



# IMPUNITY,

## The Real Budget Problem in Honduras

Analysis of the Legal Framework for Budget Implementation

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**FOSDEH**  
FORO SOCIAL DE DEUDA EXTERNA  
Y DESARROLLO DE HONDURAS

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## **FOSDEH, 2012**

### **Social Forum of External Debt and Development of Honduras**

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## Acronyms

<b>LOP</b>	Organic Budget Law
<b>LOTSC</b>	Organic Law of the Superior Accounting Tribunal
<b>LTAIP</b>	Transparency and Access to Public Information Law
<b>LCE</b>	State's Procurement Law
<b>RLOP</b>	Bylaws of the Organic Budget Law
<b>RLTSC</b>	Bylaws of the Organic Law of the Superior Accounting Tribunal
<b>RLTSIP</b>	Bylaws of the Transparency and Access to Public Information Law
<b>RLCE</b>	Bylaws of the State's Procurement Law
<b>TSC</b>	Superior Accounting Tribunal
<b>ONADICI</b>	National Office for the Integral Development of Internal Control of Public Institutions



## Foreword

Resorting to the historical record of the Social Forum of External Debt and Development of Honduras (FOSDEH), the reader might wonder and undoubtedly answer itself with absolute accuracy that so far our research papers and institutional reports had not walked the corridors of macroeconomics, corruption, poverty, and public policy in general, with an outlook that predominantly highlights the resources deriving from our national legal framework.

We can say that the laws are tied to the socioeconomic situation and are the implicit or mandatory instruments for the operation of the State and the government. In fact, the relevance of the economic establishment requires the rules that precisely define the scope, limits, and possibilities of the citizens and their institutions. As a result, FOSDEH presents this report to the national and international audiences and its analysis and the corresponding proposals related to the legal framework concerning budget implementation, from the perspective of public spending.

It is important to underline that this approach aims to complement other national development efforts, promoting a deeper understanding of additional challenges that influence public policies, while budget management as a whole shows its biggest shortfalls when governments (in a self-destructive, criminal, and irresponsible manner) encourage fiscal mismanagement (against the laws that these same governments promote and approve) to fraternize with impunity and tolerance.

Finally, this report is dedicated to the decent citizens of Honduras, with faith in God and hope in the people of Honduras. I would like to especially thank our consultant Julio Rendon and the special contribution by FOSDEH's technical team. I would also like to thank COUNTERPART, through the IMPACTOS initiative, for their support in the framework of the project "A Proposal for Transparency and Accountability."

**Mauricio Diaz Burdett**  
**General Coordinator of FOSDEH**





# Summary of Proposals Regarding the Legal Framework for Budget Implementation

This report assesses the legal framework for budget implementation, from the perspective of public spending. Its starting points are the provisions included in the Constitution and the Organic Budget Law. The report analyzes the budget process, the sources of funding of expenditures, the rules on the allocation and disbursement of expenditures, budget amendments and their causes, controls for budget implementation, accountability of public officials, anticorruption measures, and access to public information.

## I. Principles Related to Budget Implementation

### 1. Universality

All expenditures and revenues must be included in the budget. This is provided in Article 362 of the Constitution and Article 11 of the Organic Budget Law.

No incomes or expenditures can be obligated outside the budget, which would also contravene the principle of budget legality.

### 2. Annuity

The budget is approved annually by Congress considering a bill submitted by the Executive Branch within the first fifteen days of September of each year (Articles 362 and 367, Constitution). In fact, as stated in the LOP, the public sector's fiscal year "will begin on January 1 and end on December 31 of each calendar year." As an exception, if at the end of a year, the budget for the new fiscal year has not been passed, the budget of the previous year will continue to be in effect (Articles 368, Constitution; Article 29, LOP). The annuity principle is not an obstacle to program multi-year expenditures.

### 3. Budget Balance or Stability

A balance between incomes and expenditures is fundamental (Articles 362 and 364, Constitution). The LOP states that "the strictest balance" will be sought between "an estimate of revenues to be collected during the fiscal year and the allocation of credits for expenditures in a given year." (Article 11) In addition, Article 38 asserts that "to maintain a balanced budget... neither Congress nor the Executive can create new expense allocations or increase the existing ones without

the corresponding legal instrument to accurately determine the funding source to be used to finance the budget amendment.”

In brief, the State should not spend more resources than what it collects. This balance, however, is understood dynamically. Hence, if there are deficits in the collection of current revenues, they may be funded with the issuance of debt, within the limits authorized by Congress as long as it is required to meet key needs for the general interest (Articles 64 and 76, LOP). An excessive deficit, therefore, goes against the aim of financial balance.

#### **4. Coordination between Planning and Budgets**

The annual budget must be approved “in accordance with the planned economic policy and the operating plans approved by the Government” (Article 362, Constitution). The LOP similarly provides that the “budget subsystem will be based on the National Development Plan, the Medium Term Financial Program and Multiyear Budgets, the Macroeconomic Framework, the Annual Operating Plans and the Annual Budgets,” all of which “must be interrelated, reflecting the priorities and goals of the Government...” (Article 9, LOP).

Budgets must be tools for the implementation of public policies, reflecting their priorities and goals

in terms of promoting development and meeting the public or collective needs for the public good. The formulation and adoption of budgets should not be the result of improvisation or decisions made outside of officially-approved policies.

#### **5. Budget Unity**

The principle of unity implies that all public revenues should be included in a single budget, which should be consistently intended to funding all public spending. This is the ultimate goal of the Organic Budget of Revenues and Expenditures of Honduras (Article 10 LOP) as a tool for the effective use of public revenues and expenditures under the state’s economic policy. Therefore, it is wrong that the Ministries or other administrative units with the power to obligate expenditures to assume that they can do anything with “their” budget and that they can dispose of it at will, regardless of the limits established by Congress.

#### **6. Single Till Principle**

The single till principle means that all incomes must be deposited in a common fund, from which they are distributed to meet public expenditures. This principle is supported by Article 363 of the Constitution. In particular cases, additional tax revenues could be managed in separate accounts, as long as they have a specific allocation.

The abuse of exceptional mechanisms, such as the opening of “special accounts” in the Central Bank for the fulfillment of occasional objectives or obligations,” that must always be managed by the General Treasury (Article 84, LOP). This can lead to a distortion of budgetary procedures and the resulting loss of control on the implementation of expenditures, especially if the government operates with broad discretion in the management of payments.

## **7. Lack of Specific Allocation of Resources**

Closely tied to single till, this principle implies that all public revenues should be indistinctively used to finance public spending. The Constitution provides that “No income can be created if it is intended for a specific purpose,” (Article 363) although some exceptions can be made, including the possibility of allocating certain incomes for debt service, in accordance to the law (Article 363).

## **8. Specialization**

The budget approval by Congress authorizes the Executive to include expenditures for a given amount, with a particular purpose and for a specified period of time, without exceeding those limits. Thus, all resources allocated in the budget to address a specific need or goal must be invested for this purpose (except in the cases of authorized

amendments). Likewise, expenditures can only be made by the amount established for each purpose and within the timeframe for which they have been authorized (budget implementation allotments within the fiscal year). This provision is stated in Article 364 of the Constitution and Article 34 of the LOP. The implementation of this principle should avoid the inclusion of expenditure appropriations beyond the authorized limits (expenditures without budgetary allocation), which is an illegal and erroneous practice that brings about serious consequences to public finances.

## **9. Non-Binding Connotation of Budget Expenditures**

Budgeted expenditures are not compulsory, as long as they are required by the public needs to be fulfilled (Article 34, Last Paragraph, LOP). Consequently, it is not about to spend for the sake of spending, as it is the practice in management in Honduras.

# **II. The Budget Process: Calculation of Incomes and Allocation of Expenditures**

## **1. Brief Description of the Budget Process**

The budget process is understood as the set of required procedures or activities for the

formulation of budget bills, as well as for its approval, implementation, monitoring and evaluation, and the corresponding liquidation at the end of the fiscal year.

This process begins with the annual budget policy which is approved by the President in advance for the drafting of the corresponding budget bill. The general guidelines should be specifically set forth to lead the formulation of that bill, including “the objectives, goals, priorities, guidelines, and estimates of maximum amounts of global allocable funds for each office or agency.” (Article 18, LOP)

## **2. Calculation of Incomes**

Public budgets should be drafted starting from objective technical assessments of the different funding sources and economic perspectives. From these technical assessments, revenue estimates should be realistically projected throughout the fiscal year, with which it is expected to finance the estimated expenditures. If this is not done, there is a risk of drafting unbalanced or unrealistic budgets, which will result in financial imbalances during the implementation phase, with a likely increase in public debt.

In conclusion, the budgetary resources must be calculated until they are actually collected by the Treasury Bureau (Article 30, LOP). An appropriate

procedure of monitoring and evaluation for budget implementation should take into account the variables that can alter the collection of incomes to make the appropriate adjustments, preferably through the reduction of non indispensable expenditures.

## **3. Allocation of Expenditures**

Unlike the calculation of revenue estimates, which is the exclusive responsibility of the Ministry of Finance, the estimation of projected expenditures corresponds to the different Ministries of the Executive Branch according to their area of competence. To this end, these administrative units should consider “the development plans and policies” of their competence and the annual budget policy guidelines approved by the President. Using them as a starting point, they draft a proposal of budget priorities, programs, and activities to be implemented in the new fiscal year. The Ministry of Finance prepares a Bill of the General Budget of Revenues and Expenditures, including “the required amendments” (Article 23, LOP), based on the projected revenues and official priorities.

According to the General Law of Public Administration, the Ministry of Finance will be, for all purposes, the institution through which the Executive will be in contact with Congress, so that

“only through it, it may be possible to increase or decrease the allocations under the proposed budget bill or the inclusion of new expenditures.” (Article 26, LOP).

The LOP also seeks to maintain a balanced budget, as well as the prevention of expenditures that are considered to be improvised, unnecessary, or outside the framework of the public investment program. In fact, any increase of total expenditures included in the budget bill submitted to Congress by the Executive must have the required financing source, with the prior opinion and concurrence from the Ministry of Finance (Article 27).

### **III. Budget Amendments and Possible Distortions**

#### **1. Budget Amendments**

The approval of any amendments affecting the total amount of the originally approved budget and the amount of projected domestic borrowing is the sole responsibility of Congress, with the concurrence from the Ministry of Finance (Article 36, LOP). The Ministry of Finance should take into account the macroeconomic impact of the projected debt and its effect on public finances. Likewise, it is the responsibility of Congress to authorize transfers of funds between government branches (Article 37, Paragraph 1, LOP).

If the total amount of the approved budget does not change, the President must authorize the transfers of funds between Ministries or between them and decentralized institutions (Article 37, Paragraph 2, LOP). The Ministers, on the other hand, can authorize transfers, within the responsibilities of their Ministry “between specific expenditure items or categories of the same program” (Article 37, Paragraph 3, LOP).

The creation of new spending allocations or the increase of existing appropriations will only be possible if there is a “specific” funding source, requiring the previous concurrence from the Ministry of Finance (Article 38, LOP).

The broad will for the inclusion of budget amendments reveals the extensive discretion in the execution of public spending. The General Guidelines of the 2012 Budget restrict “with the purpose of achieving a sound management” to a maximum of forty annual budget amendments per year for each implementation unit, “distributed in as many as ten amendments per quarter which may be made from the last two weeks of the fiscal year’s first quarter.” However, the outcome of this rule may actually contradict the claimed “sound management.”

## 2. Possible Distortions

### a) Abuse in the concession of direct contracts, avoiding tender procedures

The first general rule in public contracting consists in opening a public or private tender, according to the amount of expenses or other particular circumstances (Article 360, Constitution; Articles 38, 59, and 60, LCE). As an exception to that rule, the LCE allows the possibility to grant direct contracts for public works, goods, or services when they are appropriate to address, in an immediate and urgent manner, the needs resulting from an emergency situation, which must be approved by a Presidential Decree in a Council of Ministers meeting (Articles 9 and 63, Paragraph 1, LCE; Article 7, Paragraph g, RLCE).

