

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

This Report on the Observance of Standards and Codes on Fiscal Transparency Module 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 **January 29, 2002**. 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.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

**To assist the IMF in evaluating their publication policy, reader comments are invited and may be sent by e-mail to [Publicationpolicy@imf.org](mailto:Publicationpolicy@imf.org).**

Copies of this report are available to the public from  
International Monetary Fund • Publication Services  
700 19th Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623 7430 • Telefax: (202) 623 7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) • Internet: <http://www.imf.org>

Price: \$15.00 a copy

**International Monetary Fund  
Washington, D.C.**

INTERNATIONAL MONETARY FUND

HONDURAS

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

Prepared by the Fiscal Affairs Department

Approved by Claudio Loser and Teresa Ter-Minassian

January 29, 2002

**EXECUTIVE SUMMARY**

This report provides an assessment of fiscal transparency practices in Honduras in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on the authorities' response to the IMF fiscal transparency questionnaire and other documents provided by the authorities.

Honduras has made good progress in recent years in improving fiscal transparency and the quality and internal consistency of fiscal data. The budget documentation has recently been improved and gives more complete information on the government's fiscal activity in the framework of appropriate institutional, economic, and programmatic classifications and recent quarterly and monthly reports make it possible to monitor financial execution of the budget and physical execution of investment projects. However, Honduras does not yet comply with a number of important requirements of the Code.

In the short term, Honduras could achieve significant improvements in fiscal transparency by: a) clarifying the division of functions and responsibilities in fiscal management between different branches and levels of government; b) introducing some changes to budget preparation and presentation procedures for all entities in the central government and phasing out the use of unclear expenditure categories; and c) adequately disseminating the annual reports that are presented by the Secretary of Finance to Congress.

In the medium term, efforts are needed to integrate the budget process and extend the framework to cover a three to five year period. Emphasis should also be placed on reorganizing and strengthening the internal and external control systems. Specifically, the internal auditing units should be part of the Executive Branch and focus their activities on conducting operating audits in accordance with a pre-established work program. The General Comptroller Office of the Republic should focus on auditing the final accounts and presenting its main findings to Congress. Institutional mechanisms should also be established to promote compliance with audit recommendations.

	Contents	Page
I.	Introduction.....	4
II.	Description of Practice.....	4
	A.    Clarity of Roles and Responsibilities.....	4
	B.    Public Availability of Information.....	10
	C.    Open Budget Preparation, Execution, and Reporting.....	11
	D.    Assurances of Integrity.....	15
III.	IMF Staff Commentary.....	16

**ABBREVIATIONS AND ACRONYMS**

ABL	Annual Budget Law
CBH	Central Bank of Honduras
DGB	Directorate General for the Budget
DGDE	Directorate General for Decentralized Entities
EDR	Executive Directorate for Revenue
FHIS	Honduran Social Investment Fund
GAO	General Accounting Office of the Republic
GBR	General Budget of the Republic
GCO	General Comptroller Office of the Republic
GFS	Government Finance Statistics
GTR	General Treasury of the Republic
IFS	International Financial Statistics
NFPE	Nonfinancial Public Enterprises
OBL	Organic Budget Law
PFI	Public Financial Institutions
SEFIN	Secretariat of Finance
SIAFI	Integrated Financial Management System (Sistema Integrado de Administración Financiera)

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

1. This report provides an assessment of fiscal transparency practices in Honduras against the principles of the IMF *Code of Good Practices on Fiscal Transparency: Declaration on Principles*. The authorities have completed the questionnaire on fiscal transparency prepared by IMF staff. There are two parts to this assessment. The first is a description of practices, prepared by IMF staff based on the responses to the questionnaire and other information provided by the authorities. The second has IMF staff comments on fiscal transparency in Honduras.

## II. DESCRIPTION OF PRACTICE

### A. Clarity of Roles and Responsibilities

2. **The public sector is well distinguished from the private sector, but the boundary between the central government and the rest of the public sector needs to be clarified.** The Constitution regulates the roles and responsibilities of the branches of government.<sup>2</sup> The law<sup>3</sup> establishes that the national public sector consists of the central government, the autonomous institutions, and the municipalities. The central government is defined so as to include the three branches of government.<sup>4</sup> Dependent on the Executive Branch (through a ministry or the office of the presidency) there are de-concentrated entities,<sup>5</sup> created by law, with technical autonomy to carry out noncommercial public functions. The autonomous institutions<sup>6</sup> (or decentralized entities, as they are usually called) have, in addition, functional

---

<sup>1</sup> This report was prepared by a mission comprised by Mr. Julio Viñuela and Ms. Maria Albino (both FAD).

<sup>2</sup> The Constitution was adopted by Decree 131 of 1982.

<sup>3</sup> Article 73 of the Organic Law of the General Accounting Office of the Republic, approved by Decree 2001 of 1980, regulates the structure of the public sector.

<sup>4</sup> More specifically, the central government consists of the Legislative Branch (National Congress), along with three auxiliary bodies (the General Comptroller Office of the Republic, the Attorney General Office of the Republic, and the Directorate of Administrative Probity); the Judicial Branch (the Supreme Court of Justice); and the Executive Branch (the President of the Republic), assisted by the Centralized Public Administration (Office of the Presidency, the Council of Ministers, and the Ministries).

