

HONDURAS

SUPPORT FOR STRENGTHENED FISCAL MANAGEMENT

(HO-0208)

LOAN PROPOSAL

This document was prepared by the project team consisting of Susana Sitja Rubio (RE2/SC2), Project Team Leader; Stephen Doherty (RE2/SC2); Manuel Márquez Fariña (INT/ITD); Lorena Rodríguez Bu (COF/CHO); Javier Cayo and Maristella Aldana (LEG/OPR). Cristina Pando and Hilia Gensheimer (RE2/SC2) helped to produce this document.

CONTENTS

EXECUTIVE SUMMARY

I.	FRAME OF REFERENCE.....	1
A.	Macroeconomic environment.....	1
B.	Public financial management	2
1.	Institutional assessment of SEFIN	4
2.	Central Bank of Honduras	13
3.	Tracking of poverty reduction strategy indicators.....	13
C.	Related activities	14
D.	Coordination with other donors.....	16
E.	The Bank’s country and sector strategy	17
II.	THE PROGRAM	19
A.	Objective.....	19
B.	Program structure	19
1.	Strengthening of the Ministry of Finance (SEFIN) and Revenue Office (DEI)	19
2.	Strengthening of areas at the Central Bank of Honduras involved in compiling, storing, and analyzing economic statistics	25
3.	Support for an Integrated Poverty Reduction Tracking System.....	26
C.	Cost and financing	27
III.	PROGRAM IMPLEMENTATION	29
A.	Borrower and executing agency	29
B.	Execution and management.....	29
C.	Procurement	32
D.	Execution period and disbursement timetable.....	32
E.	Monitoring and Evaluation.....	33
IV.	VIABILITY AND RISKS.....	35
A.	Institutional viability	35
B.	Environmental and social impact	35
C.	Benefits.....	35
D.	Risks	36

ANNEXES

Annex I	Logical framework
Annex I	Procurement plan

BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

INFORMATION AVAILABLE IN THE RE2/SC2 TECHNICAL FILES

Preparation:

Country Financial Accountability Assessment, an IDB/World Bank joint issue paper.

Design of the Integrated Poverty Reduction Strategy Tracking System (SIERP), consultant's report, December 2002.

Preliminary draft of the Financial Management Act.

Executive Order 01875, Regulations implementing the Poverty Reduction Fund Act.

Consulting assignments to support 2003/2004 budget preparation; reports prepared by Belinda Perez and Marcos Makon for the program to strengthen the budget system.

Report on the Millennium Development Goals: Honduras 2003, United Nations System.

Terms of reference of the Project Preparation Facility: Support for preparation of the program to strengthen fiscal management.

Act establishing the Office of the Auditor General.

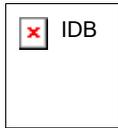
National Policy on Women, National Institute for Women's Affairs; Government of the Republic of Honduras.

Execution:

Operating Regulations for the program.

ABBREVIATIONS

AOP	Annual operating plan
BCH	Central Bank of Honduras
CAIPA	Central American Institute for Public Administration
CFAA	Country Financial Accountability Assessment
CGR	Contaduría General de la República [General Accounting Office]
CIAT	Centro Interamericano de Administraciones Tributarias [Inter-American Center of Tax Administrations]
CTA	Chief Technical Advisor
DEI	Dirección Ejecutiva de Ingresos [Revenue Office]
DFID	Department for International Development (United Kingdom)
DGCP	Office of Public Credit
DGP	Office of the Budget
GTZ	Gesellschaft für Technische Zusammenarbeit GmbH [German Agency for Technical Cooperation]
HIPC	Heavily Indebted Poor Countries
IFMS	Integrated Financial Management System
INAM	Instituto Nacional de la Mujer [National Institute for Women's Affairs]
INE	National Institute of Statistics
PMU	Project Management Unit
PPF	Project Preparation Facility
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSC	Poverty Reduction Support Credit
PRS-TAC	Poverty Reduction Strategy Technical Assistance Credit
SEFIN	Secretaría de Finanzas [Ministry of Finance]
SEN	Sistema de Estadísticas Nacionales [System of National Statistics]
SETCO	Secretaría Técnica y de Cooperación Internacional [Technical Secretariat for International Cooperation]
SIDA	Swedish International Development Agency
SIERP	Sistema de Información de la Estrategia de Reducción de la Pobreza [Integrated Poverty Reduction Tracking System]
SINACOIN	Sistema Nacional de Cooperación Internacional [National System for International Cooperation]
SISPU	Sistema de Inversiones Públicas [Public Investment Reporting System]
SNA 1993	1993 System of National Accounts
TGR	Tesorería General de la República [National Treasury of Honduras]
UNAT	Technical Support Unit of the Office of the President
UPEG	Management Planning and Evaluation Unit



Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit

Honduras

Tentative Lending Program

2004

Project Number	Project Name	IDB US\$ Millions	Status
HO0212	Poverty Reduction Sector Program	30.0	APPROVED
HO0219	Financial Sector Program	25.0	APPROVED
HO0208	Strengthening of Fiscal Management	15.0	
HO0202	Vocational and Technical Education Program	30.6	
HO0207	Improvement of the PPP Atlantic Corridor (Sections of the CA-5 Norte Highway)	50.0	
HO1001	Municipal Development Program Tegucigalpa II	22.5	
HO0197	Poverty Reduction Program focusing on Indigenous peoples and Afro descendants	10.0	
*HO0201	Privatization Four International Airport	22.0	
HO1002	Health Sector Strengthening	25.0	
HO0195	Sustainable Tourism National Program	35.0	
Total - A : 10 Projects		265.1	
HO0222	Social Protection Program	30.0	
HO0224	PPP Energy Sector Support	40.0	
HO0174	Sanitation and Water Investment Complem.	14.0	
HO1005	Rural Reactivation	30.0	
Total - B : 4 Projects		114.0	
TOTAL 2004 : 14 Projects		379.1	

2005

Project Number	Project Name	IDB US\$ Millions	Status
HO0223	Fiscal Reform	25.0	
HO0192	Credit Global Program	30.0	
RG0059	Etnoturísticos Mesoamericanos Fund Projects	30.0	
Total - A : 3 Projects		85.0	
TOTAL - 2005 : 3 Projects		85.0	
Total Private Sector 2004 - 2005		22.0	
Total Regular Program 2004 - 2005		442.1	

* Private Sector Project



HONDURAS

IDB LOANS

APPROVED AS OF FEBRUARY 29, 2004

	US\$Thousand	Percent
TOTAL APPROVED	2,517,406	
DISBURSED	2,031,103	80.68 %
UNDISBURSED BALANCE	486,303	19.31 %
CANCELATIONS	165,219	6.56 %
PRINCIPAL COLLECTED	729,768	28.98 %
APPROVED BY FUND		
ORDINARY CAPITAL	561,582	22.30 %
FUND FOR SPECIAL OPERATIONS	1,884,215	74.84 %
OTHER FUNDS	71,610	2.84 %
OUTSTANDING DEBT BALANCE	1,301,335	
ORDINARY CAPITAL	163,000	12.52 %
FUND FOR SPECIAL OPERATIONS	1,138,117	87.45 %
OTHER FUNDS	217	0.01 %
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	303,428	12.05 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	80,741	3.20 %
ENERGY	427,498	16.98 %
TRANSPORTATION AND COMMUNICATIONS	416,355	16.53 %
EDUCATION	74,209	2.94 %
HEALTH AND SANITATION	261,628	10.39 %
ENVIRONMENT	100,097	3.97 %
URBAN DEVELOPMENT	156,397	6.21 %
SOCIAL INVESTMENT AND MICROENTERPRISE	404,316	16.06 %
REFORM AND PUBLIC SECTOR MODERNIZATION	259,079	10.29 %
EXPORT FINANCING	6,908	0.27 %
PREINVESTMENT AND OTHER	26,750	1.06 %



HONDURAS

STATUS OF LOANS IN EXECUTION AS OF FEBRUARY 29, 2004

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
REGULAR PROGRAM				
Before 1998	5	63,960	52,236	81.67 %
1998 - 1999	6	183,616	93,979	51.18 %
2000 - 2001	16	265,422	88,880	33.49 %
2002 - 2003	12	149,600	3,376	2.26 %
2004	2	55,000	0	0.00 %
PRIVATE SECTOR				
2002 - 2003	1	13,700	0	0.00 %
TOTAL	42	\$731,298	\$238,471	32.61 %

* Net of cancellations. Excludes export financing loans.

SUPPORT FOR STRENGTHENED FISCAL MANAGEMENT

(HO-0208)

EXECUTIVE SUMMARY

Borrower:	Republic of Honduras	
Executing agency:	Ministry of Finance (SEFIN)	
Amount and source:	IDB (FSO):	US\$15 million
	Cofinancing (SIDA):	US\$3.2 million
	Local:	US\$150,000
	Total:	US\$18.35 million
Financial terms and conditions:	Amortization period:	40 years
	Grace period:	10 years
	Disbursement period:	5 years
	Interest rate:	1% per annum for 10 years, 2% thereafter
	Inspection and supervision:	1% per annum
	Credit fee:	0.5% on undisbursed balances
	Currency:	United States dollars or equivalent in convertible currencies, except Honduran
Objectives:	<p>The proposed program's general objective is to help Honduras better manage its government finances, so that the State can perform its function of providing citizens with fairly and efficiently funded services, thereby contributing to a stable macroeconomic environment conducive to economic and social development.</p> <p>The specific objectives are to contribute to: (i) more effective revenue collection and more efficient and effective expenditure; (ii) greater linkage between fiscal and monetary policy; and (iii) mechanisms that measure the impact of management on poverty reduction strategy (PRS) indicators. These specific objectives are geared to overall better management of public resources, better information for decision-making in their regard, and easier identification of actions to support PRS implementation.</p>	

Description:	The program has three components: (i) strengthening the Ministry of Finance (SEFIN) and Revenue Office (DEI); (ii) strengthening areas at the Central Bank of Honduras involved in compiling, storing, and analyzing economic statistics; and (iii) supporting implementation of the Integrated Poverty Reduction Tracking System (SIERP) at the Technical Support Unit (UNAT) of the Office of the President.
The Bank's country and sector strategy:	The Bank's strategy fits into the poverty reduction strategy and targets three areas: (i) increasing the competitiveness of productive activities; (ii) enhancing the development of human capital; and (iii) strengthening governance. The proposed program meshes with the Bank's strategy to strengthen governance in that it will enhance the financial management and tax administration system as a linchpin of greater efficiency, effectiveness, and transparency in government finances on both the revenue and expenditure side. Unlike prior efforts, this program proposes an integral approach with medium- and long-term solutions for problem areas at SEFIN and other agencies that supply information necessary for public resource management and implementation of the PRS, which is the cornerstone of the country's development.
Coordination with other official development agencies:	The IDB has coordinated closely with several other donors active in Honduras's government finance sector. Specifically, it has worked extensively with the World Bank on the Country Financial Accountability Assessment, leading to joint preparation of future operations in the sector and joint execution arrangements as part of a comprehensive program of government finance enhancements. The World Bank will take part in the program kickoff meeting and in monitoring and supervision missions. The Swedish International Development Agency (SIDA) has also played an important part in tax policy and management initiatives, in conjunction with the IDB. Up to now, these initiatives have been limited to the financing and execution of technical cooperation operations. For this operation SIDA will provide US\$3.2 million in cofinancing, to cover the local counterpart and bolster the revenues subcomponent. SIDA will take part in the program kickoff meeting and in monitoring and supervision missions (see paragraphs 1.48 to 1.53).
Environmental and social review:	Given the nature of the operation, the project team anticipates no direct environmental or social impact. The Committee on Environment and Social Impact (CESI) reviewed this document at its 21 November 2003 meeting and agreed with the project team's assessment.