The circumstances that must support such declaration are set out in Article 9 of the LCE and they must be fully accredited, including the causes why direct contracts are required (natural disasters, epidemics, public calamity). To verify its legality and suitability, direct contracting is subject to different controls in order to avoid the confusion between “emergency” and “urgency.” The lack of precision in evaluating emergency situations or controls required by law may bring about the awarding of unnecessary contracts, which may also be disproportionate, overpriced, or without

the required quality controls, all in detriment of public finances.

### b) Awarding contracts to companies or providers that do not properly certify their economic and financial reliability and their technical and professional expertise.

According to the LCE’s Article 15, to be able to sign public contracts, individuals or companies (either domestic or foreign) must demonstrate their full legal, economic, and financial standing and their technical and professional competence, avoiding to be engaged in conflicts of interest issues. These qualifications must be verified in the prequalification stage of contractors for public works (Articles 43-45, LCE; Articles 87-97, RLCE) or during the examination of the requirements for registration in the Records of Suppliers and Contractors.

The lack of will to comply with these provisions may lead to contracting public works with insolvent or inexperienced companies, with the frequent result of subsequent suspensions of works or other implementation problems, which are usually associated with requests for renegotiation of contracts, price adjustments, or the negotiation of new contracts, thus increasing the budgeted expenditures. It can also lead to the delivery of

poor quality goods or delays in the delivery of goods or services.

**c) Awarding contracts without the required budget allocation.**

According to the LCE, the administrative authorities are not allowed to grant contracts to individuals without a previous approval of “budget estimates” or an “approved expenditure budget,” which must be included in the respective contract files (Articles 23 and 27). Therefore, the contracts without a budget allocation must be annulled, resulting in their early termination and in administrative, civil, or criminal liabilities for the officials involved (Article 27, LCE).

Despite the accuracy of these provisions, sometimes public officials grant contracts for works, goods, or services without a budgetary allocation, which causes the grantees to demand for unlawful budget amendments to meet the committed expenditures, all in flagrant violation of the law, without being subject to penalties. Obviously, this illegal practice causes budget inconsistencies, triggering an irregular growth in expenditures.

**d) Contracting public works with bidders with the lowest prices but inconsistent unit prices.**

Tenders for public works usually require the presentation of offers with detailed unit prices according to the details provided in the tender specifications, so that the sum of the latter matches the total offered price. If there are no adequate controls, there can be “price imbalances,” allowing the contractors to bill most of the total price in the initial stages of the work, thereby leaving insufficient funds for its intermediate or final stages, with the ensuing effect of demanding the revision of final prices and an increase of the contract’s total amount.

To prevent this fraudulent practice, the evaluation of bids must be carefully done “to verify that the unit prices, if so required, correspond to market-value prices, avoiding the imbalance of such prices due to their speculative decrease or increase” (Article 135, LCE). If this is the case, the tender specifications may provide the inadmissibility of such offers, after the necessary revisions are completed (Article 135, RLCE).

**e) Contracting works from bidders offering abnormally low prices.**

To make sure that they get awarded a contract, bidders may offer unusually low prices, with the purpose of demanding price reviews afterwards when the contract has already been granted, causing similar effects to those listed in the



previous paragraph (unbalanced budgets and an increase of expenditures beyond what was originally estimated). This flawed practice results from the breach of Article 51 of the LCE, which states that “if the prices submitted in a bid are normally (sic) lower in comparison with other bids or the estimated budget, additional information will be requested from the bidder to ensure that it can successfully fulfill the contract and other investigations will be carried out as required.” In these cases, a performance bond of up to 30% (twice the normal requirement) of the total amount will be requested or the bid will be rejected if “it cannot be properly fulfilled or is speculative.”

**f) Irregular or unjustified contract amendments.**

According to the RLCE, amendments to contracts may be made “as a result of new requirements or unforeseen technical reasons at the time of the design or the procurement of the works. These circumstances must be duly included in the contract file, always considering the public interest and subject to the concurrence of an appointed supervisor” (Article 203).

In addition, these amendments may not be related to “a different purpose or goal than the one originally stated,” and its total value may not exceed 25% of the contract’s original amount,

unless the amendments are approved by Congress (Article 123, LCE).

**g) Other financial commitments without the required budget allocations.**

As stated above, Article 364 of the Constitution prohibits to make expenditures or payments “not included in the appropriations voted in the budget or in violation of budget regulations.” The committed expenditures that do not meet this essential requirement will be voided, “without disregarding the corresponding administrative, civil, or criminal liabilities” (Article 34, LOP).

However, in clear violation of this principle, financial commitments are sometimes made without the proper budget allocation, including the irregular hiring of public officials in the education and health sectors or the irregular procurement of goods or services, increasing the budget items beyond their original estimates.

**h) Exaggerated increases of unnecessary or unjustified expenditures.**

An example of this item is the apparent institutional advertising campaigns paid for by public institutions in order to promote the electoral campaigns of public officials, in violation of Article 7 of the Code of Ethical Conduct for

Public Officials (Decree No. 36-200 from April 24, 2007), which states that it is against public ethics the use of “institutional advertising or public funds for the personal promotion of the name, image, or personality of any public servant, whatever their rank or duties may be, or third parties running for office by popular election, although they may not be public officials at the time.”

**i) Distortions in the public labor system.**

Labor relations within the Executive Branch are regulated by the Civil Service Law and its bylaws. However, the provisions on the access to public service through competitions, tenure, performance evaluations, and promotions based on merit, are not properly implemented, generating various distortions in the public labor system. As a result, there is no appropriate legislation on wages and coherent policies in this area. Different sectors have their own pay schemes, including “bonuses” and collateral benefits.

**j) Payment of financial obligations derived from judicial rulings.**

Public administration is often ordered to pay compensations by the courts to third parties for dishonest or illegal practices. In other cases, rulings may be associated with deficient legal criteria due to poor interpretation or application

of legal regulations, or poor procedural practices for the defense of public interests.

In addition, regulatory gaps, such as the lack of legislation to regulate and control the regime of liabilities for public officials, can lead to judicial rulings detrimental to the public finances by speculative and unjustified claims. The inadequate administrative or judicial practices and regulatory gaps must be corrected under the rule of law, to reduce their negative impact on public finances.

#### **IV. Categorization of Payments and Deficient Control**

The LOP has decentralized budget implementation to the Ministries and other agencies responsible for the execution of various programs and projects, granting responsibility of expenditures to the relevant Management Units (previously, the duties of control or pre-intervention of expenditures were carried out by the General Budget Bureau).

By decentralizing the execution of expenditures, the LOP handed over such controls to the implementation units that operate based on “payment fees,” usually on a quarterly basis for the relevant expenditures, in accordance to the revenues that enter a Single Account of the General Treasury Bureau (Article 83, LOP).

The current system tends to achieve greater efficiency. Nevertheless, it has gaps that can cause distortions with negative effects on spending, including: (i) poor internal controls, which are necessary to verify the legality or suitability of budget operations, (ii) granting the duties of signing payment orders to the Administrative Managers of each institution, ignoring the senior authorities who may order or authorize expenditure commitments, such as the Ministers.

## **V. Control of Budget Implementation**

The law provides for several levels of control for budget implementation:

### **1. Internal Control**

Internal budget control consists of “instruments of control prior, during, and after which are included into the organization, regulations, and procedures of public sector institutions and their internal audit tools, in regard to the operation of financial management subsystems as a whole...” (Article 115, LOP).

In this context, according to the Organic Law of the Superior Accounting Tribunal, internal control has the following goals: (i) ensure “the effectiveness, efficiency, and economy in operations and quality of services;” (ii) protect “public resources against

any loss, waste, abuse, irregularities, or illegal acts;” (iii) comply “with the laws, regulations, and other government rules;” (iv) generate “valid and reliable financial information.”

Furthermore, according to the LOP, these are also goals of internal control: (i) ensure “the quality of institutional services;” (ii) improve “the decision-making capacities and initiative in those responsible for institutional management;” (iii) preserve and protect “public assets in an efficient and effective manner;” (iv) promote that “the information generated and disseminated is timely and reliable;” and (v) ensure that the “operations are conducted in strict compliance with the existing laws and regulations.”

The design and implementation of internal control tools should follow these basic principles: (i) inclusion of recurring statistical safeguards and controls to the automated systems for financial management; (ii) linking the public accounting procedures with the budgetary and financial transactions in real-time; and (iii) development of subsequent control mechanisms with independent auditing techniques implemented by the relevant internal audit units, by other institutions, or private firms hired for this purpose.

Accordingly, the application of prior checks will be the “unquestionable responsibility” of each

implementation unit. Therefore, the preventive oversight carried out by the Ministry of Finance could be discretionary, and may only be applied “after verification from the internal or external audit units regarding the mismanagement of prior checks by those responsible of the implementation units.”

On the other hand, the responsibility for the design and implementation of internal control tools falls under the duties of the Ministry of Finance, as the governing body of public financial management, which in any case are complementary to the general guidelines issued by the TSC.

However, if there is evidence of civil or criminal liability, the internal audit unit must inform the TSC which, in turn, must give notice to the Attorney General’s Office to begin any proper civil actions, or the Public Ministry to carry on with criminal proceedings, as appropriate (Article 50, LOTSC). At the same time, the breach of such duties or failure to follow up the actions taken “implies responsibility (by the internal auditor or any other staff) of the alleged perpetrators.” (Article 119, LOP).

In any case, the internal audits should verify the implementation of applicable preventive controls and must take the required measures “to prevent the occurrence of the consequences of the detected illegal act.” (Article 51, LOTSC).

Finally, starting with the implementation of the LTSC, the Executive branch, the decentralized institutions, and other public agencies are in charge of appointing the internal auditors and supporting staff (Article 106). However, the mechanisms employed for their appointment and their hierarchical relationship with the heads of various institutions, do not guarantee their independence and objectivity expected in the performance of their duties.

## **2. External Control**

External control falls under the duties of the TSC which must verify compliance with the principles of legality, efficiency, effectiveness, economy, equity, and accuracy in accordance to its regulations. Specifically, this control system comprises the following: (i) financial control; (ii) control of management and results, to “prevent, identify, and verify the mishandling of public resources”; (iii) control of public probity and ethics; and (iv) control of public assets.

To perform its duties, the TSC may follow these actions according to the law: (i) conduct administrative proceedings or special investigations to determine liabilities in specific cases; (ii) in a more frequent manner, carry out regular audits to evaluate the actions of officials during particular timeframes and may include in

such cases, the control of finances, management, or monitoring results and assets; (iii) perform special investigations from the affidavit of assets of public officials, exercising control of public probity and ethics.

As a result of its audits, the objections raised by the TSC will result in the presentation of the corresponding administrative or civil liabilities, once they have been confirmed and the objections raised by the alleged perpetrators are resolved. In any case, if there is evidence of criminal liability, the report must be submitted to the Public Ministry to proceed through the appropriate channels.

The TSC usually intervenes after the acts have been carried out, but it also has the authority to hold concurrent audits or special investigations, as well as visits or inspections, after receiving complaints from official sources or third parties. This way, irregular situations that are currently taking place can be confirmed at the time of the audit, being of the utmost importance for the timely prevention or correction for sound financial management.

### **3. Administrative Control**

The Ministry of Finance, through the General Budget Bureau, is authorized to assess the implementation of the General Budget of Revenues and Expenditures and the budgets of decentralized

institutions, both during and after the end of the fiscal year, based on the reports issued by the implementation units and submitting the results to the President for information and evaluation at the meetings of the Council of Ministers.

It is also the responsibility of the Ministry of Finance the development of a public accounting system, which records the economic, financial, and assets-related operations, providing the financial and accounting reports or other required information which should facilitate the measures of control and internal and external audit.

### **4. Legislative Control**

In addition to passing the annual budget, after receiving the required TSC reports, Congress is also authorized to approve or reject the clearance of public accounts submitted by the Executive at the end of the fiscal year.

