

# EITI INTERNATIONAL SECRETARIAT REVIEW OF THE KYRGYZ REPUBLIC, FEBRUARY 2011

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In accordance with the EITI Board decision on 19 October 2010 (see Annex A), this review was prepared by the EITI International Secretariat to supplement the Kyrgyz Republic Validation Report (February 2010)<sup>1</sup>.

## 1 Introduction

The Kyrgyz Republic was one of the first countries to commit to implement the EITI. The Government issued its first EITI report in October 2004, focusing on the gold mining sector for the first half of 2004. Data for the full year 2004 report were collected in March 2005. The EITI process stalled in 2006 and 2007. A new Government “champion” was appointed in 2008 and a decree was enacted to re-establish the EITI steering group. The first meeting of the new multi-stakeholder group - the Supervisory Board (SB) took place in late 2008. The most recent EITI Report was published in September 2009 covering data from 2008. Recently, the government established a Transparency Initiative for Fuel and Energy Sector (FESTI) modelled in part on the successful experience with the EITI. On 3 September 2010, the Supervisory Board appointed reconciler for the EITI report covering the 2009 financial year. The report is expected to be published in the second quarter of 2011.

The Kyrgyz Republic initiated validation in late 2009 and completed the process in early July 2010. The validation report was endorsed by the Supervisory Board on 26 June 2010. The validator found that the Kyrgyz Republic had met all but one of the validation indicators. Indicator 13 requires that government ensures that government reports are based on audited accounts to international standards. The validator found that “the reliability of the information of government reports has been questioned by a number of stakeholders, and there is no evidence that these concerns have been discussed by the SB or that any actions to address them have been taken” (page 18). The validator also reported conflicting views regarding the agreement of reporting templates and an agreed definition of materiality.

In Dar es Salaam, the Board agreed that the Kyrgyz Republic was a Candidate country as of 19 October and that based on a thorough assessment of the specific circumstances, the Kyrgyz Republic was considered to be ‘close to compliant’. The Board’s decision is attached at Annex A. Based on the Validator’s findings, the Board set out two remedial actions:

1. *The Supervisory Board should ensure that there is agreement regarding the reporting templates for the forthcoming EITI report, and the definition of material payments and revenues and related thresholds (indicator 9);*
2. *The government and Supervisory Board should take steps to ensure that government disclosures to the reconciler are based on audited accounts to international standards in accordance with the requirements as specified in Validation IAT 13.*

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<sup>1</sup> The Kyrgyz Republic validation report is available here: <http://eiti.org/KyrgyzRepublic>.

## 2 The Kyrgyz Republic response to the Board Decision

Following the Board's decision in October, the Supervisory Board undertook a number of corrective actions to strengthen EITI implementation, with a particular focus on ensuring that the Supervisory Board had a clearly agreed position on the reporting templates, the definition of materiality and the auditing of government accounts. On 13 January 2011 the Supervisory Board endorsed a memorandum 'On positions about indicators 9 and 13 of Validation Grid of the EITI Rules' (hereafter "the memorandum") to provide evidence of the Supervisory Board's agreed position on these issues. The Memorandum is attached at Annex B. On 14 January 2011 the Supervisory Board formally requested that the Secretariat conduct its review.

The EITI International Secretariat conducted a desk review in January and February 2011. The members of the Supervisory Board were given an opportunity to comment on the Secretariats' assessment.

## 3 Secretariat Review of Remedial Actions and Assessment of Indicators

As set out in Annex A, the EITI Board agreed two remedial actions and tasked the Secretariat with reassessing validation indicators 9 and 13.