<sup>5</sup> The de-concentrated agencies of the Executive are: the Honduran Social Investment Fund, the Family Allowance Program, the Executive Directorate for Revenue, the Education and Productivity Program, the Permanent Commissioner for Contingencies, the Directorate of Agricultural Science and Technology, the National Telecommunications Commission, the General Directorate for the Merchant Marine, and the National Graphic Arts Enterprise. They receive their resources from the parent entity and their budgets are approved by the Secretariat of Finance.

<sup>6</sup> They are created by a law that requires a 2/3 parliamentary majority, have their own assets, and their budgets, after being scrutinized by the Secretariat of Finance, are approved by their executive councils and sent to Congress for legislative approval.

and financial autonomy. They include, on the one hand, the social security agencies<sup>7</sup> and other entities that essentially conduct noncommercial activities,<sup>8</sup> and, on the other, the public enterprises, nonfinancial public enterprises (NFPE) and public financial institutions (PFI). The legal exclusion of the noncommercial decentralized entities from the central government departs from the standard definition of the government sector as set out in the GFS.<sup>9</sup> The country's territory is composed of 298 municipalities, administered by local corporations elected by the people that, under the Constitution, are independent of the central government in the exercise of their exclusive functions.

**3. The division of fiscal roles and responsibilities between the Legislative and Executive Branches is not clearly defined.** Under the Constitution, the Executive Branch takes legislative initiative on budgetary matters, while the Congress votes on the draft budget presented by the Executive Branch. However, neither the regulations of Congress nor any other laws passed by that body regulates the parliamentary passage of the draft budget (scope of legislative amendment authority, adoption of amendments in committee or in the plenary, and formal budget adoption procedures). No authoritative description of the actual process of submission and parliamentary passage of the budget is available. The Legislature's broad authority to amend the budget is not balanced by Executive power to veto the budget, a power it has for other types of laws.<sup>10</sup> This factor, together with the absence of a legal obligation to publish the draft budget submitted to Congress, along with the amendments proposed, and approved, prevents the public from assessing the relative responsibility of the Executive and Legislative Branches for the final budget document.

**4. Congress' capacity to propose and adopt laws during the budget year has repercussions on public spending and the deficit.** According to the Organic Budget Law (OBL),<sup>11</sup> the Legislative and Executive Branches cannot establish new appropriations or

---

<sup>7</sup> Honduran Social Security Institute, National Retirement and Pension Institute for Employees and Officials of the Executive Branch, and the National Institute for Teachers' Welfare.

<sup>8</sup> The most important ones are: the National Agrarian Institute, the Honduran Corporation for Forest Development, the Honduran Institute for Agricultural Marketing, the National Commodities Supplier, the Honduran Coffee Institute, the Honduran Tourism Institute, the Honduran Institute for Children and the Family, the Institute of Education Credit, the National Professional Training Institute, the Honduran Institute of Anthropology and History, the Honduran Institute of Cooperatives, the Honduran Institute to Prevent Alcoholism, Drug Addiction, and Drug Dependence, the National Children's Foundation, the National Commission on Sporting Facilities, the Honduran Olympic Committee, the Autonomous Sports Confederation of Honduras, the National School of Forestry Sciences, the National Autonomous University of Honduras, and the Francisco Morazán National Teachers' University.

<sup>9</sup> Honduras does not report institutional coverage in the Government Finance Statistics Yearbook.

<sup>10</sup> Article 216 of the Constitution stipulates that if the Executive Branch objects to a draft law passed by the Legislature, it can veto it and return it to the Legislature for renewed debate. If the Legislature ratifies the content of the draft, a two-thirds majority is needed in Congress for it to pass. Article 218 of the Constitution creates a specific exception to this veto power for the budget.

<sup>11</sup> Article 62 of the Organic Budget Law, adopted through Decree 407-76.

increase existing ones during the budget year unless the corresponding law establishes the specific source of revenue for financing the item. In practice, however, the Legislature approves new appropriations without including the necessary sources of financing. It is a practice in Honduras for Congress to negotiate directly with the civil service unions and unilaterally approve union statutes containing the amount and increase in civil servant pay and other working conditions. Congress can also legally intervene in other specific matters, such as granting direct aid or debt cancellation (for example, in 1999 it cancelled 50 percent of the municipalities' debt arrears to the National Electricity Company).

5. **The assignment of fiscal responsibilities to the central government and the municipalities is relatively well defined under the law; however, in practice, transfers to the municipalities are not based on stable principles.** The Constitution stipulates that law shall govern the organization and operation of the municipalities. The Law on Municipalities<sup>12</sup> contains a detailed provision on the role of municipalities in terms of revenue, expenditures, and borrowing. It regulates their autonomy, the public services they are to provide,<sup>13</sup> and the revenue they can collect.<sup>14</sup> Due to a lack of fiscal and institutional capacity, most revenue for the majority of municipalities comes from central government transfers. By law, the government is to distribute five percent of tax revenue among the municipalities according to a specific formula.<sup>15</sup> In practice, however, automatic transfers tend not to exceed two percent. The remainder, up to a total figure that even exceeds the five percent provided for by law, is distributed discretionally among the municipalities in the form of direct investments by central government agencies.