Furthermore, Congress has the authority to approve the administrative performance of the Executive and other public institutions, as well as to appoint special committees to investigate matters of national interest and to question the Ministers or other officials on matters related to public administration.

## VI. Accountability by Public Officials

Failure to comply with the rules on budget implementation or other applicable financial rules in the public sector is subject to administrative, civil, or criminal liability, according to the circumstances of each case.

In view of that, the LOP states that the following are considered violations:

- Embezzlement in the management of public funds;
- Management of public resources or other assets without being subject to the provisions regarding the clearance, collection, or credit to the General Treasury or other special collection units under the law;
- Commitment of expenditures or order payments without having enough credit to fulfill them or breaching the provisions of this Law or the annual budget;
- Allowing improper payments during the clearance process or during the issuance of public documents, according to the tasks entrusted to the official;
- Lack of justification for the investment of allocated funds; and

- The commission of any other act or resolution that contravenes the LOP or its bylaws.

These violations are complemented with those defined in Article 100 of the TSC law and this agency has the authority to impose administrative penalties for public officials or request warnings, suspensions, or removal from office.

Criminal liability, however, will be determined if any of the violations listed above take place or with the commission of any of the criminal offenses defined under the Penal Code. For example, these may include fraud, abuse of authority and violation of the duties of public officials, bribery, embezzlement of public funds, and negotiations incompatible with the exercise of public duties.

Civil liability will be determined when there is loss or damage to public property as a result of a violation. In these cases, after the rulings related to the ensuing challenges have been issued, the relevant files must be submitted to the Attorney General's Office which must proceed through the civil courts.

## **VII. Anti Corruption Measures and Access to Public Information**

Honduras is a party of the Inter-American Convention against Corruption and the United Nations Convention against Corruption. The latter also includes a commitment of the party States to take the appropriate measures to “promote transparency and accountability in the management of public finances.”

With these same goals, the Law of Transparency and Access to Public Information was passed in 2006 through which public institutions have “the obligation to routinely disclose and regularly update information of general interest through electronic or automated tools.” However, that law restricts the right of access to public information when it is regarded as “confidential” if “any damage that may occur is greater than the public interest of disclosing the information,” or where releasing public information may cause harm or prejudice. Nevertheless, such exceptional measures “should be based on the existence of objective factors that demonstrate that access to information is likely to cause specific damage, present and possible.”

In the circumstances explained above, it can hardly be claimed that the information on budget implementation jeopardizes public safety; the provisions of the Constitution or the law; or

governance or the economic, financial, or monetary stability; especially if the implementation of public budgets is subject to the law in its broadest sense, including the constitutional and legal principles discussed earlier in this report. This must be done to ensure good governance and economic, financial, and monetary stability, which is precisely for the best interest of all citizens.

## **VIII. Conclusions and Recommendations**

1. The constitutional and legal framework is suitable for efficient budget management. The observed gaps or inconsistencies are more related to an inadequate management or supervision rather than regulatory deficiencies.
2. The timely and adequate application of Article 364 of the Constitution, Articles 34 and 121 of the Organic Budget Law, and Articles 23 and 27 of the State’s Procurement Law, should avoid many of the irregular practices mentioned above.
3. Expenditure budgets must be the result of unbiased assessments of projected revenues, starting from the statistical analysis of the different funding sources and the macroeconomic situation, as provided

for in the regulatory framework. Likewise, they must respond to previously defined spending and investment priorities, according to public needs and avoiding unnecessary expenditures.

4. The issuance of public debt must be exceptional and meet objective indicators to allow its sustainability, avoiding instability for subsequent fiscal years.
5. To achieve a balance between projected revenues and planned expenditures, any increase or decrease in allocations or the inclusion of new expenditures must be done with the concurrence of the Ministry of Finance. As provided for in the law, no new expenditures should be approved if they do not have a specific funding source or if they just include an instruction for the Ministry of Finance to subsequently “identify the required funding.”
6. The decentralization of budget implementation is important because it simplifies the procedures and reassigns responsibility for the authorization of expenditures to the appropriate implementation units, allowing greater efficiency in public administration. However, there are deficiencies in internal control that must be corrected to ensure the legality and timeliness of financial operations.
7. The internal audit system should be strengthened, provide training for the staff and ensure its autonomy. The law has shown gaps in this area and it is recommended the creation, by law, of a technical governing agency under the Presidential Office, which should appoint the staff of internal auditing units, issue technical standards, and monitor compliance of control measures.
8. The responsibility of expenditures should not be limited to the Administrative Managers of each agency, as they are in charge of signing payment orders. This duty should also include, after the appropriate legislative reforms are passed, the senior officials of every implementation unit.
9. An adequate internal control, including the timely and efficient intervention by the corresponding internal auditing units, is a key component to prevent or correct improper or illegal practices in the process of budget implementation. This procedure should detect administrative or civil liabilities or identify, where appropriate, any evidence of criminal liability to be submitted to the Public Ministry which should proceed as required.



10. Internal control tools should work in coordination with the interventions by the Superior Accounting Tribunal. The simultaneous audits, administrative proceedings, or special investigations and visits or inspections by this agency, in addition to the regular audits, should confirm the findings of the internal audits or the level of compliance with the control duties of such audits, determining if there are any liabilities by action or omission.
11. The monitoring and evaluation reports of budget implementation prepared each quarter by the Ministry of Finance and the control measures to be carried out by Congress, including the approval or rebuttal of budget reports at the end of each fiscal year, should contribute for a sound financial management.
12. Failure to comply with the regulations on budget implementation, including commitments or payments beyond the approved allocations, must be a cause for administrative, civil, or criminal liability of the public officials involved as applicable. The lack of enforcement of punitive, administrative, or criminal penalties contributes to impunity and the recurrence of improper or illegal practices, thereby affecting public finances.
13. As an administrative activity, budget implementation is subject to the law and any action against it is illegal and must bring about liabilities. However, in practice, officials often act with broad discretion with expenditures, usually surpassing budget allocations, which imply the imposition of liabilities as set out above.
14. The general provisions of the current budget (2012) has limited to a maximum of forty the number of budget amendments per year for each implementation unit. However, the result of this rule could be the opposite of its original intent, to the extent that such exceptional amendments should only be allowed when they are fully justified, following the required legal procedures and complying with the appropriate controls. The general provisions of the 2012 budget still involve a broad discretion to make amendments, contrary to what would be reasonable.





# **IMPUNITY,**

**The Real Budget Problem in Honduras**

**Analysis of the Legal Framework for Budget Implementation**



## What Does FOSDEH Pretend with this Report?

**Impunity**, the real budget problem in Honduras, is not just a random title for this new policy proposal from FOSDEH. Actually, more than a title, is a brief but factual summary about the internal and external problems that have plagued the General Budget of Revenues and Expenditures of Honduras.

It could not have been called differently due to the lack of accountability by public officials who have caused an average floating debt of over 12 billion Lempiras without accounting for a considerable amount of expenditures, or the approval of laws and decrees motivated by partisan or electoral interests despite its economic infeasibility, or the awarding of key projects responding to private interests that harm the country's economic sustainability.

The examples that illustrate the excessive waste of public resources in recent decades, regardless of which party is in office, seem to be endless and it is also very unlikely to settle on a single figure to determine the total cost of such waste. This would be a difficult, even a daunting undertaking to perform, due to its magnitude and the sentiment of outrage and frustration that may cause in the

Honduran people. Each Lempira that has been stolen or squandered by the government means one less opportunity for development and further advancement of poverty.

Nevertheless, despite the significance of the problem, no public official has been incarcerated or any stolen or squandered resources have been returned to the State until now.

Public officials know about the laws and regulations regarding budgets and are aware of the existing civil, criminal, or administrative penalties set forth to regulate the management of public resources, but they just tend to ignore them, causing such budget "abnormalities" to become the "standard" on budget implementation in Honduras.

In Honduras, many public officials have lost the restraint to commit abuses against public finances. Starting from the top echelons of power, officials have committed atrocities against the budget and no one, not even the public comptroller or auditing institutions have made an effort to stop them, which has promoted the so-called institutionalization of chaos, abuse, and waste of public resources.

For instance, a Promotion of Public and Private Partnerships Law which created COALIANZA, a commission in charge of the definition of the major investment projects to be developed in the country, including its awarding and management, was passed without much consensus in 2010. Basically, such projects will be approved by the President in meetings of the Council of Ministers and will not actually take into account the rulings on their economic feasibility from the Ministry of Finance, the Bureau of Public Credit and Investment, or the Ministry of Planning. Furthermore, COALIANZA is able to negotiate foreign loans directly, regarded as public debt, to collect the required funding as the public counterpart for the implementation of projects with the utmost secrecy, since most of their information has been deemed as “confidential.”

FOSDEH is not against public-private partnerships. It is essential to clearly define their roles and responsibilities, respect all processes that ensure transparency and control, and above all, the public profit of every project must be clear, which means that the profitability and the effectiveness of all projects must be proved.

In other words, the current crisis in Honduras is not merely of economic nature, but moral and ethical as well. The crisis has been brought about by the sum of errors, budget abuses, and the systematic (and almost premeditated) weakening of the

control functions of the Ministry of Finance. The current budget problems can be explained by their evident consequences on the quantity and quality of services provided by the State.

However, considering the current conditions of Honduras, it is impossible to think that the country can persist in enduring a budget situation as it has been so far. Even though the government collects more taxes, it has more bills to pay and current expenditures, especially wages and salaries, consume a significant proportion of the budget, as well as the resources used to pay the internal debt. This means that the opportunities to make a change in Honduras are almost running out.

According to the official estimates, 70% of the population in Honduras is poor and the government must provide urgent and creative responses to the different needs of the Honduran people but, how can this be done? The answer is certainly complex, but part of it must be the sound and transparent use of public resources. For this reason, FOSDEH presents this report that may be considered a catalog that illustrates the main budget irregularities in order to find convincing solutions.

Some of these problems are:

1. The violation of the “single till” principle

encourages the creation and dispersion of cash sources or special allocations that in the end become a large source of out-of-the-budget expenditures.

2. There is an overestimation of tax revenues as part of the budget, which does not allow a reasonable allocation of resources that requires budget amendments that have to be financed with public bonds. In other words, you spend more than you have, which in turn increases Honduras's debt.
3. Budget sustainability is increasingly under stress while the government allocates more funds for debt service. In 2011, debt service accounted for 16% of the total budget and will reach almost 20% by 2013. In contrast, public investment only reached an average of 10%.
4. There are still out-of-the-budget expenditures, even when the annual budget states that any expenditure to be made must be included in it.
5. There are evident weaknesses in the bodies of internal and external control within the public institutions and the government as a whole. The proper operation of these bodies would prevent out-of-the-budget spending and other abuses. Their suitable operation, as well as from the Superior Accounting Tribunal, would also involve the presentation of the corresponding liabilities for those responsible of such abuses, as well as those that should have prevented or intervened to prevent such abuses.
6. There has been a blatant abuse of budget amendments, to the extent of establishing them as a rule (a maximum of 40 amendments per quarter, whereas such amendments were unlimited before 2012) not as exceptional tools for budget management.
7. Lack of an actual budget policy which must be included in the budget drafting process every year. This policy must clearly state the development goals for the collective benefit for all Hondurans, to avoid improvisation and uncontrolled spending.
8. The use of resources and government institutions as an electoral springboard. Such situation has been a problem since it usually drives all institutional activities to support the aspirations of certain public officials.
9. The institutions currently involved in the budget-drafting process are not fulfilling their duties. For instance, there are no strategic goals set by the Economic Cabinet, the assistance



provided by the Ministry of Planning is still marginal, almost limited to providing merely logistical support, and the approval process carried out by the Council of Ministers, rather than being a forum of political leadership or a platform of coordination for public policy, becomes a stage for political propaganda.

10. Budgets in Honduras are discussed and approved behind closed doors, society does not participate in the budget-drafting process and some of the documents that support the drafting of budgets are not publicly available, to the extent that the budget bill has been declared as “confidential,” which is why it is not publicly disclosed after the bill is submitted to Congress.

