

**Validation of Honduras**  
Draft Validation Report  
Adam Smith International Independent Validator  
10 Aug 2017

**1. EXECUTIVE SUMMARY**

Honduras became an EITI Candidate country on 22 May 2013. The EITI International Board agreed at its 33<sup>rd</sup> Board meeting in May 2016 that Honduras should be Validated commencing on 1 January 2017. Honduras embedded the EITI Standard into its legislative framework, through the 2013 Mining Law, which mandates mining title holders to comply with EITI.

This draft validation report follows on from a quality assurance review of the International Secretariat's initial assessment. The Validator agrees with the Secretariat's preliminary assessment that progress on requirements 1.1, 1.2, 1.3, 1.5, 4.1, 4.6, 4.9, 6.1, 6.3, 7.1, 7.3 and 7.4 are less than satisfactory.

**2. BACKGROUND**

Honduras's extractive sector is small, but there has been interest in expanding mining investments and in developing the hydrocarbon sector. According to the most recent EITI Report, the mining sector contributes 1% to GDP, accounts for 4% of exports<sup>1</sup>, provides approx. 6 500 jobs and accounts for 0.8% of government revenue. Informal mining activities are estimated to be three to four times larger than those of the commercial mining sector (EITI Honduras, 2016f).

The mining sector in Honduras is regulated by the General Mining Law of 2013 and managed by INHGEOMIN under the EITI Principles. The Ministry of Natural Resources and Environment (SERNA/MIAMBIENTE) is responsible for managing the hydrocarbon sector. Extractive companies are subjected to taxes as per the Tax Code, the General Mining Law, the Hydrocarbon Law, the prevailing hydrocarbon contracts and municipal taxes levied directly at the sub-national level as per the Municipal Law. Mining licenses are administered by INHGEOMIN.

Development prospects in the extractive sectors are uncertain. Low commodity prices, increased operation costs and a lack of social license to operate has clouded the outlook for mining companies exploring for gold, iron oxide, lead, silver and zinc. Plans for formalising the informal mining sector are delayed due to the failure to secure an operator for a proposed 200-hectare artisanal mining park. Municipal governments along with the mining regulator INHGEOMIN coordinate efforts to organize the high levels of small scale, artisanal, informal and illegal mining across the country.

The hydrocarbon sector is managed under a contract regime with licenses negotiated directly between the Government and the companies. In 2013 the Government of Honduras signed a contract with British Gas (BG) to explore for oil offshore. The area of approximately 300 million km<sup>2</sup> is located in eastern province of Mosquitia near the Caribbean Sea. With current low oil prices, the outlook of this project is uncertain<sup>2</sup>. If

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<sup>1</sup> [http://www.bch.hn/honduras\\_en\\_cifras.php](http://www.bch.hn/honduras_en_cifras.php)

<sup>2</sup> <http://www.latribuna.hn/2016/06/28/pasa-british-gas/>

exploration goes ahead as planned, it is expected the citizens of Honduras will know by August 2017 if their country has commercial quantities of oil<sup>3</sup>. Other oil exploration contracts have been inactive.

Mining and oil are regarded as a medium-long term sources of economic growth by the government and the industry. Civil society organizations (CSOs) and local communities question the negative environmental impacts, including those associated with informal mining. There was also an expectation that the 2013 Mining Law would help stabilize tax levels. More generally, following a recommendation of the International Monetary Fund (IMF), Honduras' tax system is being overhauled, resulting in the creation of the new tax authority, the System for Rent Administration (SAR).

In line with the Validation Guide, the International Secretariat carried out the first phase of validation—initial data collection, stakeholder consultations, and preparation of their initial evaluation of progress against the EITI requirements (the “Initial Assessment”). Adam Smith International (ASI) was appointed as the independent Validator to evaluate whether the Secretariat's work was carried out in accordance with the Validation Guide. ASI's principal responsibilities as Validator are to review and amend the Initial Assessment, as needed, and to summarize its independent review in this Validation Report for submission to the Board through the Validation Committee.