6. **Although fiscal coordination mechanisms for government and autonomous institution activities are well defined under the law, coordination is weak in practice.** The Secretariat of Finance (SEFIN) coordinates the formulation and execution of the budgets of the central government and the autonomous institutions through the Directorate General for the Budget (DGB) and the Directorate general for the Decentralized Entities (DGDE), respectively. The DGB prepares the draft of the General Budget of the Republic (GBR), which includes the three branches of government and their auxiliary bodies. The DGDE scrutinizes the budget proposals of all the decentralized entities and its recommendations must legally be incorporated before the draft budgets are presented to Congress for discussion and approval.<sup>16</sup> In fact, as a result of delays in presenting draft budgets to SEFIN, insufficient institutional capacity in SEFIN to scrutinize them and the time required by

---

<sup>12</sup> Adopted by Decree 134-90, amended through Decree 48-91.

<sup>13</sup> Articles 12-20 on municipal autonomy.

<sup>14</sup> Articles 70-86 on municipal revenues.

<sup>15</sup> Of this, 40 percent must be distributed in equal parts among the municipalities and the remaining 60 percent according to the number of inhabitants.

<sup>16</sup> Legally, both the draft GBR and the draft budgets of the decentralized entities must be submitted to Congress in the first 15 days of September to be approved before the beginning of the fiscal year, which coincides with the calendar year. In case a budget is not approved in due time, the previous budget is temporarily adopted.

Congress to debate and approve them, the budgets of these entities are often approved throughout the budget year and, occasionally, after it is over. The budget process for the deconcentrated agencies is different. The GBR contains the transfers made to each of them. The detailed budgets are approved during the fiscal year by the SEFIN<sup>17</sup> and are not made public. Within these off-budget activities are, for example, those carried out by the Honduran Social Investment Fund (FHIS), which executes almost 45 percent of the investment expenditures of the public sector.

7. **The Central Bank of Honduras (CBH) has functional and operating autonomy for monetary and exchange policy.**<sup>18</sup> The 1996 reform of the law regulating the CBH has modernized the bank's functions, which are focused on monetary, credit, and exchange policy and has increased its autonomy in exercising those functions. Furthermore, since the bank no longer serves as a development bank, its relations with the Public Treasury are more strictly delineated. The members of the board of the CBH are appointed by the President for a four-year period, can only be removed by a guilty verdict of the Supreme Court of Justice, and have to report the results of its activities annually to Congress and semiannually to the President, through the SEFIN.<sup>19</sup> The CBH legally maintains some powers permitting intervention in the financial system. One is the power—so far unused in practice—to regulate interest rates for operations in the financial system, when economic circumstances so require. Another is the power to require financial institutions to hold mandatory investments in specific securities when there is excess liquidity in the system. This provisional power has become permanent in practice, but with a clear tendency in recent years to reduce those investments. A third is the authority to grant loans to the central government to cover seasonal cash deficits, up to a limit of 10 percent of tax receipts from the previous fiscal year.<sup>20</sup>

8. **The CBH conducts quasi-fiscal activities.** Progress in achieving autonomy has been limited by provisions in the reform law itself that reflect some continuing quasi-fiscal activities between the CBH and the Public Treasury. The CBH is the government's financial and fiscal agent and economic advisor, for which it receives no commission. It also maintains the current accounts of all government agencies, on which it pays no interest.<sup>21</sup> As provided

---

<sup>17</sup> Article 20 of the 2001 Annual Budget Law regulates the budget process of the de-concentrated entities for that year.

<sup>18</sup> The Law on the CBH, adopted through Decree 53–1950, was amended by Decree 17–1996 to give it functional and operating autonomy.

<sup>19</sup> The budget of the CBH must be approved by Congress, and any subsequent substantial modification to the operating plan or the approved budget, without exception, requires congressional approval (Decree 202–2000).

<sup>20</sup> This legal provision has not been used in practice.

<sup>21</sup> At the end of 1999, public sector deposits in the CBH totaled 6.6 billion lempiras.



under the reform law, the government covered the CBH losses reflected in the December 31, 1996 balance sheet with a 50-year bond that does not accrue interest and is not tradable.<sup>22</sup>

9. **Government involvement in ownership of financial entities is low.** Only two PFI—Autonomous Municipal Bank and National Agricultural Development Bank—are considered commercial banks; they account for 2.7 percent of the system's total assets. The former, which used to be funded with transfers from the central government to lend the municipalities, has been closed, is calling in its portfolio and is being liquidated. The latter competes directly with private banks and is funded primarily through deposits. It lends to the agricultural sector. The share of nonperforming loans in its loan portfolio is important and is virtually decapitalized.<sup>23</sup> The National Fund to Support Production and Housing is a second-tier bank established in 1997 to assume the development bank role, which the CBH had played until then through specialized funds, which financed housing and productive activities. Roughly 58 percent of its portfolio is self-financed, and the remainder is financed by trust, which consists in the administration of central government transfers, external loans and aid from the European Union and USAID.