Budget problems are not limited to this short list. In addition to those mentioned above, there have been problems related to public procurement processes, the significant budget disparity caused by demands to increase wages for public employees, the duplicity of duties of many public institutions, lack of access to detailed information on budgets, among others.

What needs to be done to address these facts? What kind of decisions must be taken to correct them? How can fiscal discipline be guaranteed in a year marked by political and electoral turmoil

ahead of the general elections? How can a better and enhanced public investment be promoted? How can public funding be aimed for the benefit of the people? These are the questions that must be addressed and that FOSDEH presents for debate within the Honduran society, especially ahead of the discussion of the 2013 budget and its consequences on multiannual budgets.

Along with the doubts and fears that always come at the time of budget debates, FOSDEH also presents to the public some of the broad questions and proposals that sooner or later must be answered or addressed by the relevant authorities. For instance, should Honduras need the drafting of a Budget Stabilization Law? Will there be a single and permanent formula for a more accurate estimation of tax revenues? How can we agree on a general wage policy that is fair and equitable for all public employees? Is it urgent to define our own parameters to regulate the borrowing capacity of the government taking into account its incomes? Will the public comptroller institutions be finally able to fulfill their duties and avoid economic impunity?

Honduras still has chances of survival, straighten its course, and seize its last opportunities for development.

# Legal Framework for Budget Implementation

## I. General Guidelines

This report assesses the legal framework for budget implementation, from the perspective of public spending.

For methodological reasons, the analysis begins with the general laws that guide the budget process, such as the Constitution and the Organic Budget Law. This report also discusses the budget process, funding for expenditures (current and capital incomes), the standards for allocating and disbursing expenditures, budget amendments and their causes, control of budget implementation (internal and external control, management, and legislative oversight), liabilities by public officials, and anti-corruption measures and access to public information. At last, the report presents its conclusions and recommendations.

A short definition of budget is the calculation or probable estimation of revenues and expenditures of the State during a fiscal year. The budget is passed by Congress and is drafted and implemented by the Executive branch. This report refers to an analysis of the regulations related to

the General Budget of Revenues and Expenditures of Honduras.

## II. Principles Related to Budget Implementation

### 1. Universality

According to this principle, all public expenditures and revenues must be included in the budget. This is stated in Article 362 of the Constitution (“All revenues and expenditures will be accounted for in the General Budget...”) and explained in detail in Article 11 of the Organic Budget Law, which reads as follows:

“Article 11. Content of Budgets. Budgets will include all estimated resources and expenditures for the fiscal year, which will be listed separately with their full amounts without any compensation between them and will show the economic performance of their current and capital accounts... The budget will consist of an estimate of revenues to be collected during the fiscal year and the allocation of credits for expenditures in a given year...”

Therefore, the budget cannot include the out-of-the-budget revenues or expenditures which also contravene the principle of budgetary legality (the State's financial activity is regulated by the law, including the collection of revenues, its management and disbursement to meet public expenditures for the fulfillment of public needs and other goals of general interest, which have been properly programmed).

## **2. Annuity**

The budget should be "voted" (passed) by Congress every year taking into consideration the bill submitted by the Executive within the first fifteen days of September of each year (Articles 362 and 367, Constitution) and will be implemented during the fiscal year.

According to the LOP, the public sector's fiscal year "will begin on January 1 and end on December 31 of each year" (Article 8). On this date, the budget of the fiscal year will be closed, serving as the basis for its corresponding liquidation (Article 42).

As an exception, when a budget for a new fiscal year has not been "voted" at the end of the previous year, the budget of the preceding year will continue in effect (Article 368, Constitution; Article 29, LOP).

However, this exception is subject to the following considerations which are implicit in the context of the law: (i) the constitutional obligation of the Executive to submit to Congress a budget bill for the new fiscal year, within the timeframe stated in Article 367 of the Constitution, cannot be waived under any circumstance; (ii) if such bill is not passed for any reason, the extension of the previous year's budget is subject to the Executive and the spending authorization still corresponds to Congress (Articles 362 and 366, Constitution). In any case, this should not have a negative effect on the internal administrative amendments that may be applicable (Article 37, Paragraphs 2, 3, and 4; LOP); (iii) through these amendments, the Executive Branch cannot modify the total amount of expenditures originally approved by Congress for the previous fiscal year and extended into the new fiscal year, or the amount of the estimated internal debt, since these obligations correspond to Congress (Article 36, LOP); (iv) therefore, under these assumptions, the Executive cannot make commitments or approve discretionary expenditures that have not been included in the budget, which will otherwise imply liabilities for public officials (Article 364, Constitution; Article 34, LOP).

On the other hand, the annuity principle is no obstacle to draft multi-year expenditure programs (obligations to be fulfilled beyond a particular

fiscal year) related to the implementation of public works, the supply of goods, the provision of technical assistance services, leases or public debt service. The payment of the remaining balances must be included in the budgets of the following fiscal years.

### **3. Budget Balance or Stability**

This principle refers to the balance between revenues and expenditures, which is stated in Articles 362 and 364 of the Constitution.

Regarding this issue, the LOP asserts that the State will seek “the strictest balance” between the “estimated revenues to be collected during the fiscal year and the allocated expenditures in a given year” (Article 11). In addition, the LOP includes the following considerations:

“Article 38. Maintaining a Balanced Budget. To maintain a balanced General Budget of Revenues and Expenditures during its implementation, neither Congress nor the Executive can approve new expenditures or increase the amounts allocated to the existing expenditures without accurately identifying the funding sources to finance these amendments, requiring in any case the concurrence of the Ministry of Finance. In those cases where the funding source is internal debt, the procedure to follow is explained in Article 76 of this Law.”

In summary, the State should not spend more than it takes in and accordingly, the budget must comply with the State’s actual financing limits. This balance, however, is understood dynamically. Hence, if there is a deficit in the collection of current revenues, the budget may be funded with internal debt within the limits authorized by Congress and as long as it is required to meet prioritized needs of general interest. This scenario must not include wasteful or unnecessary expenditures, also considering that the debt must be paid in subsequent years, bearing the corresponding financial cost (Articles 64 and 76, LOP).

Therefore, an excessive deficit negatively affects the financial balance outlined in the law, which is also unsustainable over time.

### **4. Coordination between Planning and Budgets**

According to the Constitution, the annual budget must be passed “in accordance to the planned economic policy and operational plans approved by the Government.” (Article 362). Furthermore, the LOP provides that the “budget will be based on the National Development Plan, the Medium-Term Financial Program and Multi-Year Budget, the Macroeconomic Framework, and the Annual Work Plans and Budgets,” all of which “should be

consistent, reflecting the priorities and goals of the Government... ” (Article 9).

Thus, budgets must be tools for the implementation of public policy, reflecting public priorities and goals in terms of promoting development and the timely, efficient, and effective fulfillment of public or collective needs for public service (health, education, infrastructure, public safety, etc.). The allocation of budgetary resources considering the resources available, as well as the actual implementation of expenditures should address these issues, allowing for an objective assessment of compliance with program goals (Articles 45, 46, and 61; LOP).

The LOP also provides for the multiannual implementation of the public investment program, to be updated annually, “with a timeframe consistent with the Medium Term Financial Program,” which “will consist of a set of sectoral and institutional programs and projects proposed by public agencies, previously assessing their economic and social feasibility, and the allocation of resources according to their timeframe for implementation.” In addition, this program must “meet the policy guidelines of the Government under the National Development Plan, regarding the definition of key sectors and areas and the criteria for the allocation of financial resources.” (Article 56) At the same time, the annual public

investment program (the essential tool for the drafting of budgets) will include the programs and projects of the multiannual program “that public institutions have included in their annual work plans and their budget bills, in the framework of the guidelines for the drafting, approval, and scheduling for budget implementation.” (Article 57).

The drafting and approval of annual budgets must then meet these criteria and should not be made as a result of improvisations or decisions that overlook officially approved policies.

The Ministries of Finance and Planning, as well as other Ministries, starting from the guidelines set forth by the President, must be in charge of coordinating these efforts.

## **5. Budget Unity**

Linked to universality, the principle of unity implies that all public revenues must be included in a single budget, which must be evenly allocated for the financing of all public spending. This must be a key feature of the General Budget of Revenues and Expenditures (Article 10, LOP), as a tool for the efficient use of public revenues and expenditures as part of the State’s economic policy.

The mistaken practice carried out by the Ministries and other administrative units in charge of making purchases to assume that they can manage “their” budget at their discretion has persisted, usually going beyond the appropriations approved by Congress.

## **6. Single Till Principle**

Having a single till system means that all incomes must be deposited in a single fund, where funds are distributed to meet public expenditures.

In this regard, the Constitution states that “all ordinary tax revenues will be deposited in a single fund” (Article 363). On the other hand, extraordinary tax revenues (such as loans) may be handled in separate accounts, as long as they are allocated for a particular purpose.

This principle is linked to the Treasury’s single account system, which exists at the Central Bank, and is mentioned in Articles 83 and 84 of the LOP. It is a duty of the General Treasury Bureau “the management of financial resources, including their collection and administration as well as their distribution for the payment of financial obligations, in order to meet program goals.” (Article 83, LOP).

The General Treasury operates as the State’s savings bank, concentrating the collection of revenues, as well as the estimated and authorized payments, in accordance with efficient and timely budgetary procedures (Article 84, LOP).

The misuse of special mechanisms, such as the opening of “special accounts” in the Central Bank “for the fulfillment of particular tasks or obligations,” which still are handled by the General Treasury Bureau (Article 84, LOP) can lead to the distortion of budgetary procedures and the ensuing loss of control of expenditures, especially if the government operates with a broad discretion in the management of payments.

## **7. Lack of Specific Allocation of Resources**

Closely tied to the single till principle, this concept implies that all public revenues should be indistinctively used to finance public spending. The Constitution provides that “No income can be created if intended for a specific purpose.” (Article 363) Although some exceptions can be made, including the possibility of allocating certain incomes for public debt service (Article 363).

## **8. Specialization**

The budget approval process by Congress authorizes the Executive to include expenditures

for a given amount, with a particular purpose and for a specified period of time, without exceeding those limits. Thus, all resources allocated in the budget to address a specific need or goal must be invested for this purpose (except in the cases of authorized amendments). Likewise, expenditures can only be made by the amount established for each purpose and within the timeframe for which they have been authorized (budget implementation allotments within the fiscal year). Regarding this issue, the Constitution states that: “No commitments or payments can be made if they have not been properly appropriated in the Budget, or in contravention of budget regulations. Such offenders will be subject to civil, criminal, and administrative liabilities.” (Article 364).

In addition, providing more details regarding the Constitutional provision mentioned above, the LOP (Article 34) states that:

“Funds for expenditures are exclusively due for the purposes for which they were allocated in the Budget or the amendments approved under this Law. It is not possible to make expenditures for an amount greater than the total funds authorized or to exceed the balance of pending payments. Those actions that conflict with the provisions herein will be null and void, without prejudice to any administrative, civil, or criminal liability.”

Therefore, the implementation of this principle, which is of crucial importance in Honduran budget law, should avoid the inclusion of expenditure appropriations beyond the authorized limits (expenditures without budgetary allocation), which is an illegal and erroneous practice that brings about serious damage to public finances.

Regarding this issue, the Constitution also provides that these are financial obligations of the State: “1. The debts legally contracted for current expenditures or investment, originated in the implementation of the General Budget of Revenues and Expenditures; and 2. Other debts legally recognized by the State.” (Article 353) The latter includes, for instance, those derived from standing judicial rulings requiring to pay damages to third parties, which must be included in the budget for payment. Thus, other commitments or contracted debts beyond the provisions of Articles 364 of the Constitution and Article 34 of the LOP must be considered absolutely null and void by law (Article 34, LOP). Therefore, these debts may not be considered “legally contracted” or “legally recognized,” on the other hand, such commitments or expenditures without legal backing must be a cause for administrative, civil, or criminal liability by the public officials involved.