### **1. Work Performed by the Independent Validator**

The Secretariat's Initial Assessment was transmitted to ASI on 16<sup>th</sup> July, 2017. Our Validation Team undertook this phase of the Validation process through: (1) In-depth review and marking up of the EITI Assessment by each team member; (2) Detailed review and comments by the Multi-Stakeholder Specialist of Requirements 1 and the Civil Society Protocol; (3) Detailed review and comments by the Financial Specialist of Requirements 4, 5 and 6; (4) Consolidation of reviews and the production of this draft Validation Report, sent to the International Secretariat on the 6<sup>th</sup> August, 2017.

### **2. Comments on the Limitations of the Validation**

The Validator carefully reviewed the Secretariat's Initial Assessment and at this stage has no comments on the limitation of the validation process.

### **3. Comments on the International Secretariat's Initial Assessment**

The initial data collection, stakeholder consultations, and drafting of the Initial Assessment were generally undertaken by the International Secretariat in accordance with the 2016 Validation Guide. The data collection took place across three phases. Firstly, from 1<sup>st</sup> January to 30<sup>th</sup> March 2017, a desk review of the available documentation relating to the country's compliance with the EITI Standard, including but not limited to:

- The EITI work plan and other planning documents such as budgets and communication plans;
- The multi-stakeholder group's Terms of Reference, and minutes from multi-stakeholder group meetings;
- EITI Reports, and supplementary information such as summary reports and scoping studies;
- Communication materials;

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<sup>3</sup> <http://www.elheraldo.hn/pais/990024-466/bg-group-shell-se-prepara-para-comenzar-fase-de-perforar-pozos-en>

- Annual progress reports; and
- Any other information of relevance to Validation.

Secondly, a country visit, which took place from 6<sup>th</sup> to 10<sup>th</sup> February 2017. All meetings took place in Tegucigalpa. The secretariat met with the multi-stakeholder group and its members, the IA and other key stakeholders, including stakeholder groups that are represented on, but not directly participating in, the multi-stakeholder group.

Finally, the International Secretariat prepared a report making an initial assessment of progress against requirements in accordance with the Validation Guide. The initial assessment did not include an overall assessment of compliance. The report was submitted to the Validator, with the National Coordinator (NC) also receiving a copy.

## 2. GENERAL COMMENTS

- **Progress in EITI Implementation**

Honduras set out to implement the EITI in 2013 with sound multi-stakeholder engagement. The initial effort given to the EITI was meticulous and in full alignment with the EITI Standard. Crucially, Honduras embedded the EITI Standard into its legislative framework. The Mining Law of 2013 mandates mining title holders to comply with the Standard. The contract signed with the BG Group also obliged the company to follow the EITI's disclosure requirements. The process was supported by international partners including the World Bank with funding through the multi-donor trust fund (MDTF).

In preparing for the first reporting cycle, EITI-Honduras sought to address capacity constraints, raising awareness about transparency and good management of natural resources. More importantly, government agencies involved in managing and monitoring the oil, gas and mining sector prepared to provide information in accordance with the EITI Standard. The mining regulator, the tax office and the finance ministry were brought together to understand and design the scope of the reporting process. The mining regulator overhauled the licensing and cadastre system and other internal procedures with the EITI as guide. Civil society and industry representatives actively engaged with government officials during this phase. Stakeholders comment that the multi-stakeholder group collaboration was institutionalised. In a country with high level of distrust toward the mining and oil industries, this trust-building collaboration was a significant achievement.

The two EITI Reports published by EITI-Honduras to date, covering three fiscal years, have provided an unprecedented overview of the extractive industries. While some of the data was not new, it had never previously been brought together in this way. In addition, the report provided disaggregated data that was not previously publicly available. That said, this initial assessment has identified several areas that require further attention.

- **Impact of EITI Implementation**

The EITI Standard has been an important reference for government agencies in modernizing their systems and embedding transparency. This work could be further strengthened, e.g., by further improving the cadastre system to include beneficial ownership information, harmonizing the classification of extractive companies by the mining regulator, and integrating revenue collection data in the systems of the tax agency (SAR). There are also opportunities, using the financial monitoring systems (national and municipal) in the finance ministry, to examine how EI revenues are distributed and utilised.

