

Annex B: Proposed changes to Requirements 4.1 and 4.9 on EITI reporting

For decision

For discussion

For information

Summary

This paper outlines the proposed refinements to Requirement 4.1 on “comprehensive disclosure of taxes and revenues” and Requirement 4.9 on “data quality and assurance” to reflect the Board’s decision on encouraging systematic disclosure. It also outlines the proposal to simplify Requirement 4.9, with additional detail to be provided in standardised procedures. The refinements also note the existing scope for multi-stakeholder groups (MSGs) to propose alternative procedures, subject to Board approval.

The refinements proposed would not alter the existing standardised procedures or modify the central role of MSGs in overseeing EITI implementation. The focus is on clarifying existing requirements, while providing flexibility for the Board to consider opportunities to strengthen EITI reporting in light of the findings from the Independent Review of EITI Reports. This could include commissioning further research and piloting alternative approaches in implementing countries.

Proposed changes to Requirements 4.1 and 4.9 on EITI reporting

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1 Background

A key feature of EITI implementation is EITI reporting. The EITI requires a comprehensive reconciliation of company payments and government revenues from the extractive industries. The EITI Requirements related to revenue collection include: comprehensive disclosure of taxes and revenues (Requirement 4.1); the sale of the state's share of production or other revenues collected in kind (Requirement 4.1); infrastructure provisions and barter arrangements (Requirement 4.3); transportation revenues (Requirement 4.4); SOE transactions (Requirement 4.5) and subnational payments (Requirement 4.6).

Implementing countries are required to produce their first EITI Report within 18 months of being admitted as an EITI candidate. Thereafter, implementing countries are expected to produce EITI Reports on an annual basis. Implementing countries must disclose data no older than the second to last complete accounting period, e.g. an EITI Report published in calendar/financial year 2018 must be based on data no later than calendar/financial year 2016.

It is a requirement that payments and revenues are reconciled by a credible Independent Administrator, applying international auditing standards, and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified (Requirement 4.9). The reconciliation of company payments and government revenues must be undertaken by an Independent Administrator applying international professional standards. The MSG and the Independent Administrator are required to agree a Terms of Reference for the EITI Report based on the standard Terms of Reference and the 'agreed upon procedure for EITI Reports' endorsed by the EITI Board. The agreed upon procedure for EITI Reports is outlined in the standard Terms of Reference for Independent Administrators¹.

At the EITI Board meeting in February 2018, the EITI Board agreed a set of recommendations regarding encouraging systematic disclosure². The 2016 EITI Standard enables implementing countries to disclose the information required by the EITI Standard through routine government and corporate reporting, and consultation systems such as websites, annual reports etc. The EITI Board agreed that "systematic disclosure should be firmly established as the default expectation, with EITI Reports used to address any gaps and concerns about data quality. Implementing countries could still continue to publish annual EITI Reports collating and analysing the information from primary sources in order to make this information

¹ <https://eiti.org/document/standard-terms-of-reference-for-independent-administrator-services>

² <https://eiti.org/document/encouraging-systematic-disclosure>

more accessible and comprehensible, especially for stakeholders that do not have access to online information”.

The paper noted that there were divergent views on the value of reconciliation as part of EITI implementation:

Reconciliation is often complex, involving dozens of revenue streams, low materiality thresholds and a large number of reporting entities. The data collection process is often time consuming. The Validations that have been completed to date have shown that most of the discrepancies identified during the reconciliation process arise from reporting errors created by the complexity EITI reporting procedures themselves, not by missing payments or intentional gaps in company or government disclosure. In addition, the overall assessments from IAs are either absent or have so many caveats that they add very little in terms of assuring the quality of the data.

Nevertheless, stakeholders often consider reconciliation as a valuable exercise in verifying that government and company disclosures are complete. However, reconciliation is not the only or best way to safeguard reliable data. In many EITI Reports, the disclosures are not audited, and are only assured in the narrowest sense through attestations from senior representatives of the entities submitting the data.

One of the most important outcomes of EITI implementation is that it requires disclosures from reporting entities on their routine audit and assurance practices, and whether these are up-to-date, and whether national standards are in line with international best practice. Where these systems are weak, reconciliation is valued because it provides some additional assurances that the disclosures are complete. However, this is not a sustainable solution. The goal should be to strengthen routine audit and assurance procedure so that additional assurances are unnecessary.

The results from the 2016 and 2017 Validations also show that reconciliation has sometimes become an end in itself, without sufficient attention to the underlying audit and assurance procedures that ought to be the primary guarantor of data quality. Where these audit and assurance systems are strong, MSGs are increasingly arguing that reconciliation is unnecessary.