## **9. Non-Binding Connotation of Budget Expenditures**

Finally, budgeted expenditures are not compulsory, as long as they are required by the public needs to be fulfilled (Article 34, Last Paragraph, LOP). Consequently, it is not about to spend for the sake of spending, as it is the prevalent practice of public management in Honduras.

## **III. The Budget Process: Calculation of Incomes and Allocation of Expenditures**

### **1. Brief Description of the Budget Process**

The budget process is defined as the set of required procedures or activities for the formulation of budget bills, as well as for its approval, implementation, monitoring and evaluation, and the corresponding liquidation at the end of the fiscal year.

This is also referred to in Article 368 of the Constitution and more details are provided in Articles 18 to 46 of the LOP.

The Executive and Congress actively interact during this process. The former is responsible for the drafting of the budget bill, the budget implementation once it is passed, its monitoring

and evaluation, and the drafting of reports for accountability for the corresponding liquidation at the end of the fiscal year. The latter is responsible for approving the budget and its amendments when the total amount of expenditures is modified or when it includes transfers between branches of government, as well as of the liquidation or final approval of public accounts, with the additional authority to control the State's financial management.

This process begins with the annual budget policy which is approved by the President in advance for the drafting of the corresponding budget bill. The general guidelines should be specifically set forth to lead the formulation of that bill, including "the objectives, goals, priorities, guidelines, and estimates of maximum amounts of global allocable funds, for each office or agency." (Article 18, LOP) Consequently, this process must be meticulous, thorough, and conducted with the proper coordination, starting from the policy goals defined by the President based on key national priorities.

### **2. Calculation of Incomes**

Evidently, public budgets should be drafted starting from objective technical assessments of the different funding sources and economic perspectives (for instance, growth, stagnation, or



recession cycles) and other circumstances that may influence income collection as well as their performance during the years preceding the current fiscal year. (Article 21, LOP).

The following are sources of funding for public finances: taxes (levies, fees, and contributions, which include fees and royalties), ordinary (leases) or extraordinary (realization of assets) proceeds from asset management, public credit operations (loans, bonds, or other internal debt operations), transfers from other public agencies, and donations and other incomes received for various purposes (such as tax penalties).

From these technical assessments, revenue estimates should be realistically projected throughout the fiscal year, with which it is expected to finance the estimated expenditures. If this is not done, there is a risk of drafting unbalanced or unrealistic budgets, which will result in financial imbalances during the implementation stage, with a likely increase in public debt. For that reason, the projected incomes resulting from the corresponding technical assessments should also be taken into account in the definition of budget policy which will lead the drafting of the budget bill.

Likewise, once the budget is passed and the collection of revenues is lower than the amount

originally estimated, resulting in a shortage of projected expenditures, the President (through a Executive Decree approved by the Council of Ministers) is authorized to cut or freeze the budget appropriations to the appropriate governmental institutions or agencies (Article 39, LOP), in order to restore fiscal discipline.

In conclusion, the budgetary resources are calculated until they are actually collected by the General Treasury Bureau (Article 30, LOP). An appropriate procedure of monitoring and evaluation of budget implementation should take into account the variables that can alter the collection of incomes to make the appropriate and necessary adjustments, preferably through the reduction of non indispensable expenditures.

### **3. Allocation of Expenditures**

Unlike the calculation of revenue estimates, which is the exclusive responsibility of the Ministry of Finance, the estimation of projected expenditures corresponds to the remaining Ministries, according to their area of competence (Executive Branch). To this end, these administrative units should consider “the development plans and policies” of their competence and the annual budget policy guidelines approved by the President. Using these as a starting point, they draft a proposal of budget priorities and programs and activities to

be implemented in the new fiscal year, including programmed investment (Article 21, LOP). The expenditure bills will be a starting point for the drafting of a Bill of the General Budget of Revenues and Expenditures by the Ministry of Finance, including “the necessary amendments” (Article 23, LOP), based on the projected revenues and official priorities.

According to the General Law of Public Administration, the budget bill drafted by the Ministry of Finance must be approved by the President in a Council of Ministers meeting (Article 22, Paragraph 4), prior to its submission to Congress for its ensuing discussion and approval. It is understood that, at this early stage, the Ministers may be able to provide recommendations for possible consideration and inclusion in the budget bill.

Once the budget bill is submitted to Congress, the Ministry of Finance will be, for all purposes, the institution through which the Executive will be in contact with Congress, so that “only through it, it may be possible to increase or decrease the budget allocations under the proposed budget bill or the inclusion of new expenditures.” (Article 26, LOP).

Obviously, such mandate of the Law aims to maintain the required balance between revenues

and expenditures, according to the estimated figures. However, in practice, that does not always occur. For instance, it is well known that the Ministers and other officials authorized to make expenditures, often with aspirations to run for public office, directly request to Congress (bypassing the Ministry of Finance) increases in their corresponding allocations, even after the budget bill has been approved by the President in the Council of Ministers. As long as these distortions in the allocation of expenditures still exist, such practices must be corrected, especially if they cause inconsistencies during the implementation stage.

The LOP also aims to maintain a balanced budget, as well as to avoid unnecessary, improvised, and out-of-budget spending. It actually provides that any increase in total spending as estimated in the budget bill submitted to Congress by the Executive will include its actual funding source, with the prior concurrence by the Ministry of Finance (Article 27). It also states that the amendments made by Congress to the budget bill may not include “public investment projects that have not completed the evaluation and approval procedures under the National Public Investment System.” (Article 27, Paragraph 1, LOP) However, these provisions are usually ignored, generating imbalances, improvisation, and other distortions in the allocation of expenditures.

Finally, another important feature is the quality of spending, to the extent that most public resources are allocated to finance current expenditures, often with little added value, in detriment of investment spending. If this trend continues as such, the national efforts for the promotion of development and collective welfare will have a limited impact. Therefore, the allocation of current expenditures (such as wages) must be driven by their productivity.

## **IV. Budget Amendments and Possible Distortions**

### **1. Budget Amendments**

Since the budget refers to a projected calculation of revenues and expenditures during a given fiscal year, it is understandable that there may be unforeseen circumstances throughout the implementation stage that warrant amendments to the original estimates.

According to the LOP, these amendments may involve the creation of new appropriations or a decrease, increase, or transfer of funding among the budget allocations originally voted by Congress (Article 35). In any case, the proposal to make any of these amendments must be made by the Executive (Article 27, Paragraph 2).

The approval of any amendments affecting the total amount of the originally approved budget and the amount of projected domestic borrowing is the sole responsibility of Congress, with the concurrence from the Ministry of Finance (Article 36, LOP). Evidently, the latter should take into account the macroeconomic impact of the projected debt and its effect on public finances. Likewise, it is the responsibility of Congress to authorize transfers of funding between the branches of government (Article 37, Paragraph 1, LOP).

If the total amount of the approved budget does not change, the President must authorize the transfers of funds between Ministries or between them and decentralized institutions (Article 37, Paragraph 2, LOP). The Ministers, on the other hand, can authorize transfers, within the responsibilities of their Ministry “between specific expenditure items or categories of the same program.” (Article 37, Paragraph 3, LOP).

As it has been stated previously, the creation of new spending allocations or the increase of existing ones will only be possible if there is a “specific” funding source, requiring the previous concurrence from the Ministry of Finance (Article 38, LOP). Nevertheless, this principle is not always observed, as stated in the “overdraft” that has been paradoxically provided for in Article 26 of the General Guidelines of the current budget (2012).

Furthermore, as noted above, budget amendments may also include cuts or “freeze” the allocations originally approved (Article 39, LOP).

Finally, it is worth to note the broad discretion for the inclusion of budget amendments beyond any reasonable limit, which also reveals the extensive discretion in the execution of public spending, regardless of the purposes originally intended for such spending. Actually, the General Guidelines of the 2012 Budget restrict “with the purpose of achieving a sound management” to a maximum of forty annual budget amendments per year for each implementation unit, “distributed in as many as ten amendments per quarter which may be made from the last two weeks of the fiscal year’s first quarter.” (Article 28) However, the effect of this rule may actually contradict the claimed “sound management,” since these extraordinary amendments should only proceed when they are fully justified and must also comply with the corresponding legal guidelines and existing control processes.

## **2. Possible Distortions**

Increased spending via budget amendments, often financed with public debt, or cuts in budget allocations to transfer funds for other programs, while overlooking other public needs originally prioritized may be caused by irregular or unusual

practices such as the following:

### **a) Abuse in the concession of direct contracts, avoiding tender procedures.**

The first general rule in public contracting is to open a public or private tender, according to the amount of the expense or other particular circumstances (Article 360, Constitution; Articles 38, 59, and 60, LCE). These procedures require the participation of qualified bidders and contracts should be awarded in a competitive process, which should ensure that the best conditions for awarding contracts are fulfilled. For that reason, the winning bid should be the one that meets all requirements for participation, the most convenient offer, the lowest priced, or the one that meets other qualifications included in the tender specifications (such as delivery time, availability of spare parts when required, and flexible financing terms) (Articles 51 and 52, LCE).

As an exception to that rule, the LCE allows the possibility to grant direct contracts for public works, goods, or services when they are appropriate to address, in an immediate and urgent manner, the needs resulting from an emergency situation, which must be approved by a Presidential Decree in a Council of Ministers meeting (Articles 9 and 63, Paragraph 1, LCE; Article 7, Paragraph g, RLCE). The circumstances that must support such

declaration are set out in Article 9 of the LCE and they must be fully accredited, including the causes why direct contracts are required (natural disasters, epidemics, public calamity, national security issues, a state of emergency, or “other extraordinary circumstances that will particularly impede the timely and efficient delivery of public services.”)

To verify its legality and suitability, direct contracting (understood as an extraordinary practice) is subject to the following controls: a) subsequent approval of contracts through a Presidential Decree and the appropriate Ministry, b) if a state of emergency has been declared, the official statement must be submitted to the Superior Accounting Tribunal within ten working days (Article 9, LCE).

For this reason, both the President and the Superior Accounting Tribunal will ensure that there are no fraudulent or improper practices within their respective competencies, which may include, for example:

a) Verification of the circumstances that determined the declaration of state of emergency to prevent abuses with the sole purpose of avoiding controls through bidding processes;

b) Prior qualification of selected contractors which will be required to provide evidence of their economic and financial reliability, their technical and professional expertise, and the absence of obstacles to sign contracts with the State, in accordance with Articles 15 and 16 of the LCE;

c) Certification of the price of goods or services to be provided, to prevent unfair prices or poor quality;

d) Verification of the link between the declaration of state of emergency and the awarding of contracts, to make sure that there is not a large time lag between them. Regarding these situations, it will be important the timely intervention of the internal audit procedures.

Special consideration must be taken to avoid the confusion between “emergency” and “urgency.” The latter, unlike the actual emergency, is determined by unforeseen circumstances from which there may be needs “whose fulfillment has not been planned in advance, requiring prompt and efficient action to maintain an effective delivery of services,” authorizing private bidding as the proper procurement practice (Article 60, Paragraph 2, LCE).

Evidently, the lack of precision in determining the relevance of emergency states or controls required by law may bring about the awarding of unnecessary contracts, which may also be disproportionate, overpriced, or without the required quality controls, all in detriment of public finances.

**b) Awarding contracts to companies or providers that do not properly certify their economic and financial reliability and their technical and professional expertise.**

According to Article 15 of the LCE, to be able to sign public contracts, individuals or institutions (either domestic or foreign) must demonstrate their full legal, economic, and financial standing and their technical and professional competence, avoiding to be engaged in conflicts of interest.

These qualifications must be verified in the prequalification stage of contractors for public works (Articles 43-45, LCE; Articles 87-97, RLCE), during the examination of the requirements for registration in the Records of Suppliers and Contractors or their subsequent updates, according to the requirements and specifications for each tender (Articles 60, Paragraph d; Articles 66, 67 and 160, RLCE). Since this is a general requirement to sign contracts with the government (Article 15,

LCE), similar qualifications must be required for direct contracts.