### 3.1 Remedial Action 1

*The Supervisory Board should ensure that there is agreement regarding the reporting templates for the forthcoming EITI report, and the definition of material payments and revenues and related thresholds (indicator 9).*

#### 3.1.1 Validator's findings

The validator has set out the approach to defining materiality as follows:

*Government Resolution No. 382 "On further measures to implement EITI" approved by the EITI SB on 16 July 2008, set the threshold for EITI reporting for reconciliation purposes at US\$5million or more. Those companies with annual revenue over US\$5 million are required to submit EITI reports and are subject to review in the reconciliation report, while those companies with annual revenue under US\$5 million are required to submit reports but not subject to the reconciliation.*

*The SB meeting minutes indicate that a threshold of US\$5 million was ultimately decided upon for the threshold of participation in extractive companies in the EITI reconciliation. The minutes did not elaborate on why this level was chosen. However, further clarification was provided by the Secretariat, which stated that it had undertaken an analysis of revenues generated by the extractive sector and determined that 90% of revenues would be captured using the US\$5 million threshold. (page 12).*

However, the validator also notes that:

*The Validators did not find evidence that the issue of what constituted a 'material payment' had been formally discussed and agreed between government, companies and civil society members of the SB.*

*In addition, when the Validators observed the SB meeting on 22 January 2010, it was apparent from some of the questions raised in regard to revenue streams that some members were unclear of the concept of "materiality", referring to the need to capture very small revenue streams, and moreover that the triumvirate stakeholders were still not in accord as to what constitutes a material payment.*

For example, the validator notes that "payments made in cash or kind to local authorities" were of concern to civil society. In finding that the indicator is met, the validator emphasised that:

*...the reporting templates and threshold for reporting have been discussed on numerous occasions with full participation from all stakeholders and agreed by the SB. While a discussion of "what is a material payment" has not been made, it is the Validator's opinion that the extensive revisions of the reporting templates and*

*discussions on reporting in effect qualify as discussions over the definition of material payments in terms of threshold for reporting and included revenue streams.*

### 3.1.2 Progress since validation

As set out the Memorandum, the Supervisory Board has confirmed that there is a consensus on the reporting templates for the forthcoming EITI report and the definition of material payments and revenues and related thresholds. To summarize from the Memorandum:

- The Supervisory Board approved the reporting templates on 25 February 2010 based on experience from previous reporting cycles and following extensive stakeholder consultation;
- With respect to defining materiality, the Supervisory Board's agreed position is that "all taxes and payments from the mining sector have material importance .... Therefore reporting templates cover all taxes stipulated in the tax code of the Kyrgyz Republic". The reporting templates also include payments to local government.
- Given the large number of small companies, a threshold has been agreed for which companies will be subject to reconciliation. The agreed threshold is annual income of US \$1million (45 companies in the forthcoming report). Reports from companies below this threshold are reported without reconciliation.

### 3.1.3 Secretariat's Assessment

It is clear that the reporting templates have been agreed by the Supervisory Board, with appropriate consultation with stakeholders. The templates reflect an agreed approach to defining material payments and revenues. **The EITI International Secretariat's assessment is that the remedial action requested by the Board has been satisfactorily addressed.**

## 3.2 Remedial Action 2

*The government and Supervisory Board should take steps to ensure that government disclosures to the reconciler are based on audited accounts to international standards in accordance with the requirements as specified in Validation IAT 13.*

### 3.2.1 Validator's findings

The validator found that "the reliability of the information of government reports has been questioned by a number of stakeholders, and there is no evidence that these concerns have been discussed by the SB or that any actions to address them have been taken" (page 18).

### 3.2.2 Progress since validation

Follow the Board's decision in October, the Kyrgyzstan EITI Secretariat and EITI Supervisory Board has undertaken a number of actions to address this issue. The Kyrgyzstan EITI Secretariat has liaised with other Ministries and government agencies to document and assess the procedures for the government accounting and auditing, with reference to international standards (e.g., INTOSAI) as set out in the Memorandum. This review included an assessment of work being conducted in collaboration with the World Bank on capacity building in public sector auditing. The Supervisory Board has been briefed on the accounting procedures, the ongoing capacity building activities, and has discussed the adequacy of these procedures in assuring the quality of government data in EITI reporting. The Supervisory Board has expressed its satisfaction with the current arrangements.