The Board subsequently agreed to an *independent review of EITI Reports*. The objective of the review was to undertake an independent review of EITI Reports prepared in accordance with the standard terms of reference for Independent Administrators. Building on the findings from the 2016 and 2017 Validations, this should include:

- i. An assessment of Independent Administrators’ adherence to the standardised procedure;
- ii. A review of the assurance procedures most commonly adopted by implementing countries, the time required and compliance costs;
- iii. An independent assessment of the extent to which the work undertaken safeguards comprehensive and reliable data.

The review concludes:

*In aggregate, [the] procedures as applied by independent administrators (IAs) are considered by this review to be **broadly adequate to safeguard reporting of comprehensive and reliable data** albeit with caveats as described in this Report.*

*The Standard Terms of Reference (TOR) is valuable in promoting a consistent approach by IAs to their work. However, and as can be expected in a decentralized form of EITI implementation, there does remain **variability in EITI Reports** prepared by IAs including on completeness of disclosures and*

Annex B: Proposed changes to Requirements 4.1 and 4.9 on EITI reporting *uncertainty on how data assurance conclusions were reached. The impact of this on validation is significant but the wider concern is public trust and the work done under the auspices of the EITI. **Insufficient oversight** of IA work by multi-stakeholder groups may also be a contributing factor.*

*Importantly, many EITI Reports showed extensive work done on reconciliation or resolving discrepancies of relatively minor amounts or resulting mainly from clerical reporting or timing errors. This is amplified by effort and cost of work on relatively small revenue flows or companies. **Both issues raise questions on cost-benefit and utility of such recurrent IA effort given the sums involved.***

This review and stakeholder feedback also identifies other broader implications. Foremost is the widespread misperceptions on what the EITI reconciliations means. Many stakeholders believe that independent administrators (IAs) and audit firms provided a stamp of assurance that the EITI data presented was reliable. While understandable, this view is erroneous and reflects an expectation gap in what stakeholders wish a EITI Report to deliver - and what EITI-reconciled data actually is. In particular, IAs themselves explicitly caveat that reconciliation and EITI Reports are not audits. Additionally, audited financial statements of reporting entities that underlie EITI Reports are not easily available to stakeholders.

***Overall therefore, while IAs do deliver important contributions** including in collating EITI data in one place in easy-to-understand formats; describing the data assurance steps employed in their work (with the caveats noted) and providing recommendations for improvement, the **long-term financial sustainability of reconciliations** repeated year after year can be questioned. Further, aside from cost-benefit concerns, the risk of excessive focus on clerical and reporting discrepancies is that EITI is dragged towards and **reduced to being an accounting exercise**, as opposed to being the vehicle for raising substantive facts about how extractives are managed and benefit citizens*

*The core issue this raises is **whether EITI has reached an inflection point** where the value of sector and institutional transparency available in EITI Reports outweigh the value of detailed reconciliations. Could greater rigor by IAs in their work in applying the Standard TOR help address the concerns raised? But, as this review finds, there are inherent limitations in what a reconciliation exercise within cost-constraints on the amount of time that can be spent by IAs on EITI Reports. Alternatively, can EITI implementation pathways be revisited to allow countries more room to innovate and free-up resources to devote more effort on sector disclosures and analysis thereof?*

A strong business case exists for such rethinking and refinement of EITI policy. Foremost is the advances in e-government and electronic tax administration systems where the underlying record of revenues and payments are one and the same – making the original concept of “matching” or reconciliation of separate data submissions by companies and governments of respective payments and revenues moot. Further, with the EITI Board-approved direction of travel towards mainstreamed systemic disclosures, concrete policy steps (beyond encouraging words) will better help EITI countries to take concrete actions towards that goal. Finally, promoting timely disclosure of EITI through innovative approaches is an important consideration too.

The review goes on to suggest alternative approaches to EITI reporting, noting that these would need further elaboration, review and testing.

In reviewing these challenges and opportunities, a key concern from stakeholders has been that these new approaches should not undermine implementing country ownership to set their own national EITI objectives. In addition, stakeholders argue that the EITI should retain and reinforce the role of MSGs in overseeing EITI implementation.