The lack or poor accreditation of such requirements by any bidder should justify its exclusion from prequalification or registration in the Record of Suppliers and Contractors mentioned above. Therefore, these bids should not be considered for being awarded a contract, although they may offer the lowest price (Article 51, LCE; Article 131, Paragraph f, RLCE).

The lack of willingness to comply with these provisions may lead to public works contracts with insolvent or inexperienced companies, with the frequent result of implementation delays or other problems, which are often associated with requests for renegotiation of contracts, cost amendments, or even the awarding of new contracts due to abandonment of projects, increasing the budgeted expenditures in any of these cases. It can also lead to the delivery of goods of poor quality or delays, which may also increase expenditures, to the extent that the government would have to make urgent purchases to address unmet needs during periods of delay of contracted purchases.

**c) Awarding contracts without the required budget allocation.**

According to the LCE, the administrative authorities

are not allowed to grant contracts to individuals without a previous “budget estimate” or an “approved expenditure budget,” which must be included in the respective contract files (Articles 23 and 27).

Since this is an essential requirement, consistent with the provisions of Article 364 of the Constitution and Article 34 of the LOP, the contracts without a budget allocation are annulled, resulting in their early termination, and administrative, civil, or criminal liabilities for the officials involved (Article 27, LCE).

However, “a procurement process may begin before the expenditure allocation is approved but the contract may not be signed without fulfilling this requirement, all of which will be done with the prior knowledge of all parties.” (Article 23, LCE).

Despite the clarity of these provisions, sometimes public officials grant contracts for works, goods, or services without a budgetary allocation, which compels them to demand unlawful budget amendments to meet the committed expenditures, all in flagrant violation of the law without being subject to penalties. Obviously, this illegal practice causes budget inconsistencies, with a frequent and irregular growth of expenditures.

**d) Contracting public works with bidders with the lowest prices but inconsistent unit prices.**

Tenders for public works usually require the presentation of offers with detailed unit prices according to the work units provided in the tender specifications (table of unit prices per work unit), so that the sum of the latter matches the total offered price.

If there are no adequate controls, there can be “price imbalances,” allowing the contractors to bill most of the total price in the initial stages of the work, thereby leaving insufficient funds for the intermediate or final stages, with the ensuing effect of demanding the revision of final prices and an increase of the contract’s total amount. Evidently, such practices generate imbalanced budgets and the ensuing increase in expenditures.

To prevent this fraudulent practice, the evaluation of bids must be carefully done “to verify that the unit prices, if so required, correspond to market-value prices, avoiding the imbalance of such prices due to their speculative decrease or increase” (Article 135, LCE). If this is the case, the tender specifications may provide the inadmissibility of any offers, after the necessary revisions are completed (Article 135, RLCE).

**e) Contracting works from bidders offering abnormally low prices.**

To make sure that they get awarded a contract, bidders may offer unusually low prices, with the purpose of demanding price reviews afterwards when the contract has already been granted, causing similar effects to those listed in the previous paragraph (unbalanced budgets and increasing expenditures beyond what was originally planned).

This flawed practice results from the breach of Article 51 of the LCE, which states that “if the prices submitted in a bid are normally (sic) lower in comparison with other bids or the estimated budget, additional information will be requested from the bidder to ensure that it can successfully fulfill the contract and other investigations will be carried out as required.” In these cases, a performance bond of up to 30% (twice the normal requirement) of the total amount will be requested or the bid will be rejected if “it cannot be properly fulfilled or is speculative.”

**f) Irregular or unjustified contract amendments.**

The deficient implementation of public works, disregarding key responsibilities from contractors,

may lead to irregular or unjustified contract amendments, which will also increase budgeted expenditures. These issues are often linked to poor or inadequate supervision.

According to the RLCE, amendments to these contracts may be made “as a result of new requirements or unforeseen technical reasons at the time of the design or the procurement of the works. These circumstances must be duly included in the contract file, always considering the public interest and subject to the concurrence of an appointed supervisor” (Article 203).

In addition, these amendments may not be related to “a different purpose or goal than the one originally stated,” and its total value may not exceed 25% of the contract’s original amount, unless the amendments are approved by Congress (Article 123, LCE).

**g) Other financial commitments without the required budget allocations.**

As it has been pointed out, Article 364 of the Constitution prohibits to make expenditures or payments “not included in the appropriations voted in the budget or in violation of budget regulations.” The committed expenditures that do not meet this essential requirement will be



voided, “without disregarding the corresponding administrative, civil, or criminal liabilities” (Article 34, LOP).

However, in clear violation of this principle, financial commitments are sometimes made without the proper budget allocation, including the irregular hiring of public officials, especially in the education and health sectors, or the irregular procurement of goods or services, causing further social demands from key stakeholders (such as teachers or workers unions) to pass additional budget amendments, increasing the budget items beyond their limit.

#### **h) Exaggerated increases of unnecessary or unjustified expenditures.**

An example of this item is the deceptive institutional advertising campaigns paid for by public institutions in order to promote the electoral aspirations of certain officials, in violation of Article 7, Paragraph 6 of the Code of Ethical Conduct for Public Officials (Decree No. 36-200 from April 24, 2007).

This regulation points out that public ethics are breached when the use of “institutional advertising or general public resources for the personal promotion of the name, image, or personality of

any public servant, whatever their rank or duties may be, or third parties running for office by popular election, although they may not be public officials at the time.”

#### **i) Distortions in the public labor system.**

Labor relations within the Executive branch are regulated by the Civil Service Law (Decree No. 126 from October 28, 1967 and its subsequent amendments) and its bylaws (Decree A-18-2009 from August 17, 2009).

However, the provisions on the access to public service through competitions, tenure, performance evaluations, and promotions based on merit, are not properly implemented, generating various distortions in the public labor system.

Furthermore, there is no appropriate legislation on wages and coherent policies in this area. For instance, different sectors have their own pay schemes, including “bonuses” and collateral benefits.

Under these circumstances, the expenditures to address these items become unpredictable due to the constant demands by public employee’s and professional unions, triggering numerous budget amendments throughout the fiscal year.

Occasionally, the State approves wage increases to be implemented in forthcoming fiscal years, without taking into account its actual funding possibilities which do not encourage improvements in public services.

**j) Payment of financial obligations derived from judicial rulings.**

The public administration is often ordered by the courts to pay compensations to third parties for dishonest or illegal practices (such as unjustified dismissals of public officials). In other cases, rulings may be associated with deficient legal criteria due to poor interpretation or application of legal regulations, or poor procedural practices for the defense of public interests.

In addition, regulatory gaps, such as the lack of legislation to regulate and control the regime of liabilities for public officials, can lead to judicial rulings detrimental to the public finances by speculative and unjustified claims.

According to these circumstances, there is also a need to promote budget amendments to meet debt payments.

The inadequate administrative or judicial practices and regulatory gaps must be corrected under the

rule of law, to reduce their negative impact on public finances.

**V. Categorization of Payments and Deficient Control**

The LOP has decentralized budget implementation to the Ministries and other institutions responsible for the execution of various programs and projects, granting responsibility of expenditures to the relevant Management Units (Article 87).

In accordance to previous regulations (the 1974 Organic Budget Law), the duties of control or pre-intervention of expenditures were carried out by the General Budget Bureau during at least three important stages of the budget process: (i) approval of the “budget reserve” as a requirement to commit expenditures by the implementation units; (ii) registration of public contracts and other financial obligations once they have been completed; (iii) subsequent authorization of expenditures, after the relevant operations have been verified, allowing the “issuance” of the corresponding payment orders. However, these mechanisms of control have delayed the execution of expenditures, with negative consequences on the efficiency and effectiveness of public management.

By decentralizing the execution of expenditures, the LOP currently in effect eliminated the centralized controls to grant them to the implementation units. Starting from that point, the execution of expenditures operates in base of “payment fees,” usually allocated on a quarterly basis, for the purposes of the relevant expenditures, in accordance to the revenues that enter a Single Account of the General Treasury Bureau (Article 83, LOP). Thus, it is possible to directly commit expenditures (for instance, through the signing a contract) and “deducting the amount from the available credit,” so that when the expenditures are disbursed (through the implementation of public works, provision of services, or delivery of goods), the payment will be authorized by the Management Office and be effectively issued by the General Treasury Bureau (Articles 32, 83, and 87; LOP).

Evidently, the current system tends to achieve greater efficiency. Nevertheless, it has gaps that can cause distortions with negative effects on spending, including: (i) poor internal controls, which are necessary to verify the legality or suitability of budget operations; (ii) granting the duties of signing payment orders to the Administrative Managers of each institution (Article 87, LOP), ignoring the senior authorities who may order or authorize expenditure commitments, such as the Ministers.

## **VI. Control of Budget Implementation**

The law provides for two levels of control for budget implementation: the internal control, within the administrative organization of the institution itself; and external control by the Superior Accounting Tribunal. Furthermore, there are additional administrative control procedures implemented in certain cases by the Ministry of Finance through the General Treasury Bureau (Articles 45-46, 95-98; LOP) and legislative control, including several responsibilities by Congress (Articles 38 and 205, Paragraphs 20-22, Constitution; Articles 44 and 100, LOP). The following paragraphs briefly review these items.

### **1. Internal Control**

Internal budget control consists of “instruments of control prior, during, and after which are included into the organization, regulations, and procedures of public sector institutions and their internal audit mechanisms, in regard to the operation of financial management subsystems as a whole...” (Article 115, LOP). Obviously, internal audit is of key importance for internal control and includes other mechanisms integrated into the management framework and procedures, so that it allows a more adequate supervision of financial operations, through previous, concurrent, or subsequent

interventions. Therefore, it can prevent or correct irregular practices.

In this context, according to the Organic Law of the Superior Accounting Tribunal (Decree 10-2002-E from December 5, 2002), internal control has the following goals: (i) ensure “the effectiveness, efficiency, and economy in operations and quality of services;” (ii) protect “public resources against any loss, waste, abuse, irregularities, or illegal acts;” (iii) comply “with the laws, regulations, and other government rules;” (iv) generate “valid and reliable financial information, presented with accuracy.” (Article 46).

Furthermore, according to the LOP (Article 116), these are also goals of internal control: (i) ensure “the quality of institutional services;” (ii) improve “the decision-making capacities and initiative in those responsible for institutional management;” (iii) preserve and protect “public assets in an efficient and effective manner;” (iv) promote that “the information generated and disseminated is timely and reliable;” and (v) ensure that the “operations are conducted in strict compliance with the existing laws and regulations.”

The design and implementation of internal control tools should also follow these basic principles: (i) inclusion of recurring statistical safeguards and controls to the automated systems for financial

management; (ii) linking public accounting procedures with the budgetary and financial transactions in real-time; and (iii) development of subsequent control mechanisms with independent auditing techniques implemented by the relevant internal audit units, by other institutions, or private firms hired for this purpose (Article 118, Paragraphs 2, 3, and 4; LOP).

Accordingly, the application of prior checks will be the “unquestionable responsibility” of each implementation unit. Therefore, the preventive oversight carried out by the Ministry of Finance could be discretionary, and may only be applied “after verification from the internal or external audit units regarding the mismanagement of prior checks by the officials in charge of the implementation units.” (Article 118, Paragraph 1, LOP).

On the other hand, the design and implementation of internal control tools falls under the duties of the Ministry of Finance, as the governing body of public financial management, which in any case are complementary to the general guidelines issued by the Superior Accounting Tribunal (Article 118, LOP).

If throughout the performance of their duties, the internal audit units discover facts that may bring about administrative liabilities, they will be

required to inform the head of the corresponding agency or institution to adopt the appropriate remedial measures, being also responsible to follow up such measures. If these recommendations are not implemented, the internal control units must submit a report to the Superior Accounting Tribunal which must undertake the appropriate actions (Article 50, LTSC; Article 119, LOP).