- Benefits:** The program's prime benefit will be a better budget system at all levels, on both the revenue and expenditure side and in expenditure planning linked to the PRS, which is the principal tool of medium- and long-range planning. A more efficient and effective SEFIN will mean more transparent budget formulation, monitoring, execution, and evaluation consistent with the country's development objectives. Such enhancements will also be pivotal in achieving the physical targets that are part of the PRGF program being discussed with the International Monetary Fund.
- Risks:** The following risks have been identified: (i) The program will fund activities at several different agencies. As such, the main risk lies in insufficient coordination and monitoring. To mitigate this risk, the program calls for a Technical Steering Committee to be set up within SEFIN with explicit functional guidelines and documented tasks. The chief technical advisor will serve as liaison among the coordinators at the participating agencies; (ii) SEFIN's institutional weakness and the many international and bilateral institutions operating in Honduras make external assistance and complementary activities difficult to coordinate. The program mitigates such risk by setting up a joint technical execution structure with other donors in the sector, and by cofinancing the program with SIDA; (iii) Staff turnover is too high in the areas targeted for assistance. Without workforce stability over time, the investment of effort may quickly be diluted, and the agency will have to engage in an ongoing process of adjustment. An enabling environment should be fostered to address this risk by identifying ways of supporting employees whose professional qualifications meet the program objectives, through ongoing training and a workplace with clear job descriptions and performance expectations.
- Special contractual clauses:** As special conditions precedent to the first disbursement: (i) the Operating Regulations for the program must have entered into effect on the terms previously agreed with the Bank; and (ii) the cofinancing agreement between the borrower and SIDA and the funds management agreement between the Bank and SIDA must be signed and in effect. The provisions of such agreements must include: (i) the timetable for SIDA to supply grant resources to the borrower; (ii) the borrower's and SIDA's acceptance that such contributions are to be managed by the Bank, in accordance with its policies and procedures; and (iii) the borrower's commitment to use such contributions solely and exclusively for the purposes described in the loan contract.
- Poverty-targeting and social sector classification:** This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Furthermore, this operation does not qualify as a poverty-targeted investment (PTI).

Exceptions to Bank policy:

Authorization is requested to use the loan proceeds to fund the continuation of services of individual consultants hired under project preparation facility loan 1508/SF-HO, which financed preparation activities for this operation. These individual consultants should be retained to support the institutional strengthening of SEFIN by overseeing program execution and the implementation of newly designed methodologies. They will also provide the training needed to institutionalize the designs.

Procurement:

The Bank's policies and procedures will be followed in the procurement of works, goods and related services, and consulting services. International competitive bidding will be mandatory for contracts with an estimated cost of US\$1.5 million or more for works and US\$350,000 or more for goods. An international open competition will be held for consulting contracts over US\$200,000. Local laws will govern the procurement of works, goods, and services of lesser value.

I. FRAME OF REFERENCE

A. Macroeconomic environment

- 1.1 Ever since the current administration took office, the Honduran government has had to deal with a complex fiscal situation. Falling current savings combined with financial weakening of government enterprises to drive up the combined public sector deficit for 2002 and 2003, despite lower public investment and poverty reduction strategy spending.
- 1.2 The government has taken steps to rectify the situation on both the revenue and expenditure side, but more work is needed to strengthen the public sector's financial position within the framework of the economic program signed with the IMF on 2 February 2004.
- 1.3 The public sector's financial deficit has been accompanied by a deepening institutional deficit. Institutional weaknesses in tax administration and poor management of the budget and public sector financial flows have hampered the government's ability to plan, budget, execute, and track public spending. Financial constraints now facing the government have made the situation even more acute.
- 1.4 The economic slowdown in Honduras during 2001-2002 hurt tax revenues, despite three rounds of revenue measures implemented by the current administration. Economic activity picked up slightly in 2003, fueling GDP growth of around 3%. Inflation continued its downward trend of the past five years, to close out 2003 at around 7.5%.
- 1.5 As far as the external sector, Honduras's foreign exchange position declined in 2003, when it lost international reserves equivalent to over 1% of GDP due to a higher oil bill, more expensive imports generated by the economic upturn, and a disbursement lag for public sector loans. With the final rounds of fiscal measures approved by the government in December 2003 and the public sector wage freeze, the authorities are moving toward a stronger fiscal position with more room for poverty reduction strategy (PRS) spending. These policies led to the signing of a letter of intent with the IMF in 2004, to implement a Poverty Reduction and Growth Facility (PRGF) program.
- 1.6 A stronger macroeconomic framework will require a better public sector financial position, which is the cornerstone of the three-year economic program with the IMF. Delays caused by the period of negotiation with the IMF will keep Honduras from reaching the HIPC completion point until 2005. This will put even greater pressure on government finances, since the country must make debt service payments at the expense of the PRS and its targets. At the same time, programs with financing from abroad must be executed more efficiently, and new sources of funding are needed to make up the PRS shortfall. This will require more efficient

fiscal management, more and better information on execution, and greater capacity to structure and measure performance indicators.

B. Public financial management

- 1.7 The IDB conducted a Country Financial Accountability Assessment (CFAA) jointly with the World Bank on public financial management in Honduras, which yielded a matrix of enhancement actions for the short and medium term. Through the studies done for the CFAA, experts in budgets, internal control, revenue, and public debt provided input to the government on a draft Financial Management Act. This single piece of legislation would consolidate the legal framework for public finance, including an action plan for better management of public resources. The government received the document in July 2003 and expressed interest in the IDB and World Bank working on this area within the framework of the CFAA and its action plan. The diagnostic assessment presented here is based on the findings of the CFAA.
- 1.8 Among the major problems identified in the CFAA were process weaknesses ranging from planning to revenue management to budget monitoring. As a result, the Government of Honduras and its Ministry of Finance (SEFIN) have committed to enhance efficiency and effectiveness in public financial management. Revenue and expenditure issues will have to be addressed through simpler and more systematic computerized management and enforcement, which will strengthen finance ministry administration as well as other government agencies.
- 1.9 The weaknesses identified will also entail capacity building at the agency that collects taxes and customs duties; better management of domestic tax resources and investment using resources from abroad, in line with expenditure policies designed to meet PRS targets; better coordination of fiscal and monetary policy, to prevent inflationary effects on the economy; and clear identification of the poverty impact benchmarks affected by the country's expenditure and investment policy. Most of these enhancements will be brought about through better administration, better information management, greater planning capacity, and uniform management methods. This will require targeted actions to strengthen management in each of the different areas and their full integration within the finance ministry. The Central Bank of Honduras must provide better statistics to support decision-making and institute mechanisms to track the impact of public sector investments on poverty indicators.
- 1.10 The CFAA gave the Honduran authorities a list of recommendations to improve the country's financial management. The following table breaks down the CFAA recommendations to be supported under this program for each targeted area.

Table I-1

Targeted Area	Recommendations
Governance	(i) Implement regulations governing internal control; (ii) create social audit mechanisms; (iii) strengthen the capacity for budget monitoring and evaluation; (iv) strengthen the legal framework for financial management.
Budgeting	(i) Strengthen programming and evaluation capacity (UPEGs) in both SEFIN and sectors; (ii) develop evaluation methodologies for investment projects; (iii) ensure that budget allocations are reconciled with annual operating plans (AOPs) and the PRS; (iv) include all internal and external resources financing public expenditures (including grants and in-kind assistance); (v) include revenue projections, and revenue generated from agencies (e.g. health, education); (vi) develop performance indicators and the capacity to collect information on performance; (vii) make spending more effective, based on performance indicators and performance budgeting.
Accounting and financial reporting	(i) Carry out an integral review of the government accounting function; (ii) develop a plan to move from accounts that are merely a record of transactions to ones that provide an analytical capability; (iii) extend the coverage of the IFMS and the proposed single treasury account system to all entities receiving budgetary allocations; (iv) produce cash-based government financial statements consistent with international practice, while increasing capacity to manage accrual accounting; (v) update the register and reconciliations of government assets.
Treasury	(i) Restructure the National Treasury of Honduras (TGR) and review its functions and capacity vis-à-vis the central bank and Office of Public Credit (DGCP); (ii) build TGR's capacity to manage cash in the long term, and develop transitional arrangements where the responsibilities and functions move gradually from DGCP and the central bank to TGR; (iii) create a class of non-negotiable checks that TGR can issue to government suppliers; (iv) set up a registry of government suppliers.
Revenue and expenditure reporting	(i) Certify the solvency of banks acting as tax collection agents, and provide a plan for periodic reconciliation; (ii) establish collection accounts of the TGR for tax collections; (iii) reconcile funds collected and funds transferred; (iv) strengthen the DEI.

1.11 As far as activities to strengthen the legal framework and enhance public sector transparency, the CFAA pointed to a need for targeted action on two fronts: (i) better mechanisms for fiduciary accountability in public sector financial management, especially at senior levels; and (ii) more transparency and better mechanisms for monitoring public financial management systems and their processes. The World Bank, through a poverty reduction support credit (PRSC), will help to enhance institutional mechanisms for fiduciary accountability, including conditionalities for the passage and entry into effect of the following statutes and implementing regulations: the Financial Management Act, the Public Ethics Act, and the Public Access to Information Act. The World Bank will also support the modernization of government finances through strengthening of the National Assembly's Budget Committee.

1.12 The Honduran government accepted the CFAA recommendations in a letter to the World Bank, and has agreed to present them to civil society, the private sector, and government at an outreach event to be held in the next few months. An integrated approach will be taken to remedying the weaknesses identified, one that seeks to enhance synergies in expenditure planning, formulation, monitoring, and

supervision. This approach also recognizes that the institutions giving and receiving information as part of these processes must be involved in any decisions aimed at building the country's PRS implementation capacity. The Bank and other international donors have conducted a number of projects and programs in the sector, but these have been discrete and isolated. The limited resources available have resulted in the strengthening of a few areas without creating enough momentum to address the problem as a whole. The actions of the IDB, World Bank, and the donor community in the sector will be guided by the CFAA's integrated approach with coordination from SEFIN.

1. Institutional assessment of SEFIN

- 1.13 On 26 April 2003 during project preparation, SEFIN and the Bank held a workshop to develop a strategic approach for the ministry, which served as a basis for the diagnostic assessment presented here. The workshop focused on identifying the ministry's functional and organizational weaknesses, along with potential solutions. The general conclusion was that the ministry has no strategic plan that defines a mission, approach, and values for each area of its operation. Key areas are also missing strategic guidelines with projects tied to them, which they could use to set priorities. The result is poor management and coordination among the different areas, and poor communications between SEFIN and other ministries. SEFIN's areas also lack performance measures for the effectiveness and quality of services based on the functions they perform.
- 1.14 Nearly all of SEFIN's areas have quality issues with human resources, partly from the high turnover in managerial and professional staff due to: (i) the absence of a management career track underpinned by civil service legislation that calls for transparent selection of professional staff, their promotion, and evaluation of their performance; (ii) the absence of a job description in most instances, coupled with low wages and no performance-based incentive policy; and (iii) the fact that staff receive little technical training.
- 1.15 Human resource issues also impact most key processes originating at SEFIN. Such processes are laid out in *functional* terms, rather than in terms of their efficiency and effectiveness in accomplishing a common objective. This has resulted in a centralized chain of authorizations and reviews that lead to higher management costs or directly to delays in decision-making. Rules and regulations governing procedures are so nonspecific as to encourage discretionality and make it difficult for the ministry to manage its interagency coordination functions.
- 1.16 In terms of computerization at SEFIN, multiple computer systems that are not linked together fail to generate the aggregate data needed for financial planning. The Modernization Unit's computer support group is responsible for the development, support, and operation of key systems (IFMS, SISPU, and SIGADE). Software development of several modules and the procedures for their use have

gotten out of sync, either because module development is lagging or line units have received no training on how to use a given system in their area.¹

- 1.17 SEFIN's computing issues extend to the Integrated Financial Management System (IFMS) in place at all government ministries. The IFMS has not yet been rolled out to executing units, so the tendency is to maintain parallel management systems at those levels. The IFMS also has some structural limitations that make it less user friendly, especially in how it handles closing a year and opening a new one, and it is difficult to generate the reports users need. Neither is there an effective system for managing basic tables, so transactions can be performed without properly balancing a register. Taken together, the IFMS issues mean not enough information on physical execution of the budget to implement a system of PRS performance benchmarks. Nor is there reliable information on cash position, a fact made worse by the splitting of treasury functions between the Office of Public Credit (DGCP) and Central Bank of Honduras.
- 1.18 Institutional strengthening of SEFIN will have to address issues specific to each area of operation, tying them together through simpler, efficient, and specific processes that overcome obstacles to effective management of the ministry as a whole and its ability to deliver services to its customers. The issues to be addressed are: (i) duplication of effort due to ineffective functional processes in each of the different areas; (ii) a multiplicity of transactions at the ministry, making them difficult to trace and process; (iii) a classic bureaucratic system for managing records; (iv) no strategic plan tied to the ministry's technological development; (v) insufficient installed capacity for human resources management; (vi) no job descriptions that meet the requirements of the ministry's new management model; (vii) no system for staff selection and evaluation; (viii) little management skills development at senior levels of the ministry; and (ix) no ongoing training program at the ministry.

a. Revenues

- 1.19 The revenue area has undergone reforms since the early 1990s at the two main agencies of today's Revenue Office (DEI): the departments of internal revenue and customs. The Bank supported this process through funding in specific areas under ATN/SF-3204-HO "Program to strengthen tax administration and policies," ATN/JF-4172-HO "Strengthening of tax administration," and 899/SF-HO "Program for strengthening the customs system."
- 1.20 With Bank support under several different operations² the Revenue Office, a decentralized agency reporting to SEFIN, has laid the groundwork for better

¹ Consultant Osvaldo Albano (World Bank) highlights this in his report, "IFMS evaluation and next steps."