While the EITI has made a good start in building trust, the information produced through the EITI needs to put to better use. The data could be used to examine whether all companies have paid the correct amount of tax (a subject of considerable debate), and disclosing municipal-level information on revenue transfers and the utilisation of these funds. Others issues such as the cost structure in the mining industry and social contributions from mining companies could be more widely addressed and discussed.








Finally, the government needs to put the EITI on a sounder footing. Honduras's oil, gas and mining sector is small, and there should be a careful consideration of costs and benefits. The government should consider hosting the EITI supporting unit in one of the government agencies already involved in the EITI work. The government should also continue to explore opportunities to integrate the EITI's disclosure requirements in existing systems in the mining regulator, the tax agency, the finance ministry and IAIP. This approach would free up resources, with the EITI playing a greater role in analysing this data and communicating it more effectively. This approach could reduce the cost of EITI implementation while increasing its impact at the national and local level.

## The Independent Validator's Assessment of Compliance

Figure 1 – Validator's assessment

EITI Requirements		Level of progress				
		No progress	Inadequate	Meaningful	Satisfactory	Beyond
Categories	Requirements					
MSG oversight	Government engagement (#1.1)					
	Industry engagement (#1.2)					
	Civil society engagement (#1.3)					
	MSG governance (#1.4)					
	Work plan (#1.5)					
Licenses and contracts	Legal framework (#2.1)					
	License allocations (#2.2)					
	License register (#2.3)					
	Policy on contract disclosure (#2.4)					
	Beneficial ownership (#2.5)					
	State participation (#2.6)					
Monitoring production	Exploration data (#3.1)					
	Production data (#3.2)					
	Export data (#3.3)					
Revenue collection	Comprehensiveness (#4.1)					
	In-kind revenues (#4.2)					
	Barter agreements (#4.3)					
	Transportation revenues (#4.4)					
	SOE transactions (#4.5)					
	Direct subnational payments (#4.6)					
	Disaggregation (#4.7)					
	Data timeliness (#4.8)					
	Data quality (#4.9)					
Revenue allocation	Distribution of revenues (#5.1)					
	Subnational transfers (#5.2)					
	Revenue management and expenditures (#5.3)					
Socio-economic contribution	Mandatory social expenditures (#6.1)					
	SOE quasi-fiscal expenditures (#6.2)					
	Economic contribution (#6.3)					
Outcomes and impact	Public debate (#7.1)					
	Data accessibility (#7.2)					
	Follow up on recommendations (#7.3)					
	Outcomes & impact of implementation (#7.4)					
<b>Overall assessment</b>	<b>To be determined by the Board</b>					

*Legend to the assessment card*

	The country has made no progress in addressing the requirement. The broader objective of the requirement is in no way fulfilled.
	The country has made inadequate progress in meeting the requirement. Significant elements of the requirement are outstanding and the broader objective of the requirement is far from being fulfilled.
	The country has made progress in meeting the requirement. Significant elements of the requirement are being implemented and the broader objective of the requirement is being fulfilled.
	The country is compliant with the EITI requirement.
	The country has gone beyond the requirement.
	This requirement is only encouraged or recommended and should not be taken into account in assessing compliance.
	The MSG has demonstrated that this requirement is not applicable in the country.

### 3. DETAILED FINDINGS

The Validator agrees with the findings of the Initial Assessment. Therefore there are no detailed findings on disagreements to report.