10. **Generally speaking, financial relations between the central government and the NFPE<sup>24</sup> are clear, but some NFPE routinely conduct fiscal activities on behalf of the government.** The transfers or subsidies they receive are transparent, as are the contributions that some are required to make to the central government budget. These contributions, when required, are set at the beginning of the fiscal year and must be made regardless of the actual performance of the enterprise. The main contributions are from monopolies, such as the Honduran Telecommunications Company and the National Port Company. Some NFPE, such as the National Electricity Company and the National Autonomous Water Supply and Sewerage Company, cross subsidize categories of users. Finally, NFPE are subject to the same government procurement standards as the central government. Since these standards are strongest, they can be an obstacle for institutions that conduct commercial activities.

11. **Government involvement in the private sector of the economy is moderate, but the administration has broad leeway in enforcing regulations.** Government involvement in the capital of nonfinancial private enterprises is virtually nonexistent. The government sets mark-ups for petroleum products and subsidy for public transportation in Tegucigalpa, with a view to helping the low-income population. Congress occasionally becomes directly involved, on its own initiative, in setting the minimum wage for the private sector. The regulations for the nonfinancial private sector are not complex and are currently under

---

<sup>22</sup> The value of the bond is 5.4 billion lempiras.

<sup>23</sup> Since they have government guarantees, the National Banking and Insurance Commission do not supervise these two entities.

<sup>24</sup> The NFPE are: The National Electricity Company, the Honduran Telecommunications Company, the National Autonomous Water Supply and Sewerage Company, the National Port Company, the Honduran Postal Company, and the National Railroad Agency of Honduras.

review;<sup>25</sup> however, the procedures are excessively bureaucratic and the administration has broad discretion in interpreting regulatory standards.

12. **Notable progress has been made in regulating the financial system, but the oversight capacity of the supervisory agency is still limited.** There are three primary laws regulating the financial system in Honduras: the Central Bank of Honduras Law, the National Banking and Insurance Commission Law, and the Institutions in the Financial System Law.<sup>26</sup> Prudential control and oversight of financial entities is performed by the National Banking and Insurance Commission, which is making a significant effort to update the regulatory framework, despite a lack of sufficient, qualified personnel, which is an obstacle to oversight. This commission has all of the powers of a regulatory agency, except the authority to interpret the law it is enforcing. The same problem affects all regulatory agencies in Honduras, since the Constitution stipulates that only the Congress has the power to interpret laws.<sup>27</sup> This, together with the obligation to follow the long, complex procedures set forth in the Law on Administrative Procedures, prevents the commission from being able to conduct investigations and issue penalties with the necessary speed.

13. **The legal and administrative framework for fiscal management establishes sound budgetary principles, but it is not comprehensive and is not always strictly adhered to.**<sup>28</sup> The main budgetary principles (legality, universality, gross budget, and unity of funds) are recognized by the Constitution or by law, however there are exceptions to these principles, as illustrated below. The essential changes that the implementation of the Integrated Financial Management System (SIAFI) has made to the public financial management system are still pending regulation. Most provisions of the OBL refer to the GBR only. To find out how the budget, accounting, debt, and collateral regimes for the decentralized institutions are regulated, one must consult their charters, the OBL, the Law on Public Administration, the Law of Public Credit and the annual budget law (ABL). There are gaps in the legal framework. The treasury function is scarcely regulated, and is divided between the DGB and the General Treasury of the Republic (GTR), whose main and virtually sole function is to make payments, a nonexclusive function given the existence of special accounts. At present, budget preparation and execution are legally centralized in the

---

<sup>25</sup> The government has submitted a draft law on administrative streamlining to Congress that aims to simplify the procedures for creating new enterprises, which are currently too long and bureaucratic, and to set maximum deadlines for the various procedures.

<sup>26</sup> Decrees 228-96, 155-95, and 170-95, respectively. Other relevant laws are: the Provisional Law on Financial Stabilization, the Law on the Securities Exchange, and the Law on the Deposit Guarantee Fund.

<sup>27</sup> Article 205.1 of the Constitution. Sanctions imposed by the Commission are typically challenged in the courts, which in turn submit them for interpretation to the Congressional Banking and Currency Commission.

<sup>28</sup> The Constitution establishes basic provisions on the budget, taxation and the public debt. The OBL, as required by the Constitution, governs the formulation, approval, execution and liquidation of the GBR. The Law on Public Credit (Decree 111-90) regulates borrowing and the awarding of guarantees. The Organic Law of the General Accounting Office (Decree 101-80) regulates the government accounting system. Title Two of the General Law on Public Administration governs the general budgetary regime for decentralized institutions.

SEFIN. However, the excessive centralization of accounting, treasury, and control functions in the DGB, when there are already other specific units within SEFIN to do this, is causing duplications and obscuring the assignment of responsibilities. The government is preparing a draft financial administration law or budget code aimed at remedying this situation.

14. **Taxes have an explicit legal foundation, but tax laws are rather complex and contain many exemptions.** The Constitution explicitly establishes the principle of legality on tax matters, and tax laws are published in the Official Journal of the Republic, *La Gaceta*. The recent tax code,<sup>29</sup> which regulates the basic elements of taxation, the duties of taxpayers, tax procedures and infractions, and the penalty system, needs revision to strengthen cooperation between the taxpayers and the fiscal authorities. Certain provisions should be included in lower-rank legislation. The confusing penalty system is partly implemented out of the tax administration, as is the collection of tax arrears. Probably the main weakness of the laws regulating individual taxes is the excessive number of tax exemptions, exonerations, and differential tax treatments. This results in low tax revenue collections, inefficient allocation of resources, evasion, and possibly corruption.<sup>30</sup> Some concepts in the laws are not very concretely defined, creating difficulties in implementing an adequate self-assessment system of taxation. For example, the income tax law does not specify how to calculate depreciation or value inventories. Consequently, the taxpayer is required to gain approval from the Executive Directorate for Revenue (EDR) of the valuation methods to use to compute deductible expenses.