² ATN/CI-4886-HO "Modernization of the tax administration," ATN/SF-5969-HO "Modernization of the customs administration," and 1025/SF-HO "Establishment of the DEI."

management. Specifically, it has professionalized human resources through staff rules, designed and computerized some customs and tax procedures, and improved its communications infrastructure. But the scarce financial resources³ at the DEI's disposal for thoroughgoing reform, coupled with new challenges in today's foreign trade environment and regional integration process, make further modernization of the agency a necessity. This program will support this process, following a strategic plan.

- 1.21 With support under the latest operation (1025/SF-HO), the DEI recently introduced the Fenix internal revenue collection system, which enables taxpayers to file returns electronically using software provided to them. The Fenix system consolidates data received by Banks at both the DEI and central bank, facilitating the banks' clearing of documents from other banks and reporting to the DEI on the same day that returns are filed. The aggregate data is also sent to the National Treasury of Honduras for reconciliation of tax revenues collected through Fenix with the treasury accounts at the central bank. No system has been developed for payment of other taxes or duties, but the DEI has said it wants to replicate the Fenix system for other kinds of revenue collection, such as licenses.
- 1.22 The DEI also entered into an agreement with the Inter-American Center of Tax Administrations (CIAT) in 2003, to implement the e-Tax computer system for internal revenue management developed in Panama with funding under the cited operation. Only the core modules could be developed with funding under loan 1025/SF-HO; these will go into operation in March 2004. The program will support development of the remaining modules and their complete implementation. The DEI activities to be financed under the program draw on a wide range of lessons learned in the region and in Honduras. International experience shows that efficient integration of tax authorities⁴ demands strategic analysis of the factors driving each business and its culture, above and beyond any potential for scale economies. Tax authorities do not set *policy*; they implement it. In that light, another lesson learned is the absolute necessity of a professional tax administration agency, where job tenure depends on professional skills and qualifications under preestablished rules, unaffected by *policy* shifts.
- 1.23 The table below summarizes where the DEI should stand upon completion of the 1025/SF-HO program in April 2004, based on questionnaires and interviews with DEI staff to set priorities for actions with input from stakeholders at the technical level.

³ Compare, in relative terms, the funding for similar processes from the Bank and other donors to such countries as Argentina, Colombia, or Guatemala.

⁴ See the study prepared by the Integration, Trade, and Hemispheric Issues Division (INT/ITD) for the January 2003 seminar on tax integration, held in Lima.

Table I-2

<p>Human resources: The DEI has staff of 1,750 and an annual budget of 266 million lempiras (approximately US\$15 million). Its management area has no policy on selection, job tenure, incentives, or performance evaluation. While an approved administrative career track does exist, it has not been fully implemented. More training is needed, focused on meeting the agency's own needs. A targeted training program is being developed for the audit and collection areas through the Internal Revenue Service (IRS) of the United States Department of the Treasury, but there is no comprehensive ongoing training in technical areas. There is also no significant training on information technology.</p>
<p>Regulations: The regulatory framework is very scattered and poorly organized with too many exemptions and special cases, making it difficult to manage and enforce.</p>
<p>Structure: Actual practice changed substantially under Resolution 2140 of 8 February 2001. As a result, one formal structure exists on paper, and another in practice, which does not conform to stated rules and procedures. There is no culture of independent decision-making.</p>
<p>Procedures: Procedures in general are not streamlined, being overly hierarchical and having too many steps. Too much emphasis is placed on managing paper with filing systems that are obsolete or no longer perform their function. The IRS is addressing this through a program to modernize audit and collection procedures.</p>
<p>IT applications: The DEI needs administrative support tools and expanded functional and geographic coverage for line applications that collect internal tax and customs revenue.</p>
<p>IT infrastructure: Computer hardware needs upgrading. About one-third of the 700 PCs now in use are outdated or in poor condition, and need to be replaced.</p>
<p>Buildings infrastructure: Infrastructure improvements are needed at regional offices, to better serve taxpayers, and at customs facilities for better enforcement and inspections. Also in need of improvement are documentation storage, IT facilities, national and regional training centers, and the customs laboratory.</p>
<p>Communication and image: A barebones effort is being made, but a public information campaign needs to be designed and implemented.</p>

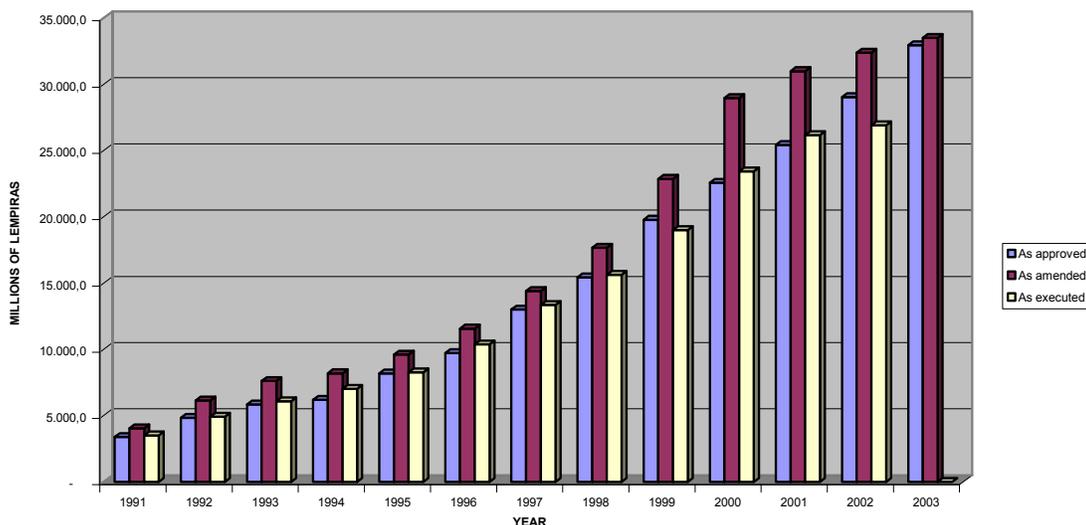
b. Expenditures

- 1.24 Different SEFIN work areas plan, execute, track, and record expenditures. These areas are quite distinct, despite being interrelated functionally and in terms of information flow. To address the ministry's overall predicament, targeted actions are needed to build each area's service delivery capability. Clear guidelines must also be set for activities involving other finance ministry offices and government agencies.
- 1.25 *Economic and fiscal analysis.* One of the chief problems facing SEFIN is the absence of an in-house economic and fiscal analysis unit. In addition to its own functions under regulations, the Management Planning and Evaluation Unit (UPEG) prepares macroeconomic and fiscal data and oversees a number of SEFIN policies toward other ministries. The UPEG designs and analyzes SEFIN policies, programs, and projects in line with macroeconomic, revenue, expenditure, and investment policies, and provides advisory support on policy matters and the development of laws and regulations. There needs to be clear separation between the UPEG's management evaluation functions and building its capacity to perform them on one hand, and its economic and fiscal analysis functions on the other. This

will require administrative restructuring of the UPEG, redeployment of its staff, and training in each area of operation.

- 1.26 *Budgeting.* The Office of the Budget (DGP) under the Deputy Minister for Finance and the Budget is weak in the area of developing and linking priority public policies to agency work plans, budget program structure, and budget performance evaluation. As a result, budgets are based on previous years with no consideration of desired outcomes for the budget execution period. While program appropriations have been broadened, they do not yet fully reflect agency accountability for budget program execution at each level, such as at the level of the executing units. This means that funds allocated as transfers to central government executing units are later dispensed without being properly recorded in the IFMS.
- 1.27 Because not all external grants and sources of funding are included in the budget, it is virtually impossible to evaluate budget performance in terms of its economic and social impact. In addition, decentralized agencies accounting for some 50% of the total national budget do not file their financial statements consistently, detracting from the completeness that should characterize public accounts. The budgeting process is also somewhat diffuse for two main reasons: (i) the DGP shares budget administration with the Office of Decentralized Institutions (DGID), which reports to the Deputy Secretary for Credit and Public Investment; and (ii) the processes of budget formulation and tracking of budget execution are not linked to procurement planning and execution processes, blocking access to information necessary for real-time budget execution. In 2002, for example, the approved general budget was 29 billion lempiras with amendments that brought it to 33 billion. However, only 27 billion was executed. The chart below shows the discrepancies among the budgets as approved, as amended during execution, and as executed, based on SEFIN records. These discrepancies reveal a degree of discretionality during execution and a lack of planning that lead to approval of larger budgets than executed, or to not all transactions being properly recorded.

**HONDURAS: GENERAL BUDGET
1991 to 2003**



- 1.28 *National Treasury of Honduras (TGR).* The TGR lacks a legally validated process for financial planning. Consequently, installment payments are merely indicative, deadlines are missed, and funds are advanced in excess of agencies' requirements. This leads to a cash deficit and reduces the transparency so necessary in the management of public funds. Moreover, the absence of a unified cash account or system for managing appropriate expenditures that incorporates administration of external disbursement accounts and foreign debt service hampers TGR monitoring and control of cash flow planning and hinders effective application of the unified cash balance principle. The TGR manages an estimated average floating debt of 1.2 billion lempiras equivalent, or around 5% of the general budget.
- 1.29 *Accounting.* Honduras's General Accounting Office (CGR) has a weakness in making accounting rules and/or changes to the charts of account used to record government transactions. The lack of integrated financial reporting makes it impossible to capture all such transactions in a timely and uniform manner, and some financial transactions go unrecorded at the proper time. Consequently: there is no integral analysis of financial statements; consultation on the management of physical and financial execution is at a low level; the information systems linked to revenue collection are not well integrated, and revenues are recorded late; there is no schedule of suppliers, so the government cannot make payments by electronic transfer; procurement and human resources management systems are not linked to the accounting system; consumables use is not monitored or tracked; and, in general, the CGR's procedures do not adequately reflect its legal mandate. The following table shows the accounting lag in the IFMS for selected accounts and operations, together with the monthly amounts they represent, based on CGR data.

Table I-3

Issue and Indicators	Last update	Arrears (%)	Amount per month (lempiras)
Nonintegrated information systems mean that some transactions not processed by computer are not recorded in the IFMS			
1. Subaccount special administration funds (central, subsidiary, special Treasury accounts)	July 2003	30%	30,000,000
2. Special funds for schools (no budget structure)	December 2002	100%	2,000,000
3. Special funds for hospitals (no budget structure)	December 2002	100%	2,000,000
4. Third-party funds (attachments)	September 2003	20%	2,500,000
5. Short-term receivables	June 2003	40%	120,000,000
6. Materials and supplies account (consumables)	March 2003	70%	1,500,000
7. Revenue stamps account	September 2003	10%	650,000
8. Preexisting assets	July 2003	30%	50,000
9. Losses from retirement of fixed assets	September 2003	10%	250,000
Externally financed transactions are not well tracked			
1. Long-term external debt		100%	5,840,880,000
Some financial transactions are not timely recorded			
1. Clearing of external debt incomings and outgoings	March 2003	70%	
2. Clearing of project fund estimates	March 2003	70%	40,000

1.30 Analysis of these data reveals that the CGR needs more timely reporting from several different SEFIN areas, including the Treasury, DEI, Office of Public Credit, central bank, and Technical Secretariat for Cooperation (SETCO). It shows a weakness in the ministry's ability to supply information across the entire expenditure tracking system with consequences for timely decision-making on budget execution, borrowing, available resources, and other areas.

1.31 *Internal control.* The elimination of the Office of the Comptroller General (Contraloría General de la República) and establishment of the Office of the Auditor General (Tribunal Superior de Cuentas) has created a need for internal audit units within government ministries and agencies. SEFIN currently has no unit with the ability to perform such audits. As such, the DGP conducts preaudits at government ministries and agencies, known as preventive controls. The DGP will give up these functions, which will be replaced by a new internal audit system as described in the Act Establishing the Office of the Auditor General. Currently, there are no procedures or model organizational structure for internal audits. The executive branch will have to establish these, based on the regulatory framework approved by the Office of the Auditor General in 2003. The framework defines internal control as maintaining accurate accounting records and detecting fraud, as well as providing guidance and facilitation for the administration to carry out its

plans and programs effectively. The last of these will require development and simplification of processes and better training of human resources.

