

# **Secretariat of the Extractive Industries Transparency Initiative – D-EITI, Berlin**

Report on the nature and extent of the work of the Independent Administrator within the context of the pilot on payment reconciliation for the third D-EITI report

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# 1. Engagement

Under agreement signed on 6 October 2020, the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH engaged us, Warth & Klein Grant Thornton AG Wirtschaftsprüfungsgesellschaft, Düsseldorf, (referred hereinafter as WKGT), to support GIZ in the implementation of the Extractive Industries Transparency Initiative (EITI) in Germany.

WKGT takes on the role of the Independent Administrator (referred hereinafter as IA) as defined by the EITI standard within the framework of the German EITI process. The purpose of our engagement is to contribute to the compilation of the German EITI report for the calendar year 2018. The IA's duties include inter alia the following aspects:

- Identification of extractive companies making material payments to government bodies in accordance with requirement 4.1 (d) of the EITI standard
- Data collection of payments made by these companies to government agencies for 2018, the year under review
- Assessment of the quality of the payment data collected using a procedure that is based among other methods on an analysis of the relevant processes and controls by the relevant government agencies and is replacing the previous direct reconciliation of payments made with the payments received by government agencies on a trial basis (pilot for payment reconciliation, cf. Section 2).

The purpose of this report is to summarise and to document the work carried out and to present the knowledge gained from carrying out the pilot on payment reconciliation.

## 2. Concept and realisation of the pilot

### 2.1. Classification of the pilot's content

The EITI Standard 2019 demands comprehensive publication of all material payments from the national extractive sector to government agencies. This information on payment flows must satisfy requirements in respect of reliability, understandability and public availability (cf. EITI requirements 4.1 and 4.9).

In the first and second German EITI report, the reliability of the published payment flows was ensured by directly reconciling the payment flows reported by the participating companies with the payments received by the government agencies ("payment reconciliation"). From a theoretical audit perspective, this payment reconciliation is a test of details for the information provided by the participating companies. The result of this assessment and the findings obtained are limited to the specific payment transaction. Therefore, they cannot be used either as a generalisation in respect of the quality of the processes and controls on which the payments are based or the relevant payment flows of non-participating companies.

Payment reconciliation processes carried out in the course of the first and second German EITI report did not – as is known – produce any or any noteworthy differences between payments made and payments received between companies and government agencies.

The pilot for the payment reconciliation replaces the described procedure for payment reconciliation on a trial basis by a procedure that is based on an analysis of the processes and controls used by the companies and the relevant government agencies to ensure the quality of assessment and collection of the payment flows relevant for D-EITI. The entirety of the procedures and controls set up must be viewed as an internal control system used to assist the defined objectives of proper assessment and collection of the relevant payments. More detailed information on the procedure for analysing internal control systems is provided in Section 3. From a theoretical audit perspective, this changed approach for assessing the quality of the payment details corresponds to the basic procedure within the framework of a risk-oriented audit procedure. According to this, system-based audit procedures such as the analysis of the business model, key business processes and control processes as well as the control environment are combined with tests of details in order to obtain sufficient audit evidence to enable the submission of an audit opinion.

Thus the combination of the results from the previously performed payment reconciliation with the system-based approach of the analysis of processes and controls within the framework of the pilot corresponds to the procedures of an auditor within the context of audits of historical financial information carried out in accordance with internationally recognised auditing standards. System analyses and tests of details are therefore "two sides of the same coin" and do not conflict with each other. On the basis that it can be assumed that the internal control system is



appropriate and effective, it is permissible to reduce the test of details without this leading to a detrimental effect on the quality of the audit opinion. As a result, it is possible to reach an audit opinion quicker and more cost-effective by using this combination.

