public debt half-yearly; (iv) the General Accounting Office of the Republic publishes the balance sheet and statement of public sector quarterly outturn; (v) the Public Investment Directorate publishes the status of execution of the public investment program quarterly; (vi) the UPEG publishes the SEFIN annual report yearly; and (vii) the legal advisors publish the decrees, resolutions, and laws half-yearly.<sup>5</sup>

10. Though SIAFI has made substantial progress in generating reliable central government data, problems of coverage and consistency of non-financial public sector statistics still remain. The authorities are, however, implementing a short-term and medium-term work plan to improve the Integrated Financial Management System (*Sistema Integrado de Administración Financiera--SIAFI*). This work plan was developed with the assistance of the Statistics Department of the IMF and aims to improve quality, compilation and dissemination of nonfinancial public sector data.

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<sup>5</sup> However, this data is incomplete and not necessarily consistent owing to the diversity of accounting systems used by the decentralized entities.

11. Important progress has been made with regard to the disclosure of revenue of some individual ministries and agencies, as well as foreign grants. The new OBL mandates the incorporation into the budget of all the self-generated revenues and the foreign grants received by central government institutions and deconcentrated entities. Since 2004, the budget includes spending financed with self-generated resources as well as most foreign grants (except some foreign grants which donor conditionality requires to be managed outside the budget). The budgets of the Electoral Supreme Court and the National Register of Persons are now in accordance with Central Government methodology in the SIAFI. However, problems still remain with the budgets of the National Congress, Supreme Court of Justice, and Attorney General's Office related to the fact that these institutions do not report on the structure and financial execution of their budgets.

12. *The original fiscal ROSC suggested deleting unclear expenditures in the form of general appropriations and recommended that, instead, a properly regulated contingency fund be created to address unforeseen situations.* Since then, general appropriations have been considerably reduced. In addition, the new Organic Budget Law defines the size, use, and reporting requirement of a centralized contingency fund.

### **C. Transparency in Budget Preparation, Execution and Reporting**

#### **Budget presentation and fiscal sustainability analysis**

13. *The original fiscal ROSC found that the procedures for budget preparation and presentation lacked transparency.* The authorities have begun, starting with the 2003 budget, to prepare a budget policy document containing forecasts of the main macroeconomic parameters, the objectives and priorities of fiscal policy for the following year, and rules for the preparation of preliminary draft budgets by each institution. This document, which is remitted to the budgeted entities together with the financial ceilings for preparing the preliminary drafts, is submitted to the Congress and published on the SEFIN Web page. However a comprehensive macroeconomic framework is still not available, nor are the procedures and assumptions used to make the forecasts. In addition, the authorities have yet to perform and publish an analysis of fiscal policy sustainability as part of the budget documents<sup>6</sup>.

14. Also, starting with the 2003 budget, accompanying documents include a multiyear budget, which is still in experimental stages. It is an information document of no legal standing, designed to show Congress how the fiscal aggregates will evolve in the medium term. It is revised annually and an additional year is incorporated into the planning horizon. It consists basically of a projection of base year data for the fiscal year and three more years, using certain assumptions on the trends of particular categories of expenditure. The document is divided into three parts:

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<sup>6</sup> Fiscal sustainability analysis are however available in Fund program documents published by the authorities.

- Nonfinancial public sector savings-investment and financial account.
- Central government revenue-outlay budget, which includes:
  - revenue projections by heading;
  - expenditure projections by purpose and function;
  - institutional budgets by program and expenditure group.
- Budget for the decentralized institutions, which includes:
  - Revenue projections for each institution;
  - expenditure projections by purpose and function;
  - institutional budgets by program and expenditure group.

15. The budget presentation has improved. Apart from the changes mentioned (inclusion in the budget documents of the budgets of the decentralized and deconcentrated entities, and reduction of general appropriations), an annex with the Poverty Reduction Strategy budget has been attached.

16. *The original fiscal ROSC recommended an appropriate classification of expenditure.* First steps have been taken to improve the budget classification:

- The reform of program classification has been improved in the budgets of all central government institutions and deconcentrated entities. New program classifications are complete for the secretariats of Education, Health, Public Works, Transportation, and Housing, and Agriculture and Livestock, as well as for decentralized entities such as the water company SANAA and the electricity company ENEE.
- The SIAFI's institutional classification has begun to be broken down to include the deconcentrated entities and executing agencies. This will make it possible to include in the budget documentation the detailed budgets of these entities (which had already been started for the deconcentrated entities), to more clearly assign responsibilities for the different expenditure programs, and to improve the planning and monitoring of budget execution. The 2005 budget includes for the first time detailed budgets of spending units for 5 pilot institutions. The execution of these budgets will be carried out through SIAFI.
- Some deficiencies in the economic classification have been corrected, mainly under the heading of transfers, which make it possible to determine the destination of the resources transferred.