1.32 *Public investment.* The Office of Public Investment (DIP) administers the SISPU Public Investment Reporting System, but has little capacity to analyze the information it receives. This limits its ability to participate in decision-making on the eligibility and oversight of projects that feed information into the system. Coordination with the DGP during budgeting is also limited to the agencies' administrative offices. Requests for information on annual plans overlap with those required by the DGP and Office of Decentralized Institutions (DGID). In addition, most public investment in Honduras is externally financed, substantially through grants coordinated by SETCO. This leads to a disorganized needs identification process, not supported by a clear division of responsibilities in investment planning on the national scale.⁵

1.33 SEFIN's expenditure area currently stands as follows:

⁵ The program on reengineering the public sector, currently funded by the World Bank, has recommended transferring SETCO to another government agency as a means of compensation. The coordination/integration of SETCO and its systems with the SISPU Public Investment Reporting System and other finance ministry systems should be supported in any event, as a way of addressing this problem.

Table I-4. Expenditures: Current Status

<p>Economic and fiscal analysis</p> <ul style="list-style-type: none"> • SEFIN's Management Planning and Evaluation Unit (UPEG) performs too many functions. • No model for estimating and updating economic indicators. • The Central Bank of Honduras has difficulty tracking below-the-line fiscal deficit items.
<p>Budget</p> <ul style="list-style-type: none"> • Only 10% of budget programs are subject to physical measurements of performance. • No complementarity between annual operating plans and the approved budget. • Only 30% of decentralized agency budget programs have clear, measurable indicators. • Budgeting and budget evaluation manuals are out of date. • Decentralized agencies have ineffective program structures (at least 25 structures need review). • The multiyear budget has no performance indicators. • Execution of PRS-related budget items is not tracked (0%). • The budget is insufficiently decentralized, and execution cannot be tracked. • The link between budget execution planning and cash flow planning is weak. • Redundant operations between the DGP and DGID, limited scope of the DGP's actual functions.
<p>Treasury</p> <ul style="list-style-type: none"> • The National Treasury of Honduras (TGR) neither plans nor manages disbursements (floating debt as of December 2003: 1.2 billion lempiras). • The financial planning manual is out of date, and foreign debt service is managed by the central bank and DGCP (100%). • The procedural framework is too weak to manage cash shorts and overs (cash as of December 2003: 200 million lempiras). • Direct payroll deposit is little used (8,000 out of 75,000 employees on the public sector payroll are paid by direct deposit through the banking system). • TGR, agency, and central bank staff are unfamiliar with new fund management tools (50 at SEFIN, 45 at central government agencies). • There is no mandatory regulatory framework for introducing a single treasury account system. • Official bank accounts have proliferated (500 out of 1,050 accounts at the central government's central bank are active). • The TGR's structure is too weak to perform its new functions.
<p>Accounting</p> <ul style="list-style-type: none"> • Some financial transactions are not recorded in a timely manner, making financial statements difficult to assess fully (equivalent to over 6 billion lempiras per month). • Externally financed transactions are not well tracked. • Consultation on the management of physical and financial execution is at a low level. • The information systems linked to revenue collection are not well integrated, and revenues are recorded late. • There is no schedule of benefit recipients, so the government cannot make payments by electronic transfer. • The system for managing real resources has no logical connection to the financial management system. • Consumables use is not monitored or tracked. • The accounting structure and procedures correlate too loosely with mission as provided by law.
<p>Internal control</p> <ul style="list-style-type: none"> • There is no regulatory framework or procedures for internal audits based on the overall framework established by the Office of the Auditor General. • There is no model organizational structure for internal audit performance. • The DGP conducts preaudits at government ministries and agencies. • There is no effective internal control system.
<p>Public investment</p> <ul style="list-style-type: none"> • Multiple systems for tracking investments are not coordinated effectively (SINACOIN tracks grants, and SISPU public investment). • Budget resources are allocated inefficiently for public investment.

2. Central Bank of Honduras

- 1.34 The Central Bank of Honduras (BCH) compiles and publishes most of the country's macroeconomic statistics and indicators through its economic research unit, the Subgerencia de Estudios Económicos. This function is essential to efficient and effective linkage between fiscal and monetary policy. In terms of enforcement of codes and rules for gathering and keeping statistics, a July 2003 IMF study found that most methods for compiling and publishing statistics are in accord with international practices. Yet there is much room for improvement, especially in coverage and timelier publication, as well as in the information provided on methodologies, data sources, and statistical techniques used to compile macroaggregates.
- 1.35 Compiling and releasing statistics yields significant outcomes. The public sector analyzes the statistics in order to design, implement, monitor, and ensure consistency of financial planning. This leads to well-coordinated economic policy, especially between fiscal and monetary policy, and results aligned with national development priorities. The conceptual framework for macroeconomic accounts (SNA 1953) and the base year (1978) probably do not fully reflect sector relationships and relative prices in the Honduran economy today. Accordingly, IDB nonreimbursable assistance is supporting the SNA 1993 implementation program and revision of the national accounts base year. Monetary, financial, fiscal, and balance of payments statistics (including external debt) are also not being compiled strictly in accordance with the recommendations of the respective statistics manuals. This leads to deviations from international best practices, especially in terms of classification, sectorization, and basis of recording. Less consistent statistics are the result, despite the special importance of consistency for the national accounts update now underway.

3. Tracking of poverty reduction strategy indicators

- 1.36 The Technical Support Unit of the Office of the President, known by its acronym UNAT, coordinates the preparation and release of PRS progress reports, based on a system of indicators for monitoring and evaluation.
- 1.37 UNAT gets its information from a range of sources, but its principal suppliers should be: the National Institute of Statistics (INE) for information on progress toward overall PRS targets and sector indicators; SEFIN and SETCO, once integrated with the IFMS and SISPU systems and in coordination with the National System for International Cooperation (SINACOIN), for information on physical and financial progress of PRS-related projects; and the central bank for macroeconomic information, supplemented by fiscal performance indicators from SEFIN.

- 1.38 The Government of Honduras has decided to introduce an Integrated Poverty Reduction Tracking System (SIERP) as a way of coordinating the collection and monitoring of data and tracking indicators to assess progress toward PRS targets and objectives. For such a system, the sources named above must be able to supply reliable data in real time. The government will be better able to track PRS indicators with this system, leading to more cohesive policymaking and development of priority programs. It will also enhance consistency between public investment planning and the budgeting process, strengthening the monitoring, oversight, and evaluation of fiscal management in Honduras.

C. Related activities

- 1.39 The Bank's fiscal management activities in Honduras have been fairly isolated and limited as far as resources, yet have had considerable impact. The proposed activities under this program seek to build on that success by taking an integral approach with the participation, coordination, and consensus of other international institutions and bilateral donors. Such an approach is part the Honduran authorities' strategy to get the greatest benefit from the reform process at the least possible cost.
- 1.40 In 2002 and 2003 the Bank approved US\$150,000 in technical cooperation funding to support strengthening of the budget system (ATN/SF-7828-HO and ATN/SF-8219-HO), to help the Government of Honduras initiate reforms of the budgeting area and take action to: (i) submit joint budget proposals at the same time for the central government's fiscal year and those of the decentralized agencies; (ii) submit a medium-term financial plan to the National Congress for the non financial national public sector budget (three-year budgets), based on the macroeconomic assumptions of the medium-term financial plan; (iii) develop and implement a system, albeit a limited one, to classify poverty-targeted programs and projects; (iv) develop and implement an IFMS-linked software application to process the multiyear budget; (v) improve linkage between plan and budget; and other actions.
- 1.41 Bank assistance for better management of the country's financial information also took the form of technical cooperation using nonreimbursable FSO resources to support reform and improvements at the National Treasury (ATN/SF-8104-HO). The objective is to strengthen its ability to process and utilize financial and administrative information more effectively.
- 1.42 With Bank support the Office of Public Credit (DGCP) began a study to redesign the processes under its management (credit management, debt service, debt negotiation, and personnel activities). The redesign also includes a review of support systems and needed improvements to the SISPU public investment reporting system, the SIGADE debt management system, the IFMS, and document control, as well as design of a data warehouse and redesign of the operating cycle for accounting and administrative operations. This plan will be buttressed by

- program activities to strengthen other areas of SEFIN and transfer functions to the DGCP and the National Treasury.
- 1.43 SEFIN and the National Institute for Women's Affairs have sponsored a gender institutional strengthening project (ATN/SF-7653-HO), to establish gender indicators for the preparation of annual operating plans and budgets at three ministries and two decentralized agencies.⁶ Sources of development cooperation, both multilateral and bilateral, have clearly identified the need to support development processes that advance equal rights and equal opportunity for men and women.
 - 1.44 The Bank has approved a poverty reduction policy support operation (1532/SF-HO) with a component that addresses efficiency and effectiveness of expenditure, to strengthen the project financial management and monitoring system with a view toward a long-term budget planning strategy. The program proposed here furthers these policy objectives as it seeks to develop methodologies for medium- and long-term planning (multiyear budgets) on the sector front, for budgeting at the level of the principal PRS executing agencies, and for raising the quality of the information needed to make decisions on planning.
 - 1.45 The Bank has also approved phase II of a poverty reduction and local development program (1478/SF-HO), one objective of which is to build the financial and institutional capacity of municipio governments, so that they can more efficiently respond to the local population. This will include funding for municipal administration projects to harness more local resources, new financial management systems, process reengineering and modernization of municipio management, and adoption of good practices in the areas of physical, strategic, and participatory planning.
 - 1.46 In 2002 the Bank approved a program to modernize the national statistics system (1112/SF-HO), cofinanced with Sweden and the Department for International Development of the United Kingdom (DFID). The aim of the project is to improve government decision-making processes through sustained development and consolidation of the system of national statistics (SEN), so that it can produce essential basic data on a timely and reliable basis. These actions by the INE will be bolstered by strengthened statistics capacity at the central bank and better financial reporting at SEFIN, as proposed here. These three pieces must be in place (INE, SEFIN, and the central bank) for UNAT to have the information it needs to track the PRS impact benchmarks.

⁶ These are: (i) the Ministry of Health, (ii) the Ministry of the Interior and Justice, (iii) the Ministry of Agriculture, (iv) the National Bank for Agricultural Development, and (v) the National Vocational Training Institute.

- 1.47 Lastly, in December 2003 the Bank approved project (1508/SF-HO) under the Honduras project preparation facility (11/LC-HO), to support budget, accounting, bursary, and planning design activities for this program and hire technical advisors to coordinate it.

D. Coordination with other donors

- 1.48 In the government finance domain, the World Bank is executing a lending program to deepen government reforms by increasing transparency and financial accountability in the management and control of government finances and human resource management. The program developed the platform for the IFMS, but did not involve process reforms. It also modified the government's internal control model. The program is now being reformulated in parallel with the SEFIN reform process, and this will finance new IFMS developments and strengthen the Office of the Auditor General.
- 1.49 Successful coordination between the IDB and World Bank on CFAA preparation has led to a coordinated work plan for preparation of the World Bank's poverty reduction strategy technical assistance credit (PRS-TAC), which should be approved before the end of this fiscal year, and preparation of the loan proposed here. The World Bank's PRS-TAC has a financial management component that concentrates on improving information systems associated with public finance management. Under SEFIN guidelines and the division of activities between the two project teams, it was agreed that the World Bank would concentrate on improving and possibly migrating the IFMS system within the parameters of the budget execution reform to be funded by the proposed program. World Bank support for tax management information systems includes an active loan of approximately US\$2.5 million and some US\$2 million in PRS-TAC resources. Counting this financing, the two institutions would be investing a total of US\$6.5 million in public expenditure management in addition to US\$1.5 million in support for restructuring SEFIN under this program.
- 1.50 The World Bank PRS-TAC plans actions to build PRS tracking capacity at UNAT, including: (i) quantifying the financing gap among the different PRS programs and identifying criteria for resource allocation to various strategy areas; (ii) better data gathering from government agency administrative records, which would appreciably improve national, departmental, and regional public statistics and complement actions under the program to modernize the national statistics system (1112/SF-HO); and (iii) institutional strengthening of UNAT through capacity building and better organization of functions with additional funding from UNDP, GTZ, and DFID. These actions would complement development of the SIERP, which this program proposes to fund.
- 1.51 The Bank has cooperated and coordinated closely with the Swedish International Development Agency (SIDA) and the Norwegian Agency for Development

Cooperation (NORAD), which have financed tax reform studies in several Central American countries (ATN/NC-7578-RS and ATN/FW-7764-RS). SIDA has agreed to provide US\$3.2 million in cofinancing for this program, specifically for the Revenue Office (DEI) component, as part of its ongoing support for tax reform in the region, and Honduras in particular, on the revenue side. These resources will cover the entire local counterpart contribution, freeing up Bank financing proceeds to expand the program's scope. On 8 January 2004 the Bank's Country Office in Honduras received a letter of intent from the Swedish Embassy in Guatemala, expressing interest in cofinancing this program. The form such cofinancing would take was mapped out during a preevaluation mission on 19-22 January 2004. SIDA accepted the preevaluation in February 2004 and confirmed its intention to thoroughly evaluate the program and finalize the cofinancing in March.