15. **The EDR has broad discretionary administrative interpretation of tax laws, which opens the way for tax evasion and could foster corruption.** The lack of effective internal controls and the ambiguity of the laws, together with the official practice of issuing resolutions or directives changing the purpose of the law to benefit certain sectors or taxpayers, have fostered discretionary enforcement of the laws among officials. The EDR recently launched a plan to deal partially with this situation. One of the measures was the dismissal of roughly 30 percent of the government officials for corrupt practices.

16. **There is no code of ethics for government officials.** However, some laws do punish unlawful conduct of government officials, including the Law on Administrative Probity, and the Law against the Illicit Enrichment of Civil Servants.

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

17. **Starting with the 2001 budget, the detailed GBR is published.** The GBR law, as well as the laws on adopting the budgets of the decentralized entities, is published in the

---

<sup>29</sup> Decree 22-97.

<sup>30</sup> The sales tax law includes a long list of goods and services that are exempted, what in the Honduran case means that they are charged a zero tax rate. To prevent the devolution of the taxes charged on the purchase of the inputs used in their production, the Executive Directorate for revenue dictates resolutions authorizing the producers of those goods to buy their inputs without paying the sales tax. The same law exempts from the tax the sales made by the public sector and enterprises providing tourism services.

Official Journal, as required by the Constitution, but not the detailed budget documentation presented to Congress. The approved 2001 GBR and the attached documents are posted in the SEFIN's web page.<sup>31</sup> As noted, the budgets of the de-concentrated agencies are not made public. No information is published on local government finances or the consolidated fiscal position of the central government as a whole.

18. **Aggregate information on the public debt is published annually, but not in an adequate format. Information on financial assets is not published.** The central government does not publish information on the stock of public debt along with the budget. The SEFIN publishes annual reports on the evolution of public debt by type of creditor and on debt service (distinguishing only between principal and interest) on its web page, but there are significant lags. No detailed data on debt broken down by maturity date or debt instrument are published. There is information on the financial assets of the public sector—excluding municipalities—in the final accounts prepared by the GAO. This information includes the cash and investment portfolio and is only submitted to the head of SEFIN, and not presented to Congress or published. No information is published on contingent liabilities, quasi-fiscal activities or tax expenditures.

19. **Periodic reports on the execution of the GBR have recently started being published, albeit not consistently.** The ABL from the last two years have required the Executive Branch to submit quarterly reports to Congress on the execution of the GBR. The same obligation was established for the decentralized entities; however, it has not yet been implemented. The SEFIN has started publishing these quarterly reports, as well as the monthly aggregate financial accounts on its web site, but not consistently. There are no explicit commitments to publish this information at predetermined intervals. The final accounts and annual reports on the execution of the budget are not published.

### C. Open Budget Preparation, Execution, and Reporting

20. **The annual budget preparation is based on a macroeconomic framework and a statement of fiscal policy goals and priorities.** In the middle of each year, the Cabinet approves a document that contains the midterm economic and fiscal strategy in qualitative terms, quantifies the main economic and fiscal objectives for the following fiscal year, defines sectoral priorities and establishes budget preparation guidelines. However, this document, which is not published or included in the budget documentation, does not offer any information on the assumptions underlying the macroeconomic projections or on the methodology used to forecast fiscal aggregates. Also, the budget documentation does not analyze the sustainability of fiscal policy.

21. **It is not yet a practice in Honduras to put budget formulation into a medium-term context.** For the first time, the 2001 GBR contains a comparison of the main fiscal aggregates (revenue, expenditures, deficit, and financing) expected for the budget year with

---

<sup>31</sup> See [www.sefin.hn](http://www.sefin.hn).

the results from the two previous years<sup>32</sup> and a projection for the next two fiscal years. There is no medium-term expenditure scenario broken down by institution, economic category, or policy. Although the public investment program is now under the SEFIN, coordination between current expenditures and investment continues to be weak.<sup>33</sup> There are no projections for the recurrent expenditures that will be generated by current investments.<sup>34</sup>

**22. Budget presentation and revenue and expenditure classifications have improved.** The GBR comprises: (1) an economic and fiscal outlook containing a summary statement of the present and expected economic situation, as well as the goals and priorities of fiscal policy; (2) the draft budget law; (3) detailed statements of revenue and expenditure according to institutional, economic, program and functional classification, though the functional is a reflection of the institutional classification (expenditures are presented by institution, program, project, and activity, by economic category and source of financing); (4) the annual operating plan that specifies by institution the goals of each spending program; and (5) public investment program with detailed information by institution, program and source of financing of the investment projects. As noted, these documents, after approval by Congress, are made available over the SEFIN web site. Comparative detailed expenditure information of past fiscal years is not provided; the main categories of budgeted revenues are compared with the estimates of revenues collected the previous year. No explicit distinction is made in the budget between existing policies and new policies and major fiscal risks are not identified.