## **Expenditure execution**

17. *The original fiscal ROSC emphasized the importance of broadening the scope of SIAFI's operations.* Remote access to SIAFI has been extended to all the state secretariats in the central government. In 2004, there are plans to integrate all the deconcentrated entities, and in the future—though the timeframe has not been specified—the decentralized entities. The development of the interface with the Public Sector Investment System (SISPU) system and the SIAFI was completed at end-2004.

18. *The original fiscal ROSC found that the national public procurement law was ambiguous and susceptible to multiple interpretations, and mentioned that a new national public procurement bill was before the Congress.* The new National Public Procurement Law<sup>7</sup> establishes principles of disclosure and transparency in procurement and prevents contracts from being commonly divided up. The allocation of procurement responsibilities and UNDP was intended to resolve ambiguities and increase transparency. However, it has not had the intended effects and hence exclusive use of UNDP has been eliminated in the provisions of the 2005 budget. However, the UNDP still manages the purchases of central government institutions, such as the telecommunication company (HONDUTEL), in exchange for commissions.<sup>8</sup>

19. *The original fiscal ROSC noted that staff recruitment is discretionary and that the compensation system is not merit-based.* In this area, the authorities promulgated the Law on the Reform on the Central Government Compensation System (Decree 220-2003 and its Regulations) which aims to ensure more equity across various salary regimes for civil servants in the Central Government and deconcentrated entities.

## **Internal and external expenditure control**

20. *The original fiscal ROSC recommended that the Office of the General Comptroller of the Republic (GCO) focus on auditing the final accounts, which had never been done in Honduras.* The recent Organic Law of the Superior Court of Audit (TSC)<sup>9</sup> incorporated into that entity the GCO and the Administrative Ethics Directorate, created a collegiate directorate of the TSC, with a chair that rotates annually, and extended the term of members from four to seven years. The appointment of TSC members must be made by a two-thirds

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<sup>7</sup> Decree 74 of July 1, 2001. The regulations for the Law were approved by Executive Agreement 055 of May 15, 2002.

<sup>8</sup> According to the authorities, resources managed through the Hondutel-UNDP program are decreasing and a deadline exists for the termination of this program.

<sup>9</sup> Decree 10-2002-E of January 20, 2003.



majority of the Congress. The TSC no longer has the power to appoint unit chiefs of internal audit in the entities and agencies but it retains the power to issue standards for internal control, internal audit, and government audit. The new TSC team publicly undertook to audit the final accounts of the 2003 budget for the first time in 2004, with the support of private audit firms. The new law establishes that the SEFIN and the decentralized institutions will have to send the corresponding final accounts to the TSC during the first six months after the close of the fiscal year. The TSC in turn must submit its opinions to the National Congress within 45 business days of receipt of the final accounts. In addition the law requires the TSC to present to the National Congress a report on the activities and performance of the previous year within the first 40 days following the end of the fiscal year.

21. *The ROSC stressed the importance of having the internal audit units report to the executive branch and focus their activity on conducting internal and operating audits following the established timetable.* Significant advances have been made in this field. Article 50 of the Organic Law of the TSC provides that the staff of the internal audit units have full independence of action and judgment in the performance of their duties relative to the public administration organ or agency of which they are a part. The law also breaks the functionally subordinate relationship the units had with the previous Comptroller's Office and makes provision for a standard to regulate the hierarchical position and organization of such units. The government enacted regulations governing the TSC law in November 2003.<sup>10</sup>

22. *The ROSC recommended that the SEFIN and the BCH regularly reconcile the fiscal and monetary aggregates.* With technical assistance received from the Statistics Department of the IMF last August, 2004, the authorities established an action plan to overcome weaknesses in this area.

### III. IMF STAFF COMMENTARY

23. Over the last year and a half, Honduras has made substantial progress in improving the transparency of fiscal activity along the lines recommended by the original fiscal ROSC. The areas that have improved the most have been budget coverage, budget classification, timeliness of presentation and approval, public access to fiscal information, procurement and employment regulations, the recent experiment in multiyear budgeting, and a more appropriate regulatory framework for internal control and external audits.

24. Further progress, however, is still needed to clarify the roles and responsibilities of the branches and levels of government, and between the various entities with the executive branch. In addition, while improvements in the budget coverage and content are welcome, continued expansion of budget documentation along the lines of the recommendations in the original fiscal ROSC is needed to strengthen the quality of fiscal information.

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<sup>10</sup> Official Journal ("La Gaceta"), November 20, 2003.

**ABBREVIATIONS AND ACRONYMS**

BCH	Central Bank of Honduras
GAO	General Accounting Office of the Republic
GCO	General Comptroller Office of the Republic
DMFAS	Debt Management and Financial Analysis System
ENEE	Electricity company
GFSM	Government Finance Statistics Manual
HONDUTEL	Telecommunications company
ROSC	Report on the Observance of Standards and Codes
SANAA	Water company
SEFIN	Secretariat of Finance
SIAFI	Integrated Financial Management System
SISPU	Public Investment Information System
TSC	Superior Court of Audit
UPEG	Planning and Management Assessment Unit