- 1.52 The DEI has also received assistance from the U.S. Treasury Department through its Internal Revenue Service (IRS) with funding from USAID. The main objectives are to support the DEI in: (i) developing a strategic plan; (ii) reviewing its organizational structure; (iii) preparing manuals for audits and collection; and (iv) other technical and management training activities. The project's scope, however, is limited in terms of time and resources. Agreement has therefore been reached with the DEI to supplement and expand the activities begun by the IRS, especially training, and to support implementation of the new organizational structure, strategic plan, and audit manuals.
- 1.53 The German Agency for Technical Cooperation (GTZ) has supported the municipal project bank and municipal real estate census in Honduras, successfully implementing them in the Centro de Atlántida municipios and soon in others. GTZ has also provided the municipalities with technical assistance to develop municipal strategic plans under the PRS.

E. The Bank's country and sector strategy

- 1.54 The Bank's strategy fits into the poverty reduction strategy and targets three areas: (i) increasing the competitiveness of productive activities; (ii) enhancing the development of human capital; and (iii) strengthening governance. The proposed program meshes with the Bank's strategy to strengthen governance in that it will enhance the financial management and tax administration system as a linchpin of greater efficiency, effectiveness, and transparency in government finances on both the revenue and expenditure side. Unlike prior efforts, which were isolated and focused narrowly on one or two areas, this program proposes an integral approach with medium- and long-term solutions for problem areas at SEFIN and other agencies that set tax policy and supply the information necessary for public resource management and national strategy implementation, in this case the PRS.
- 1.55 The program recognizes the PRS's importance as the country's medium- and long-term national development plan. Measuring the impact of locally and externally

- funded activities is therefore essential, to hone fiscal policy and set investment priorities. This means that support for UNAT in developing the SIERP to supply better data on the impact of national PRS policies is the cornerstone of any program to make spending more efficient and effective in Honduras.
- 1.56 Added to this is the need to better gather and analyze statistics that have a bearing on fiscal and monetary policy. The consequences for effective spending with an impact on PRS-related activities are clear. Accordingly, the program will build capacity at the Central Bank of Honduras, so that it can supply SEFIN and UNAT with reliable and timely information. This complements IDB-funded activities at the INE under the program to modernize the national statistics system (1112/SF-HO), as well as activities to be supported by the World Bank under the PRS-TAC. Such an approach provides an overarching fiscal management framework in that it not only improves processes, methods, and capacity, but seeks to make better information available for decision-making.

II. THE PROGRAM

A. Objective

- 2.1 The proposed program's general objective is to help Honduras better manage its government finances, so that the State can perform its function of providing citizens with fairly and efficiently funded services, thereby contributing to a stable macroeconomic environment conducive to economic and social development.
- 2.2 The specific objectives are to contribute to: (i) more effective revenue collection and more efficient and effective expenditure; (ii) greater linkage between fiscal and monetary policy; and (iii) mechanisms that measure the impact of management on poverty reduction strategy (PRS) indicators. These specific objectives are geared to overall better management of public resources, better information for decision-making in their regard, and easier identification of actions to support PRS implementation.

B. Program structure

- 2.3 The program has three components: (i) strengthen the Ministry of Finance (SEFIN); (ii) support strengthening of the economic research unit of the Central Bank of Honduras, the Subgerencia de Estudios Económicos; and (iii) support implementation of the Integrated Poverty Reduction Tracking System (SIERP).

1. Strengthening of the Ministry of Finance (SEFIN) and Revenue Office (DEI) (US\$11,610,617; IDB: US\$8,410,617; SIDA: US\$3,200,000)

- 2.4 This component's activities and expected outcomes are geared toward restructuring within the Ministry of Finance (SEFIN) and Revenue Office (DEI). Internal restructuring at SEFIN will build its capacity as a public finance policymaker and coordinator of the financial management system in areas of contact with its customer government agencies, so that it can efficiently, effectively, and transparently manage the flow of funds from a range of sources for numerous uses in performance of the State's obligations to its citizens.
- 2.5 By program end, SEFIN will be able to perform its assigned role efficiently as a public financial management and tax administration agency, so as to curb tax evasion and generate better information for spending, investment, and borrowing decisions in a setting of simpler, more transparent management and better coordination with major fiscal policy institutions. Existing procedures will be replaced by documentation to support online decision-making, electronic data exchange, integrated transaction processing, and document management systems to make management and customs control more effective and efficient.

- 2.6 This component has three subcomponents geared toward restructuring and strengthening SEFIN: (i) administrative and functional reorganization; (ii) better revenue management; and (iii) better public expenditure management.

**a. Administrative and functional reorganization of SEFIN
(US\$1,472,000)**

- 2.7 This subcomponent seeks to improve administrative procedures at SEFIN through simplification and streamlining, as well as and investment in systematic human resource management and training, for better intra- and interagency dealings. Activities are planned in two areas:
- 2.8 *Administrative simplification.* Activities will be funded to simplify internal procedures at SEFIN. Trimming administrative procedures, eliminating overlap, and shortening response times will improve management efficiency at SEFIN units and departments in general. Affected procedures include certifications, customs exemptions, power-of-attorney management, judicial notices, and legal opinions.
- 2.9 The expected outcomes of planned activities are: (i) simplified and redesigned administrative procedures for internal operations, built around the “one-stop service” concept and a flexible tracking system for records, moving initially toward a paperless office for internal procedures by linking them electronically to the records system; (ii) a strategic plan for automating and streamlining the implementation of technology at the SEFIN level; and (iii) support for the effective use of financial and technical resources for financial management of external borrowing.
- 2.10 *Human resources and training.* Activities under this heading support the restructuring and redesign of functional rules and procedures for human resources and training, both internal and external, in order to make the reform package sustainable in the medium and long term.
- 2.11 In the area of human resource management, the program will: (i) make administrative reforms sustainable by strengthening SEFIN’s human resources unit, which must plan career paths based on identified operational and strategic needs, develop job descriptions in line with the new management model, identify a staff selection, evaluation, and incentive system and determine training and professional development needs prompted by its introduction; and (ii) strengthen SEFIN’s governing body in the areas of leadership, management, and strategic planning.
- 2.12 The program will set up a training unit within the Office of Human Resources, to deliver: (i) ongoing training to SEFIN staff in topics specific to public finance; (ii) special training in SEFIN’s front office activities (budget, cash management, public debt, accounting, and investment), to staff at SEFIN and other government agencies.

- 2.13 SEFIN will coordinate with the National Institute for Women's Affairs (INAM) under this subcomponent to hire a short-term consultant with international experience in gender issues to support SEFIN in: (i) drafting standards and methods for incorporating gender into SEFIN's reform activities; (ii) develop an advisory assistance and monitoring plan for SEFIN consultants and technical staff, to ensure that gender is built into the reform process; (iii) making recommendations on mechanisms to incorporate gender into training delivered under the program.

b. Better revenue management (US\$8,247,617; IDB US\$5,047,617; SIDA US\$3,200,000)

- 2.14 This subcomponent's specific objective is for the DEI perform its foreign trade and frontier collection and control functions more effectively thereby lowering its operating costs. Five areas will be targeted: (i) institutional strengthening and skills development for human resources; (ii) strengthening of customs and domestic tax operations; (iii) strengthening of customs and domestic tax enforcement; (iv) technological modernization and innovation; and (v) upgrading infrastructure and equipment.
- 2.15 *Institutional strengthening and skills development for human resources.* This target area seeks to strengthen the institutional structure, enhance control of the administrative process, management, and the job skills of human resources, achieving a level of transparency and taxpayer support in line with a new corporate image for the agency. The following core activities are planned: (i) introduction of a multilevel administrative structure that grew out of the reengineering of administrative, operational, and enforcement procedures, based on IRS recommendations adopted by the DEI; (ii) review and codification of rules and regulations at all levels, and development of a tool for their electronic dissemination and consultation; (iii) streamlined design and implementation of new management procedures, built around electronic "one-stop service;" (iv) setting up a system to oversee management by objectives, quality, and audits; (v) support for human resource development and job skills training through the effective introduction of staff rules and career paths, giving the agency the ways and means to deliver ongoing, all-around technical, management, and administrative training to its employees in areas specific to their job; and (vi) design and implementation of services to deliver better customer service to taxpayers, along with the development and promotion of a corporate image.
- 2.16 *Strengthening of customs and domestic tax operations.* This target area seeks to make foreign trade collection and control operations more efficient, thereby lowering operating costs to the government and taxpayers. The following core activities are planned: (i) review and reengineering of customs operations, additional to those covered by the ASYCUDA customs information system, and including procedures for operational information exchange with other agencies; and (ii) review and reengineering of domestic tax operations, expanding the e-Tax

computer system to revenue collection, tax rolls, and exemption control, and decentralizing it to regional offices.

- 2.17 *Strengthening of customs and domestic tax enforcement:* This target area will support more effective control, to increase revenue and compliance with taxes and other levies on foreign trade. The following core activities are planned: (i) setting up an office to manage fiscal and parafiscal risk through a structure and work methods built around international best practices; and (ii) review and reengineering of enforcement and audit procedures, and the design or selection and implementation of tools to operate them.
- 2.18 *Technological modernization and innovation:* This target area will provide the tools needed to improve management, operations, and enforcement, along with procedures and methods to audit the DEI's systems and make them secure, enhancing the effectiveness of activities under the areas described above. The following core activities are planned: (i) development and implementation of paperless office tools of administrative management; (ii) addition of the remaining e-Tax computer system modules and expansion of the system to regional offices; (iii) full development and implementation of the ASYCUDA customs information system, and new postaudit and enforcement tools not included in the system; (iv) computer links between DEI and SEFIN; and (v) development and implementation of risk management tools.
- 2.19 *Upgrading infrastructure and equipment:* This target area will fund improvements to buildings and equipment necessary for the DEI to perform its control and facilitation function efficiently. The following core activities are planned: (i) purchase of hardware and licenses to deploy the applications developed; and (ii) remodeling, furnishings, and equipment for some regional offices and regional training centers and for central departments, the human resources area, the Center for Tax and Customs Studies, the information technology area, and the customs laboratory.
- 2.20 The planned investment under this subcomponent is justified by the many specialized activities performed by the DEI. These demand considerable investment in training, especially with the coming changes to customs and tax policy as a result of international agreements. Investment in infrastructure improvements will also be essential for customs functions. Such investment represents about 45% of the total program budget, but may generate an estimated 1% increase in GDP equivalent to a 6% increase in revenue.

c. Better public expenditure management (US\$1,891,000)

- 2.21 This subcomponent will fund activities to better enable each of SEFIN's different areas to perform its assigned function under Honduran law. Public expenditure management will become more efficient and effective, and more information will

flow more easily within SEFIN and to its customer agencies. Six areas will be targeted:

- 2.22 *Economic and fiscal planning and analysis.* This target area seeks to build institutional capacity in the design and evaluation of performance-based fiscal policies, and to lay the groundwork for a system of major economic indicators based on the International Monetary Fund's 2001 Manual on Government Finance Statistics, to be used for budget preparation and execution. It also seeks to strengthen the planning and monitoring of SEFIN's own activities and those central bank capabilities crucial to the fiscal policy planning functions of SEFIN's Management Planning and Evaluation Unit (UPEG).
- 2.23 Activities in this area will help to set up and strengthen a SEFIN economic and fiscal analysis unit within the UPEG with the following functions: (i) operate a model to simulate the behavior of economic variables and improve annual and periodic calculations of revenue and expenditure; (ii) measure tax revenue foregone as a result of tax exemptions, based on DEI reporting; (iii) develop economic growth path scenarios; and (iv) derive compatible tax performance levels and other conditions.
- 2.24 Activities in this target area will also: (i) train UPEG staff in the design of policies and programs to chart SEFIN's course of action in the medium and long term, and better enable them to evaluate the impact of those policies and programs using specific indicators; and (ii) build capacity at the Central Bank of Honduras to evaluate government finance trends by measuring fluctuations in government financial balances, and provide it with the hardware it needs to interact with SEFIN and receive timely, accurate fiscal reporting on the flow of funds to the public sector.
- 2.25 *Program-based budgeting, budget management and evaluation.* Activities will be funded to strengthen the government's medium-term strategic planning and execution, and align the budget with priorities that have been set. Program-based budgeting and budget evaluation will be redesigned, introducing a performance-based approach to budget preparation and monitoring. The expected outcome is more effective and sustainable reform of the budget system, begun with Bank support.
- 2.26 The expected outcomes at program end are: (i) the government is trained to prepare and program the annual and multiyear budget on the basis of performance-driven strategic plans, and to base its accountability and operational and strategic evaluation on physical and financial measurements of specific performance benchmarks; (ii) the budget execution process is effective and transparent with planning that reconciles commitments to the cash statement and expected flow of funds along with requests from administrative offices, and criteria for setting expenditure priorities; (iii) budgeting and budget management are decentralized to

the level of the executing units with effective engagement and input in the budget process from the various units that produce goods or services; (iv) strategic plans for investment have been made public and implemented in line with the feasibility considerations and priorities of budgets prepared by the agencies; (v) budget management has been simplified and streamlined with new procedures for budget modifications and changes to all procedures at the governing agency; (vi) a single unit governing the budget system can establish rules and practices for the entire budget process, effectively analyzing and evaluating performance and providing technical assistance and training to staff at all public-sector agencies; and (vii) planning and budget departments at government agencies involved in budget preparation, execution, monitoring, and evaluation have standardized, and their functions have been redefined.