**23.** However, there are some important exceptions to the budget principles of universality, specificity of budget credits, and gross budget. As mentioned, the expenditures of the de-concentrated agencies are not included in the GBR, and the budgets of some decentralized entities are often scrutinized by the SEFIN and approved by Congress when the GBR has been approved.<sup>35</sup> The revenue collected by some decentralized institutions in the agricultural, education, and health sectors for services provided are not contained in the budget. The budget classification includes some obscure spending categories called “overall appropriations”, the amounts of which are significant and allocated throughout the year by the SEFIN. Furthermore, the GBR incorporates a category called “centralized services”—as

---

<sup>32</sup> However, as noted elsewhere these are aggregate data and details of budget execution are not made available.

<sup>33</sup> A particularly worrisome lack of coordination is that between the FHIS, which executes and program social investments (education and health) relying on local demands that not necessarily coincide with country’s priorities, and the corresponding ministries, which are to provide for the recurrent expenditures.

<sup>34</sup> In cooperation with IMF staff, the authorities have prepared a medium-term macroeconomic framework and budgetary scenario for 2001–2005 for the Article IV Staff Report, which offers forecasts of revenues, expenditures, overall balance, and debt-GDP ratio for the central government.

<sup>35</sup> These entities represent about 20 percent of central government expenditure as defined following GFS86.

if it were another institution—that includes transfers to be made throughout the fiscal year to specific agencies, but it does not specify what category of expenditure they will finance.<sup>36</sup>

24. **Honduras is introducing an Integrated Financial Management System (SIAFI), which has made it possible to improve execution and control of expenditures; however, its sphere of operation is still limited.** The system will comprise four main subsystems on budget, treasury, accounting and public credit. The implementation is in the stage of decentralizing budget execution to the different ministries. At present, eight ministries are connected to the SIAFI via electronic data transmission, covering about 85 percent of the central government budgetary transactions. The available experience is promising in terms of time reduction of operating procedures and decentralization of budget execution documents. Apart from the generalization of the system to the rest of the central government, ongoing actions will allow automatic reconciliation of bank accounts, and improvements in the monitoring and evaluation of budget execution.

25. **The accounting system applied by the SIAFI permits control of payment arrears.** The accounting system applied by the SIAFI is midway between modified cash accounting system (income is recorded upon receipt) and a modified accrual system. The system makes it possible to enter each phase of the expenditure process and to estimate payment arrears. The government accounting system captures the expenditures of the central government financed through technical assistance from donors and records that information by sector and organization. There are difficulties maintaining a quantified record of aid in kind, despite the legal obligation to include it in the GBR,<sup>37</sup> because some ministries receive aid directly and do not report it (for example, the Ministry of Health).

26. **Budget execution and cash management are closely controlled by SEFIN.** The annual budget law authorizes the SEFIN to set the ministries quarterly quotas on the volumes of commitments and liabilities they can acquire. The quotas—which are based on monthly cash flow projections—have kept payment arrears at an insubstantial level. Virements are regulated in the OBL and the ABL.<sup>38</sup> During the fiscal year, supplementary and new budget appropriations can be created by legislative or presidential decree only if the new financing sources are identified (an obligation that is not always strictly complied with). In some circumstances, supplementary appropriations can be approved by the SEFIN when additional

---

<sup>36</sup> “Overall appropriations” represent five percent of total expenditure included in the GBR. “Centralized services,” about 23 percent. Almost 18 percent of this last figure corresponds mainly to grants to local governments and subsidies to small consumers of electricity, urban transportation, and interest rates of loans guaranteed by FONAPROVI. Nearly 32 percent are allocated to personnel expenditures. The rest are mainly grants to two deconcentrated agencies: the Honduran Fund for Social Investments and the Family Allowance Program.

<sup>37</sup> Article 69 of the OBL.

<sup>38</sup> Transfers between institutions are to be approved by presidential decree. Transfers between capital expenditures and between programs within an institution shall be authorized by the SEFIN. Finally, ministries can transfer resources between line items within aggregate expenditure groups.

revenues from fees and user charges are available. Likewise, the SEFIN can authorize new or supplementary appropriations financed by concessional funds or foreign donations.

27. **The capacity of public institutions for procurements is weak, and current legislation—now being reformed—is not very clear.** The special procurement regimes cover most of the public sector. The current legal framework for government procurements, contained in the Law on Procurements and the OBL, is ambiguous and lends itself to multiple interpretations. Congress is currently processing a draft Law on Government Purchases and Procurements that establishes the principles of disclosure and transparency in purchasing—such as access to information on the process and registration of suppliers and contractors—and prevents contracts from being divided up. The draft also includes penalties for civil servants who fail to comply with the law.

28. **The systems for selecting civil service personnel are discretionary, and wage-setting requires clarification.** The traditional competition system to select civil servants has not been used since 1982, and the only criterion of merit or capacity remaining is that candidates must have an academic degree for some positions. The selection of personnel, when there are funds to fill a vacancy, is discretionary, and there is ample scope for partiality. In the central government, there are several wage systems. Most employees of the central government receive their wages in accordance with “statutes” approved directly by Congress following negotiations with the trade unions.<sup>39</sup> The government sets the wages of the remaining public employees. In the decentralized public sector, entities are free to recruit staff, and hiring and benefits are governed by collective bargaining agreements. The government has been moving forward with a technical study on jobs and salaries and is preparing a proposal to amend the Law on the Civil Service to improve the selection and hiring processes and to establish ethical standards on the conduct of government officials.