### 4. RECOMMENDATIONS

1. The MSG should agree a revised and fully costed work plan. The MSG should review the outcomes and impact of EITI implementation to date and revise the work plan objectives to ensure that they are clearly aligned with the national priorities for the extractive industry. The revised work plan would be an opportunity to reinvigorate government, industry, civil society and donor engagement. The Government could consider convening an EITI national conference to agree high-level objectives to inform future EITI work.
2. The MSG is encouraged to reconfirm the MSG membership and agree clear rules for rotating representatives of the MSG member organizations and ensure that these procedures are followed and documented.
3. The government should provide adequate support and funding for EITI-Honduras. The government should consider hosting the National Secretariat in a government agency already involved in EITI work. The MSG should ensure that the Secretariat provides adequate support and coordination to deliver the agreed work plan.
4. The industry constituency should review its engagement in the EITI, consider opportunities to work more closely with the MSG to ensure that EITI-Honduras discusses, addresses and communicates more effectively not only the Standard-mandated disclosures but other issues of interest to the industry constituency. This assessment should inform and be reflected in the MSG's revised work plan.
5. The civil society constituency should review its engagement in the EITI, clarify the objectives for EITI engagement, and explore options to ensure that it has adequate technical and financial capacity to participate fully in the process. Such an assessment could inform and be reflected in the MSG's revised work plan. CSOs could also consider reinvigorating its participation in the MSG by, for example, refreshing its representation.
6. The government is encouraged to provide INHGEOMIN with resources to update the technological platform supporting the cadastre system to allow improved public accessibility.
7. The MSG might wish to include in future reporting information on how the production volumes and values are calculated and any other information that could enhance the understanding on how mining production is monitored. The MSG may wish to explore working with the mining regulator INHGEOMIN, the customs agency and the finance ministry in ensuring mining production is properly recorded and monitored. The EITI Report can be used to comment on progress

addressing these issues.

8. The government is encouraged to continue strengthening INHGEOMIN's internal systems including the modernization of the consolidated annual declaration (DAC) and monitoring capacities and the collaboration with the customs agency, including harmonization of procedures.
9. The MSG should ensure that future reporting adheres to the standard terms of reference approved by the EITI Board. In particular, the MSG should adopt a definition of materiality that ensures that the scope of the reporting process is comprehensive and that all material companies participate. The MSG is encouraged to work with government authorities including INGHEOMIN and SAR to developing a classification protocol that ensure that the universe of mining companies is clearly identified.
10. The MSG should clearly establish whether direct payments, within the scope of the agreed benefit streams, from companies to municipalities are material. If material, the MSG should ensure that company payments to municipalities and the receipt of these payments are disclosed and reconciled in the EITI Report. The MSG is encouraged to consider collaborating with municipalities in mining areas to improve their capacity to collect, record and manage revenues from the extractive industries.
11. In accordance with the standard terms of reference, the MSG should ensure that the Independent Administrator provides an assessment of whether all companies and government entities within the agreed scope of the EITI reporting process provided the requested information. Any gaps or weaknesses in reporting to the Independent Administrator must be disclosed in the EITI Report, including naming any entities that failed to comply with the agreed procedures, and an assessment of whether this is likely to have had material impact on the comprehensiveness of the report. The Independent Administrator should also provide an assessment on the comprehensiveness and reliability of the (financial) data presented, clearly indicating the coverage of the reconciliation exercise based on the government's disclosure of total revenues.
12. The MSG might wish to consider bringing more information about how the revenues collected through the Population security fee are budgeted and spent.
13. The MSG should ensure that the reporting of social expenditures required by the Honduras Mining Law is comprehensive. Where the beneficiary of the mandated social expenditure is a third party, i.e. not a government agency, it is required that the name and function of the beneficiary be disclosed.
14. The MSG should ensure future EITI reporting includes the total of government revenues.
15. The MSG is encouraged to consider developing a communication strategy to ensure that EITI disclosures and findings are communicated more effectively and contribute to public debate. This could include more analytical work, better linkages with the work advanced by other organizations, and addressing other issues such as industry cost structures.



16. The MSG is encouraged to take a more active role in developing recommendations from EITI Reports, and monitoring progress with implementing these recommendations.
  
17. As suggested in recommendation 1 (requirement 1.5), the MSG might wish to review the outcomes and impact of the EITI implementation with a view on informing the discussion and elaboration of the next work plan, including setting specific implementation objectives that reflect the current national priorities for the extractive industry.

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