The International Secretariat welcomes the findings from the *independent review of EITI Reports*. However,

further work is needed before considering wide-ranging changes. The proposals below therefore focus on **clarifying existing Board decisions and procedures**, while providing flexibility for the Board to consider opportunities to strengthen EITI Reporting. **The proposed refinements would not alter the existing standardised procedures or modify the central role of MSGs in overseeing EITI implementation.**

2 Proposal for changing Requirement 4.1 - Comprehensive disclosure of taxes and revenues

EITI Requirement 4.1 - Comprehensive disclosure of taxes and revenues

a) In advance of the reporting process, the multi-stakeholder group is required to agree which payments and revenues are material and therefore must be disclosed, including appropriate materiality definitions and thresholds. Payments and revenues are considered material if their omission or misstatement could significantly affect the comprehensiveness of the EITI Report. A description of each revenue stream, related materiality definitions and thresholds should be disclosed. In establishing materiality definitions and thresholds, the multi-stakeholder group should consider the size of the revenue streams relative to total revenues. The multi-stakeholder group should document the options considered and the rationale for establishing the definitions and thresholds

b) The following revenue streams should be included:

- i. The host government's production entitlement (such as profit oil)
- ii. National state-owned company production entitlement
- iii. Profits taxes
- iv. Royalties
- v. Dividends
- vi. Bonuses, such as signature, discovery and production bonuses
- vii. License fees, rental fees, entry fees and other considerations for licences and/or concessions
- viii. Any other significant payments and material benefit to government

Any revenue streams or benefits should only be excluded where they are not applicable or where the multi-stakeholder group agrees that their omission will not materially affect the comprehensiveness of the EITI Report.

c) Implementing countries must provide a comprehensive reconciliation of government revenues and company payments, including payments to and from state-owned enterprises, in accordance with the agreed scope. All companies making material payments to the government are required to comprehensively disclose these payments in accordance with the agreed scope. An entity should only be exempted from reporting if it can be demonstrated that its payments and revenues are not material. All government entities receiving material revenues are required to comprehensively disclose these revenues in accordance with the agreed scope.

d) Unless there are significant practical barriers, the government is additionally required to provide aggregate information about the amount of total revenues received from each of the benefit streams agreed in the scope of the EITI Report, including revenues that fall below agreed materiality thresholds. Where this data is not available, the Independent Administrator should draw on any relevant data and estimates from other sources in order to provide a comprehensive account of the total government

revenues.

The International Secretariat recommends that Requirement 4.1 on “comprehensive disclosure of taxes and revenues” is amended to reflect the Board’s decision on encouraging systematic disclosure. In line with the Board decision, systematic disclosure would be firmly established as the default expectation, with EITI Reports used to address any gaps and concerns about data quality:

- a) **The EITI requires disclosure of all material payments by oil, gas and mining companies to governments (“payments”) and all material revenues received by governments from oil, gas and mining companies (“revenues”) to a wide audience in a publicly accessible, comprehensive and comprehensible manner. The expectation is that implementing countries will disclose the requisite information through routine government and corporate reporting (websites, annual reports etc.), with EITI Reports used to collate this information and address any concerns about gaps and data quality.**
- b) **~~In advance of the Reporting process,~~ The multi-stakeholder group is required to agree in advance which payments and revenues are material and therefore must be disclosed, including appropriate materiality definitions and thresholds. Payments and revenues are considered material if their omission or misstatement could significantly affect the comprehensiveness of the disclosures EITI Report.**

A description of each revenue stream, related materiality definitions and thresholds should be disclosed. In establishing materiality definitions and thresholds, the multi-stakeholder group should consider the size of the revenue streams relative to total revenues. The multi-stakeholder group should document the options considered and the rationale for establishing the definitions and thresholds.

The following revenue streams should be included:

- i. The host government’s production entitlement (such as profit oil)
- ii. National state-owned company production entitlement
- iii. Profits taxes
- iv. Royalties
- v. Dividends
- vi. Bonuses, such as signature, discovery and production bonuses
- vii. License fees, rental fees, entry fees and other considerations for licenses and/or concessions
- viii. Any other significant payments and material benefit to government

Any revenue streams or benefits should only be excluded where they are not applicable or where the multi-stakeholder group agrees that their omission will not materially affect the comprehensiveness of the EITI Report.

- c) **All government entities receiving material revenues are required to comprehensively disclose these revenues in accordance with the agreed scope.** Unless there are significant practical barriers, the government is additionally required to provide aggregate information about the amount of total revenues received from each of the benefit streams agreed in the scope of the EITI Report, including revenues that fall below agreed materiality thresholds. Where this data is not available, the Independent Administrator should draw on any relevant data and estimates from other sources in order to provide a comprehensive account of the total government revenues.
- d) **All companies making material payments to the government are required to comprehensively disclose these payments in accordance with the agreed scope. An entity should only be**

~~exempted from reporting if it can be demonstrated that its payments and revenues are not material.~~

~~Implementing countries must provide a comprehensive reconciliation of government revenues and company payments, including payments to and from state-owned enterprises, in accordance with the agreed scope.~~

Section (a) above draws on the language first agreed in the 2005 EITI Criteria³, which called for: “Regular publication of all material oil, gas and mining payments by companies to governments (“payments”) and all material revenues received by governments from oil, gas and mining companies (“revenues”) to a wide audience in a publicly accessible, comprehensive and comprehensible manner”. This is reflected in the Board’s decision on *encouraging systematic disclosure*.