29. **The current internal control system needs to assign clear responsibilities.** By law, there are two internal control systems. The first, a “pre-audit,” is performed by DGB staff in the secretariats of state and basically consists of examining the legality and the availability of credits. Auditors appointed by the General Comptroller Office of the Republic (GCO) in the ministries and the decentralized entities, which have to pay them, perform the second, called “internal auditing.” This is an undefined ex post audit. The assignment under law of both internal and external auditing functions to the GCO does not seem to be very sound, because it makes it both the judge of and a party to the controls performed and can be a potential source of conflict between branches of government.

30. **Progress is being made on generating timely reports for quarterly and final accounts.** As noted, last year, SEFIN began to report the central government’s fiscal position and budget execution to Congress on a quarterly basis. Annually, the GAO prepares the final

---

<sup>39</sup> The base salary of these employees provided for under the statutes is equivalent to a given multiple of the minimum wage, so that every time wages are reviewed through a private collective decision, there is an automatic revision of the base pay.

fiscal accounts within three months of fiscal year-end. These accounts<sup>40</sup> are quite complete; although they do not include municipal government, they do consolidate ex post data from the entire central government and the public sector.

#### **D. Assurances of Integrity**

31. **The initial budgets are not yet reliable indicators of fiscal outcomes.** The reliability of the budget data has increased in recent years, especially at the aggregate level, but in-year deviations between approved and executed budgets are still significant. A number of institutions tend regularly to increase their initial budgets over the year, reflecting mainly inaccurate original budget estimates by the ministries because of insufficient costing capacity and inappropriate coordination of donors and budget preparation.<sup>41</sup>

32. **The methods used to produce fiscal data are not made public.** Budget documents and final accounts do not include a statement of the accounting policies and standards. As noted, the assumptions and procedures used to prepare the macroeconomic and fiscal aggregates forecasts are not open to public scrutiny.

33. **Data from different sources are not reconciled.** At present, accounting data are not routinely reconciled with bank accounts. Banks provide daily information of the movements in the treasury accounts, but this information is not reconciled with the available information on receipts and payments. The volume of checks floating is unknown. In addition, there is no systematic process for reconciling the aggregate above-the-line data of the SEFIN with the below-the-line data of the CBH and the discrepancies between both sources of data are significant.

34. **The GCO enjoys functional and administrative independence and is responsible for both internal and external audit of fiscal accounts.**<sup>42</sup> The independence of the GCO is established in the Constitution and in the Organic Law of the GCO. The comptroller and deputy comptroller are elected by the National Congress to a five-year term. They cannot be reelected for another term and can only be removed by vote of two-thirds of Congress, if they are proven to have committed serious irregularities or offenses. The GCO's budget is

---

<sup>40</sup> The final accounts comprise: (a) Report on the execution of the GBR; (b) Government balance sheet; and (c) Report on the consolidated financial position of the public sector.

<sup>41</sup> The approved GBR is not a good indicator of spending financed by donor funds because it only include foreign grants that are actually available when the GBR is prepared. Foreign grants are available once the budgets of the donor countries have been approved, usually at the end of the year. Only then has the recipient country guarantee that those funds will be available for a specific purpose. However, by that time the budget of the recipient country has already been approved. This prevents the inclusion of these funds in the initial budget and requires the approval of new or supplementary appropriations over the year. In countries like Honduras, in which a great part of the capital budget is financed by foreign grants, this issue necessarily distorts budget preparation and budget execution.

<sup>42</sup> Decree 224/93.



approved by the Congress. It cannot be reduced by the executive branch or made less than the previous fiscal year. Furthermore, the funds allocated to this institution, under the same law, are credited in advance by quarter.

35. **External auditing of fiscal accounts is virtually nonexistent.** There has never been a complete audit on the financial and equity situation of the public sector. Apparently, the GCO has not prepared one because of a lack of resources and, possibly, because it must devote some of its resources to internal control. The comptroller's reports are not published, and there is no mechanism for enforcing his recommendations.

36. **Since the National Statistics Institute was recently established, its functions are temporarily performed by the CBH.** The law establishing the institute was issued through Legislative Decree No. 86/2000. Honduras has never reported fiscal statistics for the Fund's compilation of Government Finance Statistics (GFS). It does report to the International Financial Statistics (IFS) Yearbook, but quite late. As of February 2001, it had reported on the third quarter of 1999.

### III. IMF STAFF COMMENTARY

37. **Honduras has taken significant steps to improve fiscal transparency in recent years.** The gradual implementation of the SIAFI has allowed for considerable improvements in the quality and internal consistency of fiscal data. The budget documentation is offering increasingly complete information on the government's fiscal activity in the framework of appropriate institutional, economic, and programming classifications. Recent quarterly and monthly reports enable the monitoring of budget execution and physical execution of investment projects. The GBR is available on CD-ROM and is published on SEFIN's web page, as are execution reports. Objectives and goals are being set for the different spending programs. Projects are being implemented to streamline and provide for transparency in government purchasing, tax administration, and civil service.