- 2.27 *Treasury.* Actions will be funded at the National Treasury of Honduras (TGR), to transition from its current role as a (partial) payment window, to that of the government's financial manager with the capability to plan and manage the flow of all treasury funds transparently in coordination with monetary policy. The expected outcomes are: (i) the TGR has received training to plan and manage the flow of public sector funds, including external funds, more effectively, efficiently, and transparently; (ii) public resources are managed integrally through a single treasury account system, lowering costs of borrowing in the short term (floating debt falls from an average of 1.2 billion to 200 million lempiras in 2007) and quickening the pace of canceled obligations in an environment of greater effectiveness and security in the timely use of public resources (avoiding cash flow shortfalls); (iii) the TGR has received training to manage funds via policies on the sources and uses of resources in coordination with the Office of Public Credit (DGCP) and the Central Bank of Honduras; (iv) the TGR has restructured and introduced new cash management procedures; (v) at least 60,000 employees are paid electronically.
- 2.28 *Accounting.* Capacity building at Honduras's General Accounting Office (CGR) will better enable it to serve as the governing agency for the accounting system and assets system, so that it can provide reliable, complete, and timely information on government management. The expected outcomes of the investment are: (i) accountability mechanisms are strengthened by providing citizens with reliable, complete, and timely information on government finances and property; (ii) financial execution and accounting for the consolidated national public sector, including executing units for external borrowing, have been integrated using a financial management and accounting system at such units; (iii) decision-making has become more efficient with a mechanism for consultation or management reports with financial and accounting information (at least 90% of the Honduran government's transactions are recorded by 2006); (iv) the CGR restructures to ensure homogeneity and functional coordination between the government's various financial management processes and the management of real resources (procurement, human resources, and government assets), which are fully reflected

in the integrated financial reporting system, eliminating time lags in recording (see table in Chapter I).

- 2.29 *Internal control.* In the area of internal control, the program will support implementation of a control system to serve as a public-sector management tool for evaluating performance. It will encourage savings and promote efficiency and effectiveness in agency administration, as well as raise service quality. The system will safeguard public resources against mismanagement, make the decision-making process more efficient, and enable more reliable and timely financial reporting. The proposed investments are expected to provide the ways and means for the policy framework developed by the Office of the Auditor General, to be implemented through a network of internal audit units based on the model unit at SEFIN. Thus, internal control will be implemented in a uniform manner across government agencies.
- 2.30 *Public investment.* Activities will be funded to strengthen the public sector's investment process from the development of public investment proposals to their evaluation, planning, execution monitoring, and ex post evaluation. The expected outcomes are: (i) public resources are allocated more efficiently, both to meet society's basic needs and to provide for medium- and long-term levels of economic activity; (ii) the government's technical capabilities improve in the area of public investment planning and management, so that it can measure the average rate of return on investment; (iii) criteria are set for coordinating the public investment program with the planning of national public expenditure, especially social spending; and (iv) institutional strengthening and technical and IT capacity building enables an investment project bank to handle all data generated during the project cycle.
- 2.31 Funding of the expenditure management subcomponent will be supplemented by World Bank loans of US\$4.5 million to US\$5.5 million (US\$2.5 million in execution and approximately US\$2 million to US\$3 million under the PRS-TAC) to support software and hardware development related to the reforms proposed here, which is needed to make the IFMS more effective. As a result, the total investment in expenditure management will be approximately US\$6.5 million. This subcomponent is a priority, if the country is to meet its PRGF obligations to the IMF and satisfy the financial management policy conditions on loan 1478/SF-HO and the conditionalities of the World Bank PRSC in preparation.

2. Strengthening of areas at the Central Bank of Honduras involved in compiling, storing, and analyzing economic statistics (US\$1,803,086)

- 2.32 Reaching and maintaining a level of statistical quality that meets the country's reporting needs will require more and better IT resources and skilled workers, as well as better interagency coordination and disclosure of changes in methodology. No less important is the need for greater interaction among users and providers of

statistics (UNAT, SEFIN, INE, and the general public) and the central bank as a source of macroeconomic data.

- 2.33 Strengthening of central bank statistics means bringing the central bank's capacity to manage and release information up to international standards for macroeconomic management in three target areas: (i) developing its capabilities and information systems to support monetary policy management consistent with fiscal policy; (ii) developing its capabilities and information systems to support compilation of balance of payments statistics and, in coordination with SEFIN, management of external debt; and (iii) developing its capabilities to provide the public, other government entities, and relevant international agencies with more up-to-date information with broader coverage. Activities to be proposed in this regard will not include financial sector policy actions.
- 2.34 Specific activities to be funded under the program are: (i) introduction of the IMF statistics manuals on balance of payments (including external debt) and the monetary, financial, and fiscal sectors and their integration into the conceptual framework of the 1993 System of National Accounts (SNA 1993); (ii) design and implementation of a plan for publicizing the fact that the manuals have been introduced; and (iii) design and analysis of an annual flow of funds for the Honduran economy, based on integrated statistics for each institutional and economic sector.
- 2.35 Each of these three activities will include training for central bank staff involved in compiling, storing, and analyzing economic statistics, as well as for a range of users and suppliers of basic statistics on each institutional and economic sector.

3. Support for an Integrated Poverty Reduction Tracking System (US\$1 million)

- 2.36 This component will assist the Technical Support Unit of the Office of the President in implementing an Integrated Poverty Reduction Tracking System (SIERP) through the following activities:
- 2.37 *Strengthening of the SIERP at the levels of information generation, consultation, and dissemination.* This activity will give management planning and evaluation units (UPEGs) the capabilities they need to introduce the SIERP. Strengthening the UPEGs in this regard will involve hiring consultants to see that quality information flows efficiently from the UPEGs to the SIERP central unit. This will ease the transition to a smoothly running system that supplies information to make projects, sector policies, and PRS targets consistent with one another, so as to enhance performance and impact. Also planned are consultation activities and actions to publicize progress on PRS execution, to raise awareness among government, civil society, and foreign cooperation providers before, during, and after PRS implementation.

- 2.38 *Procurement of hardware, software, and communication systems for the SIERP central unit and UPEGs.* The objective of this activity is to equip the SIERP central unit at UNAT to provide technical support for SIERP operation, along with the necessary communication mechanisms, such as: (i) installation and configuration of PDC and database servers with their respective licenses; (ii) LAN, WAN, and Internet communications; and (iii) consulting services for information systems, when and as needed. Funding for this activity will also be used to provide the ministry UPEGs, which will be co-owners of the SIERP, with the technical support they need to meet SIERP reporting requirements in a timely manner.
- 2.39 *Installation and maintenance of the computer network for SIERP-specific operation.* This activity's objective is to develop and upgrade the platform and applications on which the SIERP will run by: (i) getting the SIERP central unit up and running; (ii) installing and configuring the database; (iii) maintaining the SIERP database and website; (iv) building an interface between the SIERP and the IFMS, SISPU, and other systems; and (v) assisting in the preparation of PRS progress reports.
- 2.40 *Training.* This activity consists of workshops and courses to build capacity at the institutions that are to supply the information needed to keep the SIERP up to date.
- 2.41 *External evaluations of SIERP function and use.* This activity's objective is to continually improve the system in terms of information generation, information systems, institutional structure, technical support, indicator quality, quality of system reports, quality of human resources, and the quality of relationships among agencies. This will be accomplished through annual external evaluations, beginning once the SIERP is fully operational. This activity will help to make the SIERP more reliable, contributing to its future sustainability.
- 2.42 A consultant with international experience will be hired under this component, to support UNAT in its institutional development with the World Bank PRS-TAC and in implementing the SIERP proposed here. The consultant will be funded jointly by this program for two years, and for the remainder of the execution period by the World Bank PRS-TAC through its component at UNAT.

C. Cost and financing

- 2.43 The total cost of the program will be US\$18.35 million, broken down into US\$15 million in reimbursable resources from the Bank's Fund for Special Operations, US\$3.2 million in grant funding from the Swedish International Development Agency (SIDA), and US\$150,000 in local counterpart funding to cover the credit fee. The SIDA cofinancing will fund the local counterpart contribution of US\$1.6 million with the remainder going to investment under the DEI revenue subcomponent. The country will use its own resources to pay the Bank's credit fee. The SIDA contribution will be delivered to the Bank under a

bilateral resource management agreement, entered into for the project, in accordance with Bank policies and procedures. The table below shows the consolidated budget for the program. Itemized budgets for each component are available for consultation in the technical files.

Table II-1

Component and Category	Cost	IDB	Local/SIDA
Ministry of Finance (SEFIN)	11,610,617	8,410,617	3,200,000
a. SEFIN restructuring subcomponent	1,472,000	1,472,000	
Consultants	972,000	972,000	
Training	200,000	200,000	
Equipment	300,000	300,000	
b. Revenue subcomponent	8,247,617	5,047,617	3,200,000
Consultants	4,491,577	2,748,886	1,742,690
Equipment	2,132,000	1,304,804	827,197
Training	369,040	225,856	143,184
Works	1,255,000	768,071	486,929
c. Expenditure subcomponent	1,891,000	1,891,000	
Consultants	1,359,000	1,359,000	
Training	132,000	132,000	
Equipment	400,000	400,000	
Central Bank of Honduras	1,803,086	1,803,086	
Consultants	1,012,636	1,012,636	
Training, dissemination, and publication	578,000	578,000	
Equipment	212,450	212,450	
UNAT/SIERP component	1,000,000	1,000,000	
Consultants (includes technology development)	804,000	804,000	
Training	166,000	166,000	
Equipment	30,000	30,000	
Project management	737,600	737,600	
Consultants	537,600	537,600	
Equipment and materials	200,000	200,000	
Audits	100,000	100,000	
Evaluation	100,000	100,000	
Finance charges	1,950,000	1,950,000	150,000
Credit fee	150,000		150,000
Inspection and supervision	150,000	150,000	
Interest	600,000	600,000	
Project preparation facility repayment	1,200,000	1,200,000	
Contingencies	898,697	898,697	
Total	18,350,000	15,000,000	3,350,000

III. PROGRAM IMPLEMENTATION

A. Borrower and executing agency

- 3.1 The borrower is the Republic of Honduras, which has designated its Ministry of Finance (SEFIN) as executing agency.

B. Execution and management

- 3.2 The program will be executed by the Ministry of Finance through a project management unit (PMU) headed by a project management coordinator. The PMU is being set up within SEFIN to introduce a single central execution and monitoring system for the international technical and financial cooperation programs and projects it runs. The aim is to maximize economies of scale and make best use of human, material, and financial resources. SEFIN, acting through the PMU, will have the following responsibilities for this loan: (i) maintain an effective contract management system that can match procurement processes to payments to vendors and consultants from program start to finish; (ii) maintain an effective financial accounting system that can record transactions involving program resources and is integrated with the agency's own systems and internal control structure; (iii) prepare financial statements and other reports required by the Bank, including semiannual reports on movements of the revolving fund; (iv) prepare disbursement requests and supporting documentation for eligible program expenditures; and (v) maintain the system to store supporting documentation for eligible expenditures, to be reviewed by Bank staff and external auditors.
- 3.3 The project management coordinator running the program will have duties in relation to this loan that include the following: (i) conduct competitive bidding or tenders as required by SEFIN, the central bank, and UNAT; (ii) support SEFIN in fulfilling the conditions precedent to the first disbursement of financing; (iii) work with the DEI coordinator to coordinate SEFIN activities with those funded under the DEI subcomponent of the program; (iv) consolidate work plans, budgets, flows of funds, replenishment or disbursement requests, regular reports, and financial statements for the program; (v) monitor and control the fulfillment of obligations under the loan contract; (vi) request nonobjections from the Bank as necessary; (vii) prepare annual work execution plans for the components he or she coordinates; (viii) account for funds advanced and prepare disbursement, payment, or replenishment requests.
- 3.4 The SEFIN Technical Steering Committee will handle technical coordination of the program. Under the direction of the SEFIN deputy ministers, the Technical Steering Committee will be the decision-making body for the program. It will include the SEFIN department directors, including the Revenue Office (DEI). For matters relating to the UNAT and central bank component, the Technical Steering

Committee will invite the director of UNAT and the president of the central bank to sit on the committee. The minister who heads the National Institute for Women's Affairs will also serve on the Technical Steering Committee in a guest capacity. The operating Regulations for the program will set out the Technical Steering Committee's duties and responsibilities as agreed between the Bank and the borrower.