There are some additional edits to provisions (b), (c) and (d) with a view to ensuring that the MSG agrees a clear definition of materiality. There are no substantive changes to these requirements. The reference to reconciliation is removed, as it is addressed in requirement 4.9.

3 Proposal for changing Requirement 4.9 - Data quality and assurance

EITI Requirement 4.9 - Data quality and assurance

- a) The EITI requires an assessment of whether the payments and revenues are subject to credible, independent audit, applying international auditing standards.
- b) It is a requirement that payments and revenues are reconciled by a credible, Independent Administrator, applying international auditing standards, and with publication of the administrator’s opinion regarding that reconciliation including discrepancies, should any be identified.
- i. The reconciliation of company payments and government revenues must be undertaken by an Independent Administrator applying international professional standards.
- ii. The Independent Administrator must be perceived by the multi-stakeholder group to be credible, trustworthy and technically competent. The multi-stakeholder group should endorse the appointment of the Independent Administrator.
- iii. The multi-stakeholder group and the Independent Administrator are required to agree a Terms of Reference for the EITI Report based on the standard Terms of Reference and the ‘agreed upon procedure for EITI Reports’ endorsed by the EITI Board. Should the multi-stakeholder group wish to adapt or deviate from these agreed upon procedures, approval from the EITI Board must be sought in advance (Requirement 8.1).
- c) Where the assessment in 4.9(a) concludes that there is (i) routine disclosure of the data required by the EITI Standard in requisite detail, and (ii) that the financial data is subject to credible, independent audit, applying international standards, the multi-stakeholder group may seek Board approval to mainstream EITI implementation in accordance with the ‘Agreed upon procedure for mainstreamed disclosures’. Without such prior approval, adherence to 4.9.b is required.

The International Secretariat recommends that Requirement 4.9 is simplified as follows:

³ See https://eiti.org/sites/default/files/documents/eiti_iag_report_english.pdf

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- a. The EITI requires an assessment of whether the payments and revenues are subject to credible, independent audit, applying international auditing standards. **The expectation is that government and company disclosures as per Requirement 4 are subject to credible, independent audit, applying international auditing standards. The expectation is that disclosures as per Requirement 4 will include an explanation of the underlying audit and assurance procedures that the data has been subject to, with public access to the supporting documentation.**
- b. The multi-stakeholder group is required to agree a procedure to address data quality and assurance based on a standard procedure endorsed by the EITI Board. The MSG is required to apply the standard procedure without any material deviations. Should the multi-stakeholder group wish to adapt or deviate from the standard procedures, approval from the EITI Board must be sought in advance. The request from the MSG should address: (i) the rationale for deviating from the Standard procedure; (ii) whether there is routine disclosure of the data required by the EITI Standard in requisite detail; (iii) whether the financial data is subject to credible, independent audit, applying international standards, and (iv) whether there is sufficient retention of historical data.

Section (a) draws on the Board's decision on *encouraging systematic disclosure*. It puts the emphasis on reporting entities to disclose information about their routine audit and assurance work and adherence to international standards.

Section (b) requires MSGs to follow a Board approved procedure to address data quality. Currently, there is only one Board approved procedure (whereby "payments and revenues are reconciled by a credible, Independent Administrator, applying international auditing standards, and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified"). The Board-approved ToRs provide additional detail on requirements regarding how this work is undertaken.

This formulation would allow the Board to consider approving additional standardised procedures that could be adopted by MSGs without prior Board approval. In the interim, the current approach to EITI reporting as per the Standard terms of Reference would apply.

The final sentence notes that MSGs may make alternative proposals subject to prior Board approval. It is suggested that this generic approach replaces Requirement 4.9.c and the 'agreed upon procedure for mainstreamed disclosures', which has only been adopted by one country (Norway). Requirement 4.9.c has been misinterpreted to mean that mainstreaming as an "all or nothing" proposition. Norway's (Board approved) application would not be affected.

In addition, it is recommended that requirement 7.2 is amended specifying that **"Implementing countries are required to complete summary data files for each fiscal year covered by EITI implementation in accordance with the template approved by the EITI Board"**. This is an existing requirement, current specified in the standard ToRs for IAs. It warrants a clearer reference in requirement 7 which addresses open data.