However, if there is evidence of civil or criminal liability, the internal audit unit must inform the Superior Accounting Tribunal which, in turn, must give notice to the Attorney General's Office to undertake any proper civil actions or to the Public Ministry to carry on with criminal proceedings, as appropriate (Article 50, LOTSC).

At the same time, the breach of such duties or failure to follow up the actions taken "implies responsibility (by the internal auditor or any other staff) by the alleged perpetrators." (Article 119, LOP).

In any case, the internal audits should verify the implementation of applicable preventive controls and must take the required measures "to prevent the occurrence of the detected illegal act." (Article 51, LOTSC).

As stated above, the timely intervention of internal audit units or the effective implementation of

other internal control tools should allow for the prevention or correction of improper or illegal practices, including those specified in Section IV of this report. This must be the basis for the timely introduction of administrative, civil, or criminal liabilities. In contrast, the lack of will for the implementation of internal audit procedures and other control mechanisms interferes with the execution of expenditures, with the ensuing negative consequences for public finances.

Finally, starting with the implementation of the LTSC, the Executive branch, the decentralized institutions, and other public agencies are in charge of appointing the internal auditors and supporting staff (Article 106). However, the mechanisms employed for their appointment and their hierarchical relationship with the heads of each institution do not guarantee their independence and objectivity in the performance of their duties. This issue may be resolved by the creation of an independent public auditing agency, directly attached to the Office of the Presidency and tasked to appoint internal auditors and other supporting staff. The National Office for the Integral Development of Internal Control of Public Institutions (ONADICI), created by the Executive Decree PCM-26-2007 of September 6, 2007 could be reoriented to fulfill these duties. To do so, it is required to redefine its legal framework and its main goals.

## 2. External Control

As it has been pointed out above, external control falls under the duties of the Superior Accounting Tribunal which must verify compliance with the principles of legality, efficiency, effectiveness, economy, equity, and accuracy (Article 36, LOTSC) in the economic and financial management of public institutions.

Specifically, this control system comprises the following: (i) financial control, including verification of proper collection of revenues and the implementation of current expenditures and investment, according to the principles of legality and accuracy (Articles 38 and 41, LOTSC); (ii) control of management and results, involving the subsequent verification of the efficient and effective use of public resources to ensure the timely compliance with the goals with which the expenditures were originally approved, evaluating their results and administrative capacity to “prevent, identify, and verify mismanagement of public resources” (Articles 38 and 42, LOTSC); (iii) control of public probity and ethics, to prevent and combat illicit enrichment by public officials (Articles 38, 53, and others; LTSC); and (iv) control of public assets, including supervision and monitoring of the proper management of public assets (Articles 38 and 74, LOTSC).

To perform its duties, the Superior Accounting Tribunal may follow these actions according to the law: (i) conduct administrative proceedings or special investigations to determine liabilities in specific cases (Articles 82-84, LOTSC); (ii) in a more frequent manner, carry out regular audits to evaluate the actions of officials during particular timeframes and may include in such cases, the control of finances, management, or monitoring results and assets (Articles 43-45, 74, 85, and others; LOTSC); (iii) perform special investigations from the affidavit of assets of public officials, exercising control of public probity and ethics (Articles 54, 56, and others; LOTSC).

As a result of its audits, the objections raised by the Superior Accounting Tribunal will result in the introduction of the corresponding administrative or civil liabilities, once they have been confirmed and the objections raised by the alleged perpetrators are resolved (Articles 94-95, 100-102; LOTSC). In any case, if there is evidence of criminal liability, the required report must be submitted to the Public Ministry to proceed through the appropriate channels (Articles 61-62, RLTC).

The Superior Accounting Tribunal usually intervenes after the acts have been carried out, but it also has the authority to hold concurrent audits or special investigations, as well as visits

or inspections (Article 44, LOTSC), after receiving complaints from official sources or third parties (Articles 69-72, LOTSC). This way, irregular situations that are currently taking place can be confirmed at the time of the audit, being of the utmost importance for the timely prevention or correction for sound financial management.

Finally, the Superior Accounting Tribunal must work in accordance with internal audits and other control procedures (Articles 40, 50, and 106, Paragraph 2; LOTSC).

### **3. Administrative Control**

The Ministry of Finance, through the General Budget Bureau, is authorized to assess the implementation of the General Budget of Revenues and Expenditures and the budgets of decentralized institutions, both during and after the end of the fiscal year, based on the reports issued by the implementation units and submitting the results to the President for information and evaluation at the meetings of the Council of Ministers (Articles 45 and 46, LOP).

As stated above, in particular cases, the General Budget Bureau may also carry out preventive actions to monitor budget implementation when the existing control mechanisms are not properly implemented, as confirmed by the internal or

external audit procedures (Article 118, Paragraph 1, LOP).

It is also the responsibility of the Ministry of Finance the development of a public accounting system, which records the economic, financial, and assets-related operations, providing the financial and accounting reports or other required information which should ease the implementation of measures of control and internal and external audit (Articles 95-97, LOP). In addition, each implementation unit must keep track, when applicable, of the budget implementation records, taking into account the provisions issued by the Ministry of Finance (Article 98, LOP).

### **4. Legislative Control**

In addition to passing the annual budget, after receiving the required reports from the Superior Accounting Tribunal, Congress is also authorized to approve or reject the clearance of public accounts submitted by the Executive at the end of the fiscal year (Article 205, Paragraph 38, Constitution; Articles 44 and 100, LOP). Furthermore, Congress has the authority to approve the administrative performance of the Executive and other public institutions, as well as to appoint special committees to investigate issues of national interest and to question the Ministers or other officials (including the Minister of Finance) on matters relating to

public administration (Article 205, Paragraphs 20, 21, and 23; Constitution).

## **VII. Accountability by Public Officials**

Failure to comply with the rules on budget implementation or other applicable financial regulations in the public sector is subject to administrative, civil, or criminal liability, according to the circumstances of each case.

As stated above, the general principle that regulates this subject is set forth in Article 364 of the Constitution: “No commitments or payments can be made if they have not been properly appropriated in the Budget, or in contravention of budget regulations. Such offenders will be subject to civil, criminal, and administrative liabilities,” and in Article 34 of the LOP: “No expenditures will be contracted for an amount greater than the total funds authorized or exceeding the balance of pending payments. The actions that conflict with the provisions herein will be null and void, without prejudice to any administrative, civil, or criminal liability.”

In addition, Article 121 of the LOP also provides: “No public official or employee under any circumstance through willful misconduct, fault, or negligence may adopt resolutions or commit acts in violation

of the provisions of this Law. Such offenders will be subject to the corresponding civil, criminal, and administrative liabilities.”

In view of that, the LOP states (Article 122) that the following must be regarded as violations:

- Embezzlement in the management of public funds;
- Management of public resources or other assets without being subject to the provisions regarding the clearance, collection, or credit to the General Treasury or other special collection units established under the law;
- Commitment of expenditures or order payments without having enough credit to fulfill them or breaching the provisions of this Law or the annual budget;
- Allowing improper payments during the clearance process or during the issuance of public documents, according to the tasks entrusted to the official;
- Lack of justification for the investment of allocated funds; and
- The commission of any other act or resolution that contravenes the LOP or its bylaws.



According to the cited Article 112 of the LOP, any previous offenses related to the duties of public officials supplement those defined in Article 100 of the LOTSC, which are the following:

- Do not appear before the formal appointments called for by the Superior Accounting Tribunal;
- Do not provide the information requested by the Tribunal or by internal audit units or lack of disclosure of such information in a timely or appropriate manner;
- Impede or prevent the proper implementation of the duties assigned to the staff of the Tribunal or the internal audit units;
- Do not pursue the timely implementation of actions to address the shortcomings identified by the Tribunal or by internal audit units;
- Facilitating or allowing, by act or omission, any actions which defrauds the agency or institution where they are employed;
- Make any commitments or obligations on behalf of the agency, institution, or organization in which they are employed that violate the law or are not subject to the binding opinions as provided in the law;
- Do not provide a refund of any public resources that have not been used for their authorized use;
- Authorization of expenditures exceeding the amounts provided for in the law or its regulations;
- Lack of organization of the accounting system, in accordance with the laws, regulations, and other applicable standards;
- Authorization of amendments of plans, programs, and provisions related to the implementation of contracts or the budget of the institution without having the required clearances;
- Lack of timely reporting of any amendments of the plans and programs for the execution of contracts, or their illegal, incorrect, or improper implementation;
- Mismanagement of public assets;
- Remove, conceal, or destroy public documents considered relevant;
- Any other offense under this Law (LOTSC).

In the cases described above, the Superior Accounting Tribunal, guaranteeing due process and “without prejudice to any administrative, civil, or criminal liability that may apply,” could impose fines on the public officials involved (from 2,000 Lempiras to 1,000,000 Lempiras, according to the significance of the offense), and may also be “reprimanded, suspended, or removed from office by the appointing authority at the request of the Tribunal” (Article 100, LOTSC). The payment of such fines may be enforced by the courts if requested by the Attorney General’s Office (Article 101, LOTSC). Similar administrative penalties will apply to the violations described under Article 122 of the LOP.

Criminal liability, however, will be determined if any of the violations listed above take place or with the commission of any of the criminal offenses defined under the Penal Code. For example, these may include fraud (Articles 240 and 242), abuse of authority and violation of the duties by public officials (Article 349), bribery (Article 361-363), embezzlement of public funds (Articles 370-373), and negotiations incompatible with the exercise of public duties (Articles 374 and 375). As it has been mentioned previously, if there is reasonable evidence of criminal liability, the appropriate report must be submitted from the internal audit units to the Superior Accounting Tribunal and the

Public Ministry which must proceed accordingly (Articles 61 and 62, RLTSC).

Finally, civil liability will be determined when there is loss or damage to public property as a result of a violation (Article 119, RLTSC). In these cases, after the rulings related to the ensuing challenges have been issued, the relevant reports must be submitted to the Attorney General’s Office which must proceed through the civil courts (Article 61, RLTSC).

## **VIII. Anti Corruption Measures and Access to Public Information**

Honduras is a party of the Inter-American Convention against Corruption (IACAC) and the United Nations Convention against Corruption (UNCAC).

According to the IACAC, besides active and passive bribery, are also considered “acts of corruption” any act or omission by a public official “in the discharge of his duties for the purpose of illicitly obtaining benefits for himself or for a third party.” (Article VI, Paragraph 1.c) For its prevention, among other measures, the States Parties agree to “create, maintain, and strengthen standards of conduct for the correct, honorable and proper fulfillment of public functions,” preventing conflicts of interest and ensuring “the proper conservation and use

of resources entrusted to government officials in the performance of their functions.” (Article III, Paragraph 1).

A similar commitment has been pledged in the UNCAC (Article 8, Paragraph 2). This Convention also includes a declaration from the State Parties to “take appropriate measures to promote transparency and accountability in the management of public finances. Such measures shall encompass, inter alia: (i) procedures for the adoption of the national budget; (ii) timely reporting on revenue and expenditure; (iii) a system of accounting and auditing standards and related oversight; (iv) effective and efficient systems of risk management and internal control; and (v) where appropriate, corrective action in the case of failure to comply with the requirements established in this paragraph.” (Article 9, Paragraph 2).

Furthermore, Honduras adopted the Code of Ethical Conduct for Public Officials (Decree No. 36-200 from April 24, 2007), under which public officials are bound to meet the following requirements: (i) the efficient and effective management of public resources; (ii) accountability for their acts and decisions, providing regular reports pursuant to procedures set forth by the Superior Accounting Tribunal or by each institution; (iii) refrain to take advantage of their office, power, authority, or influence to obtain benefits, or illegal or improper

advantage for themselves or for third parties; (iv) if needed, provide confidential reports to their supervisors or the proper authorities about acts that could cause damage to the State or that may be considered a crime, violation, or other offense against the law (Article 6, Paragraphs 9, 13, 17, and 19).