- 3.5 A consultant with international experience will support the Technical Steering Committee as chief technical advisor (CTA) for SEFIN's country financial accountability assessment (CFAA). This program will fund the CTA for the first two years. For the remainder of the execution period the position will be funded by the World Bank PRS-TAC. The CTA will coordinate, implement, and execute the several program components for which SEFIN is responsible under the CFAA recommendations. The CTA will also report to SEFIN on component progress and keep data up to date for the program indicators agreed with the Bank. The CTA will coordinate with the central bank and DEI through the central bank coordinator and DEI coordinator, as well as with UNAT, to ensure consistency in component execution. The CTA and an assistant will work at SEFIN, which will provide office space and logistical support (for details see the Operating Regulations for the program):
 - a. The chief technical advisor (CTA) will be a consultant with international experience, who will advise SEFIN on all activities associated with technical execution of this program and the World Bank PRS-TAC at SEFIN, coordinate execution of the central bank and UNAT components, run Technical Steering Committee meetings, and support the committee in implementing the proposed reforms.
 - b. The CTA will be assisted by a local consultant, who will provide support on all technical and administrative activities related to program execution.
- 3.6 An open competition will be held for these two consultant positions, in accordance with Bank policies. They will be funded under project preparation facility loan 1508/SF-HO.
- 3.7 **Execution of activities at the DEI.** Given its special subject-matter, activities under the DEI subcomponent will be executed by personnel hired with IDB/SIDA cofinancing, who will work at the DEI:
 - a. A DEI coordinator, who will report to the director of the DEI and work directly with the DEI technical team. As the person in charge of technical execution of the DEI subcomponent, he or she will prepare and submit to the PMU coordinator terms of reference for consultants to be hired and technical specifications for works, goods, and related services to be funded with DEI subcomponent resources. The DEI coordinator will also provide the PMU with

the administrative documentation it needs for financial reports, disbursement requests, contract preparation, etc.

- b. A chief technical advisor (CTA-DEI) will be a consultant or consultants with international experience in taxation and customs, who will advise the DEI on all relevant program activities. The CTA-DEI may be multiple experts, depending on the subject-matter, and will be responsible for the technical quality of outputs and progress under the DEI subcomponent.
 - c. The DEI coordinator will be assisted by a local consultant, who will provide support on all administrative activities related to execution of the DEI subcomponent.
- 3.8 **Execution of the UNAT and central bank components.** Both UNAT and the central bank will be responsible for technical execution of their respective subcomponents. The central bank will hire a coordinator (BCH coordinator). UNAT and the central bank will submit to the PMU coordinator the terms of reference for consultants to be hired, technical specifications for goods and related services to be procured, and progress reports on the program. SEFIN, acting through the PMU, will be in charge of all administrative aspects of these components. Under no circumstances will SEFIN transfer cash proceeds of the loan to UNAT or the central bank. The Operating Regulations for the program, agreed upon in advance between the Bank and borrower, will set out in detail the arrangements for execution of the UNAT and central bank components.
- 3.9 **Management of SIDA cofinancing.** At SIDA's request, Sweden will deposit the grant funds for its cofinancing of this program in a Special Account used by the Bank for such purpose. The Bank will charge administrative fees as agreed with the Government of Sweden.⁷ As a condition precedent to the first disbursement, the cofinancing agreement between the borrower and SIDA and the funds management agreement between the Bank and SIDA must be signed and in effect. The provisions of such agreements must include: (i) the timetable for SIDA to supply grant resources to the borrower; (ii) the borrower's and SIDA's acceptance that such contributions are to be managed by the Bank, in accordance with its policies and procedures; and (iii) the borrower's commitment to use such contributions solely and exclusively for the purposes described in the loan contract.
- 3.10 **Operating Regulations.** The program activities will be conducted under specific rules and procedures set out in the Operating Regulations for the program. As a condition precedent to the first disbursement, the Operating Regulations for the program must have entered into effect on the terms previously agreed with the Bank.

⁷ "Framework Agreement," 23 September 1999.

3.11 **Kickoff meeting.** Once the operation has been approved, the kickoff meeting will be held with authorities from SEFIN, DEL, the central bank, and UNAT, along with IDB, SIDA, and World Bank staff; to (i) review the AOP for year one, coordinate it with the activities funded by the World Bank, the active loan at SEFIN, and the PRS-TAC, and determine what remains to be done under the new PPF and included in the AOP for year one; (ii) review the logical framework; (iii) present and/or reinforce the IDB's procurement rules; and (iv) review the Operating Regulations. The joint action plan will be finalized, and the logical framework for this program merged with the results framework for the World Bank PRS-TAC, at the kickoff meeting, to establish a set of baseline, midterm, and final indicators for the entire fiscal management program, tied to the CFAA action plan. The kickoff meeting for the program will be held within 30 days after the effective date of the loan contract.

C. Procurement

3.12 The Bank's policies and procedures will be followed in the procurement of works, goods and related services, and consulting services. International competitive bidding will be mandatory for contracts with an estimated cost of US\$1.5 million or more for works and US\$350,000 or more for goods. An international open competition will be held for consulting contracts over US\$200,000. Local laws will govern the procurement of works, goods, and services of lesser value.

3.13 Authorization is requested to use the loan proceeds to fund the continuation of services of individual consultants hired under project preparation facility loan 1508/SF-HO, which financed preparation activities for this operation. These individual consultants should be retained to support the institutional strengthening of SEFIN by supervising program execution and the implementation of newly designed methodologies. They will also provide the training needed to institutionalize the designs.

D. Execution period and disbursement timetable

3.14 The program execution period will be 48 months, and the disbursement period 60 months, both running from the effective date of the loan contract. Table III-1 shows the planned disbursement timetable, based on these periods.

Table III-1. Disbursement timetable (in US\$ millions)

Source	Year 1	Year 2	Year 3	Year 4	Total	%
IDB/FSO	6.7	5.3	2.20	0.8	15.00	82
SIDA/Local	0.9	1.2	1.0	0.25	3.35	18
Total	7.6	6.5	3.45	1.05	18.35	100
%	41	35	18	6	100	

- 3.15 **Revolving fund.** The loan proceeds will be deposited via the Central Bank of Honduras in a separate SEFIN account exclusively for program execution. In accordance with Bank policies, a revolving fund of up to 5% of the total loan amount is recommended. Supporting documentation for goods and services procurements and disbursement requests will be reviewed ex ante during program execution. The executing agency will deliver semiannual status reports on the revolving fund within 60 days after the end of each semester.
- 3.16 **Audits.** During the program, the borrower will submit annual financial statements through the executing agency. External audits of the program will be performed by an independent audit firm acceptable to the bank, in accordance with Bank policies using the guidelines established in the Terms of Reference for External Audits of IDB-Financed Projects (document AF-400). The firm will be contracted using the procedures described in the Audit Bidding Document (document AF-200).
- 3.17 The external audits will be financial and operational in nature. A semiannual “interim” report on the program will be submitted within 60 days after the end of the first semester of each year. An annual report on the program’s financial statements will be submitted within 120 days after the end of fiscal year. The final audited financial statements for the program will be submitted within 120 days after the last disbursement. The auditing costs will be included in the program costs and financed with the Bank loan proceeds.

E. Monitoring and Evaluation

- 3.18 SEFIN, through the PMU, will submit semiannual reports to the Bank, beginning on the date the program is declared eligible for disbursements. The reports will cover progress on the AOP. The Bank and SEFIN will reach agreement on the structure for the semiannual reports. The Bank’s Country Office in Honduras will monitor the program with support from RE2/SC2 and INT/ITD for the DEI activities, based on information in the AOPs and the semiannual physical and annual financial progress reports received from the executing agency through the PMU.
- 3.19 Beginning in program year one, the IDB, SIDA, SEFIN, and the World Bank will hold annual follow-up meetings to agree on the incoming AOP and review performance under the outgoing AOP. The performance indicators described in the program framework will also be reviewed at such meetings, and the efficiency of the execution arrangements proposed here will be assessed.
- 3.20 A midterm review and final evaluation of the program are also proposed, both funded with loan proceeds. These will be based on the indicators and physical targets set in the logical framework and agreed on at the kickoff meeting. With the chief technical advisor’s support, SEFIN will keep information up to date and generate the indicators regularly. SEFIN, the IDB, SIDA, and the World Bank will

hold meetings to review the evaluations and agree on ways of implementing any recommendations that may come out of them. The midterm review will be done 24 months after the effective date of the loan contract, or once 50% of the loan proceeds have been disbursed, whichever comes first.

- 3.21 The final evaluation will be done once 90% of the loan proceeds have been committed, and will focus on: (i) determining how well the program objectives and those of its individual components have been accomplished, including progress on IFMS modifications and migration with World Bank financing, so as to gauge overall progress during program execution in terms of procedures and information technology; (ii) evaluating program design and execution, to identify lessons learned; and (iii) recommending action to be taken, and design elements to be replicated or eliminated in other, similar operations.

IV. VIABILITY AND RISKS

A. Institutional viability

- 4.1 The program activities and expected outcomes are geared toward restructuring the Ministry of Finance (SEFIN) internally in areas where it comes into contact with its customer agencies, so that it can meet the government's obligations to its citizens by efficiently, effectively, and transparently managing the flow of resources for many different uses from a variety of sources. By program end, SEFIN will be able to perform its assigned functions in a simplified, transparent manner, efficiently managing government finances and taxation, reducing evasion, and supplying better information for decisions to be made on expenditures, investments, and borrowing. Current procedures will be replaced by tools for online decision-making, electronic data exchange, integrated transaction processing, and document management systems. All these steps will make SEFIN more efficient and effective.
- 4.2 A key factor in achieving the program objectives will be communication among SEFIN's various areas of operation, and making decisions based on internal consensus. SEFIN's Technical Steering Committee will serve as the program consultation body for building consensus and reaching the internal agreements needed to execute the SEFIN and Revenue Office (DEI) components, as well as forge the ties necessary for the systems and information developed under the Technical Support Unit (UNAT) component to be compatible with the statistics coming out of the central bank component.

B. Environmental and social impact

- 4.3 Given the nature of the operation, the project team anticipates no direct environmental or social impact. The Committee on Environment and Social Impact (CESI) reviewed this document at its 21 November 2003 meeting and agreed with the project team's assessment.

C. Benefits

- 4.4 The program's prime benefit will be a better budget system at all levels, on both the revenue and expenditure side and in expenditure planning for the PRS, which is the principal tool of medium- and long-range planning. A more efficient and effective SEFIN will mean more transparent budget formulation, monitoring, execution, and evaluation consistent with the country's development objectives. Such enhancements will also be pivotal in achieving the physical targets that are sure to be part of the PRGF program being discussed with the International Monetary Fund.

- 4.5 Institutional strengthening under the central bank component will have a very beneficial long-term impact on effectiveness, efficiency, and transparency in the design, implementation, monitoring, and consistency of economic policy, especially in terms of coordination between fiscal and monetary policy, by providing a stream of fully interrelated macroeconomic data consistent across sectors, based on timely, integral, and more accurate and reliable statistics than currently available. This will lower unnecessary costs in economic policy implementation and empower the private sector to make the right decisions for better allocation of productive resources.