38. **However, Honduras has not yet complied with several fundamental requirements of the *Code of Good Practices on Fiscal Transparency*.** In particular, the division of fiscal functions and responsibilities among branches of government, levels of government, and the different executive entities involved in fiscal management should be clarified. Commitments should be made to make public additional, relevant fiscal information. Persistent problems weaken budget preparation, coverage, execution, and control. The comments below examine in greater detail the areas in which fiscal transparency could be improved.

39. **In the short term, Honduras could significantly improve fiscal transparency with relatively simple changes to budget preparation and presentation procedures, and increased public access to existing fiscal data.** In particular, priority areas are the following.

- **First, the budget should cover the fiscal activities of all the entities comprising the central government.** This requires that the detailed budgets of the de-concentrated and noncommercial decentralized entities should be presented to Congress simultaneously with the GBR and a consolidated budget for the central government as a whole should be provided. It is also recommended to include the individual budgets of the public enterprises, along with a consolidated budget of the nonfinancial public sector. As information on the fiscal activities of the municipalities is available, ex-post consolidated information on the general government could be provided.
- **Second, the preparation of the budget should be strengthened.** In particular:
  - *unclear categories in the GBR, such as “overall appropriations” and “decentralized services,” should be replaced with more detailed classification consistent with GFS principles;*
  - *a contingency fund should be established for unexpected situations. The use, size and purpose of such fund must be clearly regulated, and the use of such funds recorded and reported against; and*
  - *the gross expenditures of public services should be identified in the budget. Therefore, the budget has to include a projection of all non-tax receipts expected for the fiscal year and should present, on a gross basis, the expenditures to be financed with those resources.*
- **Third, the expansion of the SIAFI should be carried out within the established timetable.** This will not only simplify budget formulation, execution, and control procedures, but will also improve the quality and timeliness of budget execution reports and final accounts.
- **Fourth, the reporting of fiscal information could be improved in the following ways:**
  - *the periodic budget execution reports should have the same coverage and classifications as the budget, and their dissemination should be promoted. Comparisons of outturns with initial and modified appropriations should be provided. The authorities could consider the advisability of assuming a permanent legal commitments, for example, in an upcoming budget code, or public commitments to disseminate fiscal data periodically according to a pre-established schedule;*
  - *routine reconciliation of the budget balance and the financing items should be strengthened through a closer cooperation between the SEFIN and the CBH;*
  - *the annual final accounts presented to Congress should be adequately disseminated. They are the report on the execution of the GBR prepared by*

the DGB, as well as the government balance sheet, and the report on the consolidated financial situation of the public sector prepared by the GAO; and

- *more detailed information on the public debt, broken down by holder, debt instrument and maturity, could be made public* in the budget documents and periodic reports.
- **Fifth, the information content of the budget document could be broadened by including:**
  - *the macroeconomic framework* that has been the basis for preparing the budget and *the procedures used to make revenue projections*, as well as the assumptions used in both cases; and
  - *information on past fiscal performance* and, in particular, a comparison of the main budgetary aggregates, and sub-aggregates by main items or programs, with initial figures and outturns for the two previous years as well as the expected outturn for the current year.

40. **Important improvements to fiscal transparency could be made in the medium term as the oversight capacity of internal and external control agencies and the fiscal analysis and sectoral planning systems are strengthened.** Such improvements could begin right away, and a gradual implementation system could be designed. Specifically, measures could be taken in the following areas:

- *the role of the entities responsible for budget control should be redefined and their ability to act strengthened.* This issue should receive the highest priority. The internal auditing units should be in the executive branch and should focus on conducting internal and operating audits in accordance with a pre-established work program. The GCO should focus on auditing the final accounts for presentation to Congress, a task that it has never fully completed. Clear institutional mechanisms should also be established to promote compliance with audit recommendations;
- *budget preparation should gradually be put into a medium-term framework* that strengthens macroeconomic forecasting capacity, has adequate functional and program classification of expenditures, and improves the multiyear programming of investments and the sectoral programming capacity of spending agencies. This is particularly important in a country like Honduras, which receives significant concessional resources, whose allocation must be reconciled with government policy priorities. A medium-term expenditure scenario will also make it possible to distinguish between pressure on resources from existing and new policies and consider the impact of public investments on recurrent expenditures; and
- to present a more complete measurement of government fiscal activity, *the authorities should begin to develop a methodology to quantify quasi-fiscal activities, tax*

*expenditures, and contingent liabilities and to publish this information in the budget documents.*

**41. Significant ambiguities in the assignment of fiscal roles and responsibilities should be clarified.** In a priority ordering, the following issues should be addressed.

- *The Congress's ability to make amendments to the draft GBR, the relative powers of the executive and legislative branches to amend the budget during the execution phase and the procedures and deadlines for the Legislature to process and adopt the budget should be clearly defined.* Current regulations on the matter are not adapted to international practice and undermine the capacity of public authorities to achieve fiscal discipline and allocate resources effectively.
- *Greater clarity and stability should be given to intergovernmental fiscal relations.*
- *The authorities should speed up the process of replacing the diverse laws that currently regulate the public financial administration system with an OBL or budget code that clearly defines the different fiscal management functions and indicates who is responsible for their execution.*