### 3.2.3 Secretariat's Assessment

The Secretariat's understanding is that while the Kyrgyz Republic has established accounting procedures in accordance with international standards, the implementation of these procedures is still constrained by various capacity constraints. However, as noted above, there is a clearly established programme for strengthening these systems. The indicator assessment tool for indicator 11 states that "where figures submitted for reconciliation are not to audited standards, the group is content with the agreed way of addressing this". It is clear from the Memorandum that the EITI Supervisory Board is "content with the agreed way of addressing this issue". The Secretariat recommends that the Board recommends that the Supervisory Board continues to monitor compliance with the agreed procedures for the auditing of government data and regularly reviews the effectiveness of the capacity building initiatives in this area.

## 4 Conclusion

The EITI International Secretariat is satisfied that the Kyrgyz Republic has satisfactorily addressed the remedial actions requested by the Board and has therefore satisfied the requirements to be admitted as a Compliant country.

## Annex A - EITI Board Decision on the Kyrgyz Republic, 13 October 2010

The EITI Board agreed the following statement:

**The Board designates the Kyrgyz Republic as a Candidate country as of 19 October.**

**Based on a thorough assessment of the specific circumstances, the Kyrgyz Republic is considered to be 'close to compliant'.**

The Board congratulates the government, companies and civil society organisations in the Kyrgyz Republic for the progress made in implementing the EITI, and the leadership provided by the Supervisory Board. It also notes the government's recommitment to maintain momentum in EITI implementation, working closely with companies and civil society organizations.

The validator has found that the Kyrgyz Republic has met all but one of the validation indicators (indicator 13). The Board concurs with the validator's conclusion regarding the need for further work to ensure that government disclosures to the reconciler are based on audited accounts to international standards. The Board also wishes to highlight the importance of ensuring that company and government participation in the reporting process is based on a clear and agreed definition of materiality (indicator 9).

In all decisions on Validation the Board will place a priority on the need for comparable treatment between countries and the need to protect the integrity of the EITI brand. As set out in EITI Policy Note #3, the designation of "close to compliant" applies in cases where the EITI Board considers that a candidate country has not only made meaningful process, but can reasonably be expected to achieve compliance within a very short time. Based on the Validator's findings, the Board recommends two remedial actions necessary for achieving compliance:

1. The Supervisory Board should ensure that there is agreement regarding the reporting templates for the forthcoming EITI report, and the definition of material payments and revenues and related thresholds (indicator 9);
2. The government and Supervisory Board should take steps to ensure that government disclosures to the reconciler are based on audited accounts to international standards in accordance with the requirements as specified in Validation IAT 13.

When the Supervisory Board considers that these remedial actions have been addressed, the EITI International Secretariat will reassess the Kyrgyz Republic's compliance by reassessing indicators 9 and 13. The Secretariat will consult widely with stakeholders during the review. The Supervisory Board should be given an opportunity to comment on the Secretariat's findings. The Secretariat's review will be a public document - supplementing the Validation Report - thereby ensuring that the basis for the Board's decision regarding compliance is clear to all stakeholders.

The Secretariat should submit its report to the Board via the Validation Committee. If the Board is satisfied that remaining requirements have been met, the country will be designated as EITI Compliant. In the interim, the Kyrgyz Republic will retain its Candidate status. The Board retains the right to require a new Validation if the Supervisory Board does not request the Secretariat review within six months (i.e. by 19 April 2011). The Board agreed that if the Supervisory Board requests the review by 15 January 2011, the Board shall make a decision on Compliance in advance of the Paris EITI Conference.

## Annex B – Memorandum of EITI Supervisory Board of Kyrgyzstan "On positions about indicators 9 and 13 of Validation Grid of the EITI Rules"

Attached