D. Risks

- 4.6 The program will fund activities at several different agencies. As such, the main risk lies in insufficient coordination and follow through. To mitigate this risk, SEFIN's Technical Steering Committee will direct technical execution of the program with explicit functional guidelines and documented tasks. The chief technical advisor will provide guidance and coordination among the three components. Management and technical staff from all three agencies supported by this program will serve on the Technical Steering Committee.
- 4.7 SEFIN's institutional weakness and the many international and bilateral institutions operating in Honduras make external assistance and complementary activities difficult to coordinate. This program mitigates such risk by setting up a joint technical execution structure with the World Bank, tied in to the Technical Steering Committee, and by cofinancing the program with SIDA, which is the chief donor in the area of tax administration and policy. The SIDA cofinancing also eliminates the risk to the program associated with the country's fiscal position, since the Government of Honduras will not be required to put up a local counterpart.
- 4.8 While the Financial Management Act would facilitate the enhancements proposed here, its enactment is not a sine qua non. This program is an administrative reform that can operate on the basis of current legislation and fill any existing gaps. Significantly, however, the Act's passage is a conditionality on the first World Bank poverty reduction support credit (PRSC), making it all the more urgent. At SEFIN's request, the IDB has hired a senior consultant through the Project Preparation Facility (PPF) to support the authorities in preparing the final preliminary version of the bill, so that it can be passed promptly. The National Assembly is expected to pass the Financial Management Act before the World Bank approves the PRSC in June/July 2004.
- 4.9 Another potential risk is related to overly high staff turnover in the areas targeted for assistance. Without workforce stability over time, the investment of effort may quickly be diluted, and the agency will have to engage in an ongoing process of adjustment. The program should sharpen the technical skills of SEFIN, UNAT, DEI, and central bank staff and build a management structure on a technical

foundation that meets policy needs. Standardized procedures and training, along with clearer job descriptions and requirements for technical positions, will aid recruitment and make it easier to train staff in the agency's specific procedures.

**SUPPORT FOR STRENGTHENED FISCAL MANAGEMENT (HO-0208)
LOGICAL FRAMEWORK**

Narrative Summary	Indicators	Means of Verification	Assumptions
Goal			
To help Honduras better manage its government finances, so that the State can perform its function of providing citizens with fairly and efficiently funded services.	Improve the country's rankings in the Transparency International index, the Heritage Foundation index of openness, the World Bank index of ease of doing business, and the Moody's and Standard and Poor's credit ratings.	Change in Honduras's ranking in published indices.	The next administration continues execution of the program.
Purpose			
To make revenue collection more effective, and expenditures more efficient and effective; to create greater linkage between fiscal and monetary policy; and to establish mechanisms that measure the impact of management on poverty reduction strategy (PRS) indicators.	(i) Revenue collection rises 6% by end-2007. (ii) By 2006, 100% of expenditures are tied to the National Development Plan. (iii) By 2006, the Technical Support Unit (UNAT) of the Office of the President has the capacity to monitor PRS impact using data from the Ministry of Finance (SEFIN), the central bank, the National Institute of Statistics (INE), and management planning and evaluation units (UPEGs).	Final evaluation of the project in relation to SEFIN performance in terms of accomplishing sector plans and their cost, the size of the projected budget deficit, the ratio of expenditures to tax revenue collection, performance on the financial market and the accessibility of financial information to civil society, central bank statistics manuals in line with IMF manuals, PRS indicator tracking reports.	No external climate, financial, or economic factors.
Components			
1. Ministry of Finance (SEFIN)			
Strengthening of SEFIN. SEFIN and the Revenue Office (DEI) restructure internally, building SEFIN's capacity as the public finance policymaker and coordinator of the financial management system.	The government's consolidated financial statements are delivered within 90 days after the close of the fiscal year by 2007.	Consolidated financial statements CFAA for 2007.	The authorities have the political will to continue the reform process.
a. Administrative reorganization of SEFIN. SEFIN has a human resources and training system, to make the package of reforms and simplified internal procedures sustainable, and management more efficient.	(i) The "one-stop service" concept has been implemented by year 2. (ii) 100% of SEFIN staff have a clear job description and assigned functions by 2006, and at least 80% have been trained in those functions by 2007.	Measurement of procedures for certifications, customs exemptions, power-of-attorney management, judicial notices, and legal opinions.	The authorities have the political will to continue the reform process.

Narrative Summary	Indicators	Means of Verification	Assumptions
<p>b. Better revenue management. The DEI can perform its foreign trade and frontier collection and control functions effectively.</p>	<p>(i) A selective enforcement model using the risk analysis method for both customs and domestic taxation results in:</p> <ol style="list-style-type: none"> 1. Annual enforcement plans that call for 50% more businesses to be audited each year from 2006 to 2008. 2. More successful customs and domestic tax enforcement actions using a risk-based system. 3. Collection revenue, discounted for the effects of integration and trade agreements, rises by 1% of GDP by 2006. 	<ol style="list-style-type: none"> 1. The DEI's website is up and running for public access to financial data on revenue collection. 2. Hiring under the new system begins by 2006. 3. Evaluation reports on training. 4. Performance evaluations of trained staff. 5. Usage evaluations of new systems by trained staff. 6. Usage evaluations of new systems by trained staff. 	<p>The authorities have the political will to continue the reform process.</p>
<p>c. Better expenditure management. SEFIN has the capability to manage public expenditures more efficiently and effectively, facilitating the generation and dissemination of information within the ministry and to its customer government agencies.</p>	<p>Economic and fiscal analysis</p> <p>(i) Timely information on the fiscal deficit is reported to the central bank by 2005.</p> <p>Budgeting</p> <p>(i) All public resources are included in budget planning with targets, goals, performance indicators, and dates by 2006.</p> <p>Treasury</p> <p>(i) Floating debt falls by 20% each year during program execution. (ii) Annual and monthly plans for program-based flows of funds from 2006 onward. (iii) Responsibilities for external debt management are well defined among the National Treasury of Honduras (TGR), central bank, and Office of Public Credit (DGCP) by 2006. (iv) The number of government accounts drops from 1,050 to 50 by 2007 on the way to a single treasury account system.</p>	<p>Economic and fiscal analysis</p> <ol style="list-style-type: none"> 1. Published economic indicators. 2. Data revised weekly. <p>Budgeting</p> <ol style="list-style-type: none"> 1. A 100% program-based budget prepared by the central government in 2006. 2. Budget proposal. 3. Publicly accessible data on budget execution on SEFIN's website. 4. Country Financial Accountability Assessment (CFAA) for 2007. <p>Treasury</p> <ol style="list-style-type: none"> 1. Annual financial statements of the National Treasury of Honduras (TGR). 2. Disbursement plan published by the TGR. 3. Updated manuals at the TGR. 4. No debt payments are made by the central bank or DGCP in 2007. 5. Account balances. 6. Only one account per ministry. 7. Government's audited financial statements. 	<p>Political will.</p>

Narrative Summary	Indicators	Means of Verification	Assumptions
	<p>General Accounting Office (CGR)</p> <p>(i) 90% of the Honduran government's financial transactions are recorded in a timely manner by 2006, reducing transactions not timely recorded from an average of 6 billion to 600 million lempiras per month.</p> <p>(ii) The CGR's structure is aligned with its functions by 2007.</p> <p>Internal control</p> <p>(i) The Office of the Budget (DGP) conducts preaudits of disbursements over [to be determined] lempiras.</p> <p>Public Investment Reporting System</p> <p>(i) The average rate of return on investment is measured.</p>	<p>General Accounting Office (CGR)</p> <ol style="list-style-type: none"> Government financial statements. New organizational structure with staff job descriptions. Country Financial Accountability Assessment (CFAA) for 2007. <p>Internal control</p> <ol style="list-style-type: none"> Manuals and guidelines published on the website. Number of disbursements and amounts requiring preaudit. <p>Public Investment Reporting System</p> <ol style="list-style-type: none"> A single system for tracking investments that combines the SISPU Public Investment Reporting System and the National System for International Cooperation (SINACOIN) and reports data to the Integrated Poverty Reduction Tracking System (SIERP) in a timely manner, once implemented with the capacity to measure average return on investment. 	
2. Central Bank of Honduras			
<p><i>Strengthening of areas at the Central Bank of Honduras involved in compiling, storing, and analyzing economic statistics.</i></p> <p>The central bank has the capacity to conduct monetary policy in a way that complements fiscal policy.</p>	<p>(i) A system for up-to-date reporting on the monetary sector, balance of payments, external debt, and fiscal position has been established by 2007.</p>	<ol style="list-style-type: none"> Reporting flow and coverage is more current. 	<p>Political will and availability of specialists.</p>

Narrative Summary	Indicators	Means of Verification	Assumptions
3. Technical Support Unit (UNAT) of the Office of the President			
<p><i>Set up the Integrated Poverty Reduction Tracking System (SIERP).</i> UNAT has the capacity to monitor the PRS using data from the Integrated Financial Management System (IFMS), the central bank, the SISPU, SINACOIN and other reporting systems, and management planning and evaluation units (UPEGs).</p>	<p>(i) UNAT reports identifying PRS accomplishments, based on performance indicators identified by 2006.</p>	<p>Information generated. System as implemented. Evaluation reports. Country Financial Accountability Assessment (CFAA) for 2007.</p>	<p>Political will and availability of specialists.</p>
<p>Activities</p> <p style="text-align: center;">See the Operating Regulations for a detailed description of activities.</p>			

**PROCUREMENT PLAN
SUPPORT FOR STRENGTHENED FISCAL MANAGEMENT (HO-0208)**

Major Procurement Items ¹	Funding Sources		Procurement Method ²	Prequalification	Specific Procurement Notice	Status ³
	IDB (%)	Local/ Other (%)		Yes/No	Tentative publication date	
1. Goods <i>Computer hardware at SEFIN 1</i> Program management Amount: US\$200,000 Revenue Office (DEI) Amount: US\$2,132,000	100 61	0 39	PQ ICB	No No	Second quarter 2004 Fourth quarter 2004	Pending Pending
<i>Computer hardware at SEFIN 2</i> Budget Office, Accounting, Treasury, Internal Control, Public Investment Office, Economic and Fiscal Analysis Unit Amount: US\$400,000, divided several ways	100	0	PQ	No	First quarter 2005	Pending
<i>Computer hardware at Central Bank of Honduras</i> Amount: US\$212,450	100	0	ICB	No	First quarter 2005	Pending
<i>Computer hardware at UNAT</i> Amount: US\$30,000	100	0	PQ	No	First quarter 2005	Pending
<i>Computer hardware at SEFIN 3</i> Human Resources, Training, and Administrative Department Amount: US\$300,000	100	0	PQ	No	Fourth quarter 2006	Pending
2. Works <i>Improvements to DEI departments of internal revenue and customs</i> Average amount per project: US\$300,000	61	39	LCB	No	Second quarter 2005	Pending

¹ **CIE:** Consultants with international experience **LC:** Local consultants

² Notes: **ICB:** International competitive bidding **LCB:** Local competitive bidding **PQ:** Price quotations (shopping)
 DC: Direct contracting **LB:** Limited bidding **FA:** Force account

³ The terminology used will be: Pending / in process / awarded / canceled.

Major Procurement Items ¹	Funding Sources		Procurement Method ²	Prequalification	Specific Procurement Notice	Status ³
	IDB (%)	Local/ Other		Yes/No	Tentative publication date	
3. Consulting services						
<i>SEFIN Expenditure Area</i>						
75 months CIE Average contract: US\$70,000	100	0	LCB	No	First quarter 2004	In process
90 months LC Average contract: US\$20,000	100	0	LCB	No	First quarter 2004	Pending
1 consulting firm for implementation of internal control Amount: US\$351,000	100	0	ICB	Yes	Fourth quarter 2004	Pending
<i>SEFIN restructuring and human resources</i>						
2 consulting firms for design, implementation, and training Average contract: US\$500,000	100	0	ICB	Yes	Second quarter 2004	Pending
<i>SEFIN DEI</i>						
600 months LC Average contract: US\$36,000	61	39	LCB	No	Second quarter 2004	Pending
100 months CIE Average contract: US\$30,000	61	39	LCB	No	Second quarter 2004	Pending
<i>Central Bank of Honduras</i>						
35 months CIE Average contract: US\$80,000	100	0	LCB	No	Third quarter 2004	Pending
582 months LC Average contract: US\$30,000	100	0	LCB	No	Third quarter 2004	Pending
<i>Technical Support Unit</i>						
1 consulting firm for design, implementation, and training Amount: US\$730,000	100	0	ICB	Yes	Fourth quarter 2004	Pending
1 CIE as chief technical advisor (CTA) at UNAT 2 years: US\$240,000	100	0	ICB	No	Fourth quarter 2004	Pending
<i>Project management</i>						
24 months CIE Amount: US\$336,000	100	0	ICB	No	First quarter 2004	In process
72 months LC Average amount: US\$100,000	100	0	LCB	No	Second quarter 2004	In process

¹ **CIE:** Consultants with international experience **LC:** Local consultants

² Notes: **ICB:** International competitive bidding **LCB:** Local competitive bidding **PQ:** Price quotations (shopping)
DC: Direct contracting **LB:** Limited bidding **FA:** Force account

³ The terminology used will be: Pending / in process / awarded / canceled.