In addition, there are other acts which are considered “violations against public ethics,” such as the use of office to influence people for obtaining illegal benefits; improper use of public funds, goods, or services; and the use of institutional advertising or public resources for the personal promotion of any public official or third parties running for office (Article 7, Paragraphs 2, 3, and 6). Any public official who fails to comply with the provisions of this Code of Conduct will be subject to the applicable administrative, civil, or criminal liabilities (Article 27).

With these same goals and in agreement to Article 10 of UNCAC (specifically related to access to public information), the Law of Transparency and Access to Public Information was passed in 2006 (Decree No. 170-2006 from November 26, 2006).

According to this law, public institutions have “the obligation to routinely disclose and regularly update information of general interest through electronic or automated tools,” which may include:

(i) general policies, plans, programs and projects, reports, activities, financial statements, and quarterly liquidations by programs; (ii) budgets and quarterly and annual reports of budget implementation, including details of transfers, expenditures, physical and financial investments, debts and arrears; (iii) tendering and procurement documents, including files containing bid openings, awards, contract extensions, renewals, and statements of direct contracts and their results; (iv) final reports from interventions by the Superior Accounting Tribunal and its applicable rulings; (v) key statistics and information regarding the financial and macroeconomic situation of the State (Article 14, Paragraphs 3, 8, 9, 15, and 18). In addition to its disclosure through the appropriate outlets, this information must also be available to any individual or institution that may request it (Articles 14 and 15).

However, that law restricts the right of access to public information when it is regarded as “confidential” if “any damage that may occur is greater than the public interest of disclosing the information,” or where releasing public information may cause harm or prejudice to: (i) the national security of the State; (ii) the interests protected by the Constitution and the law; and (iii) the economic, financial, or monetary stability or national governance (Article 17). Nevertheless,

such exceptional measures “should be based on the existence of objective factors that demonstrate that access to information will likely cause specific damage, present and possible,” which should be proven by the institution involved (Article 25, Bylaws of the Law of Transparency and Access to Public Information). Therefore, this decision cannot be taken at the discretion of the authorities; in contrast, such decision must be fully certified and publicly disclosed.

In the circumstances explained above, it can hardly be claimed that the information on budget implementation jeopardizes public safety (except in some exceptional cases related to national security); the provisions of the Constitution or the law; or governance or the economic, financial, or monetary stability; especially if the implementation of public budgets is subject to the law in its broadest sense, including the constitutional and legal principles discussed earlier in this report. This must be done to ensure good governance and economic, financial, and monetary stability, which is precisely for the best interest of all citizens.

## **IX. Conclusions and Recommendations**

The analysis presented in this report leads to the following conclusions and recommendations:

1. In general terms, the current constitutional and legal framework in Honduras is suitable for efficient budget management. The observed gaps or inconsistencies are more related to an inadequate management or supervision rather than regulatory deficiencies, such as the performance of financial operations without budgetary support (procurement of works, purchase of goods or services, or hiring of public officials without the required budgetary allocations), excessive budget amendments or without following the proper transparency procedures, or the performance of other operations disregarding the appropriate processes (such as the abuse of direct contracts).
2. The timely and adequate application of Article 364 of the Constitution, Articles 34 and 121 of the Organic Budget Law, and Articles 23 and 27 of the State's Procurement Law, should avoid many of the irregular practices mentioned above. For instance, similar results would be accomplished by following the legal procedures for recruitment or dismissal of public officials and for public procurement (appropriate prequalification of bidders, competitive procedures and objective and transparent awarding to the bidder that meets the requirements and presents the best bid, disqualification of bidders with evidently low or speculative prices after they do not provide evidence of their actual implementation capacity, disqualification of bidders with "unbalanced" prices, verification of the legality and timeliness of emergency declarations, thorough and responsible supervision of the implementation of public works or the delivery of supplies to ensure quality and prevent irregular or unjustified amendments).
3. Furthermore, expenditure budgets must be the result of unbiased assessments of projected revenues, starting from statistical analysis of the different funding sources and the macroeconomic situation, as provided for in the regulatory framework. Likewise, they must respond to the spending and investment priorities previously and objectively defined by the government, according to public needs and avoiding unnecessary expenditures.
4. Moreover, the issuance of public debt must be exceptional and meet objective indicators to allow its sustainability, avoiding instability for subsequent fiscal years.
5. With the purpose of preventing possible distortions that may alter the balance between

projected revenues (including public credit operations) and planned expenditures, any increase or decrease in allocations or the inclusion of new expenditures must be done with the concurrence of the Ministry of Finance. As provided for in the law, no new expenditures may be approved if they do not have a funding source or if they just include an instruction for the Ministry of Finance to subsequently “identify the required funding,” which is not an efficient practice and is also a violation of the law (Articles 26 and 38, Organic Budget Law).

6. As provided in the Organic Budget Law, the decentralization of budget implementation simplifies the procedures and reassigns responsibility for the authorization of expenditures to the appropriate implementation units, allowing greater efficiency in public administration. However, there are deficiencies in internal control that must be corrected to ensure the legality and timeliness of financial operations.
7. The internal audit system should be strengthened, provide training for the staff and ensure its autonomy. The law has shown gaps in this area and it is recommended the creation, by law, of a technical governing agency under the Presidential Office, which

should appoint the staff of internal auditing units, issue technical standards, and monitor compliance of control measures. ONADICI may be considered a starting point for the creation of this agency.

8. The responsibility of expenditures should not be limited to the Administrative Managers of each agency, as they are in charge of signing payment orders, in accordance to the provisions of Article 87 of the Organic Budget Law. This duty should also include, after the appropriate legislative reforms are passed, the senior officials of every implementation unit.
9. An adequate internal control, including the timely and efficient intervention by the internal auditing units, is a key component to prevent or correct improper or illegal practices in the process of budget implementation. This procedure should detect administrative or civil liabilities or identify, where appropriate, any evidence of criminal liability to be submitted to the Public Ministry which should proceed as required.
10. Internal control tools should work in coordination with the interventions by the Superior Accounting Tribunal, as provided in the law. The simultaneous audits,

administrative proceedings, or special investigations and visits or inspections by this agency, in addition to the regular audits, should confirm the findings of the internal audits or the level of compliance with the control duties of such audits, determining if there are any liabilities by action or omission.

11. The quarterly monitoring and evaluation reports of budget implementation prepared by the Ministry of Finance and the control measures to be carried out by Congress, including the approval or rebuttal of budget reports at the end of each fiscal year, should encourage a sound financial management.
12. As it has been mentioned, failure to comply with the regulations on budget implementation or other financial norms, including commitments or payments beyond the approved allocations, must be a cause for administrative, civil, or criminal liability by the public officials involved as applicable. The lack of enforcement of punitive, administrative, or criminal penalties contributes to impunity and the recurrence of improper or illegal practices, thereby affecting public finances.
13. As an administrative activity, budget implementation is subject to the law and any action against it is illegal and must bring about liabilities, in accordance to the provisions of Article 321 of the Constitution. However, in practice, officials often act with broad discretion with expenditures, usually surpassing budget allocations, which imply a liability as set out above.
14. The general provisions of the current budget (2012) has limited to a maximum of forty the number of budget amendments per year for each implementation unit, "distributed in as many as ten amendments per quarter which may be made from the last two weeks of the fiscal year's first quarter." (Article 28) However, the result of this rule may actually contradict its original intent ("sound management") to the extent that such exceptional amendments should only be allowed when fully justified, following the required legal procedures and complying with the appropriate controls. The general provisions of the 2012 budget still involve a broad discretion to make amendments, as opposed to any reasonable policy.
15. Budget information must be available to the public, as provided in the Law of Transparency and Access to Public Information. Its handling

as confidential information, restricting access and retrieval from the public, is clearly unfounded and should definitely be revised.

16. Besides the sound implementation of existing laws, including the principle of budget balance or stability (the drafting, approval, and implementation of annual budgets should maintain a balance between revenues and expenditures), the legal framework regarding budgets should include the principle of financial sustainability (ability of the State to cover current and future commitments and expenditures within the previously defined limits on deficit and debt). Under that framework, for the formulation of fiscal policy to guide the drafting of budgets, the President through the Council of Ministers (after evaluating the corresponding economic and financial assessments and using as a reference the Gross Domestic Product data) must determine the goals for acquiring public debt and for budgetary stability for the upcoming fiscal year, according to the State's funding needs. Once the objectives described above have been approved, they will influence the drafting, approval, and implementation of the budget, subject to the corresponding evaluation and follow-up procedures.

17. Public spending must be managed responsibly and efficiently, to meet the proposed objectives.

18. Being a major component of public spending, salary adjustments or bonuses should be regulated by a special law, which is convenient to promote order and consistency, to avoid the current distortions and wage changes on a case-by-case basis.

19. It is also essential the passing of a law to regulate the civil liability of public officials, as well as the collective liability of public employees, according to the provisions of Article 327 of the Constitution. The lack of legislation to clarify this issue causes frequent judicial rulings against the State, forcing it to disburse significant severance payments, often without a valid argument, following purely speculative claims, or rejecting the principle of force majeure that may apply to claimants. Furthermore, the regulation of the collective liability of public officials and the repeal action that corresponds to the State when it is sentenced of negligent acts or omissions actually committed by those officials should definitely encourage efficiency and legal compliance.



20. This law should also consider: (i) the collective liability by internal auditors or supporting staff when they do not properly perform their control duties, including failure in making commitments or expenditures without a budget allocation or budget amendments without proper justification; (ii) the liability by officials who authorize to make commitments or order expenditures when they are not properly authorized to sign payment orders; (iii) liabilities by supervisors of public works when they negligently authorize irregular or unjustified contract amendments, increasing budgeted expenditures; (iv) liabilities by public officials who approve contracts or evaluate bids on public works which offer evidently “unbalanced” unit prices (including speculative increases in initial work units beyond market values and speculative decrease of such values in subsequent work units). In these cases, after proper verification, such tenders must be disqualified; (v) liabilities by those officials referred to in the preceding paragraph when they prequalify contractors who do not fulfill the appropriate requirements or when they overlook the provisions of the second paragraph of Article 51 of the State’s Procurement Law, regarding the assessment of incongruously low bids in comparison to other bids or the estimated budgets.
21. Without disregarding the convenience to pass a specific law regarding the issues discussed in the previous paragraph, they may be included in the Budget’s General Guidelines for the upcoming fiscal year.
22. Moreover, Article 26 of the Budget’s General Guidelines should be reformed to reaffirm the prohibition set out in Article 364 of the Constitution and Articles 34 and 121 of the Organic Budget Law regarding the illegality of commitments or payments beyond the appropriations included in the budget or in contravention to budget rules, with the ensuing liabilities for any wrongdoing (the actual wording of Article 26 mentioned above refers to the existence of expenditures without budgetary allocation that certain officials attempt to legalize afterwards). The existing Article 28 should also be reformed to regulate the grounds for the inclusion of budget amendments. Annual budgets must not provide for a specific number of budget amendments per year, which in fact allows for a broad discretionality in spending. Such amendments must be approved when they were justified on grounds of public interest, where legal procedures are faithfully respected and the required controls are accurately followed.

## Laws Consulted

1. **Constitution of the Republic of Honduras (1982).**
2. **Organic Budget Law.**
3. **Organic Law of the Superior Accounting Tribunal.**
4. **State's Procurement Law.**
5. **Transparency and Access to Public Information Law.**
6. **National Anticorruption Council Law.**
7. **Code of Ethical Conduct for Public Officials.**
8. **Civil Service Law.**
9. **Penal Code.**
10. **Inter-American Convention against Corruption**
11. **United Nations Convention against Corruption.**
12. **Budget's General Guidelines (2012).**
13. **Bylaws of the Organic Budget Law.**
14. **Bylaws of the Organic Law of the Superior Accounting Tribunal.**
15. **Bylaws of the State's Procurement Law.**
16. **Bylaws of the Transparency and Access to Public Information Law.**
17. **Decree TSC-082/2004 (Internal Control).**
18. **Executive Decree PCM-26-2007 (Creation of ONADICI).**
19. **Decree 1341/2008 (Technical Rules of the Budget Subsystem).**