## **2.2. Data provided and type and scope of the work carried out**

The aspects already stated in the previous D-EITI reports on assessing the quality assurance measures on the part of the reporting companies remain unchanged for the third German EITI report. The publicly available payment reports in accordance with Sections 341 q ff. of the German Commercial Code (HGB) are not subject to any legal obligation to be audited by an independent third party; however, the companies are free to have the payment reports audited on a voluntary basis. The data reporting for the third D-EITI report has addressed this matter accordingly and requires a statement as to whether the payment reports have been subject to a separate assessment by an independent third party. Due to the legal form and the size of the participating companies the annual financial statements of which the data reporting was based have been subject to an audit or review.

With regard to the pilot on payment reconciliation, members of the Multi-Stakeholder Group (MSG) have provided us with a written overview on the processes and controls used by the government agencies responsible for minesite and extraction royalties and corporate tax to ensure the proper assessment and collection of payments. These processes and controls were subsequently described verbally in greater detail. In the case of minesite and extraction royalties, the verbal representations relate to the State Office for Mining, Energy and Geology (LBEG) in Hanover. In Germany, the LBEG is by far the most important government agency for the payment flow of minesite and extraction royalties. For 2017, the year under review of the second D-EITI report, it handled approx. 98% of all minesite and extraction royalties. As a variation, the representation of processes and controls for the corporate tax payment flow is based on an approach which largely abstracts from the circumstances of a specific local tax office in order to ensure a statement that is generally valid. This seems to be appropriate in view of the federal structure of the tax administration in Germany and the many tax offices as well as the fundamentally standardised implementation of the organisational regulations via the tax office rules of procedure (FAGO) ("Gleichlautender Erlass zur Neufassung der Geschäftsordnung für die Finanzämter"/Identical ordinance on the new version of the rules of procedure for tax offices).

We have used this information as the starting point for subsequent in-depth expert discussions with individual office holders in order to verify the information provided, obtain greater detail and make our own assessment of the respective system of processes and controls. All the information gained from this has been considered on the basis of the requirements from the framework concept of the American Committee of Sponsoring Organisations of the Treadway Commission and with own experience from the analysis of Internal Control Systems: it provides the basis for assessing the pilot, which is summarised in Section 4. Here the assessment includes the payment reconciliations undertaken for the first and second

D-EITI reports where these can be seen as tests of details in the sense of the explanations given in Section 2.1. An assessment as defined by the terms of reference can only be made with these tests of details together with the system-based analysis of the pilot.

The results are shown in greater detail in Section 3 below. Furthermore, we have developed two figures to visualise the results (see Annex 1 and Annex 2).

## **3. Ensuring through internal control systems that payment flows are correct**

### **3.1. General understanding of internal control systems**

#### **3.1.1. Basic principles**

An internal control system is generally understood to mean a system comprising technical and organisational rules that is used to steer processes and controls the results of the processes. The aims of an internal control system are to safeguard ownership, ensure the reliability of process workflows and, in this context, achieve the aims associated with these process workflows. Among other things, these aims include compliance with relevant laws and regulations.

Internal control system is a term and concept that does not offer legal certainty. Different framework concepts provide orientation for the specific design of internal control systems. The one that is probably best known internationally is the framework concept introduced for the first time in 1992 by the US American Committee of Sponsoring Organisations of the Treadway Commission ("COSO" for short). It was introduced under the title "Internal Control – Integrated Framework" and currently exists in the version published in 2013. This version is also called "COSO 1", since an extended framework concept with the title "Enterprise Risk Management – Integrated Framework" has existed since 2004, which sees the internal control system as an integral element of a company's risk management system. This framework concept, which is also known as "COSO 2", emphasises the significance of the interaction between strategy, risk management and company success. For the purposes of this report, the IA has used the framework concept COSO 1 as a basis, because firstly strategies, risk management and company success are of secondary importance for the issues to be examined here. Secondly, COSO 1 is comparable to the new version of the rules of the German Auditing Standard 261 (as amended) "Feststellung und Beurteilung von Fehlerrisiken und Reaktionen des Abschlussprüfers auf die beurteilten Fehlerrisiken" (Determination and assessment of error risks and responses of the auditor to the evaluated error risks) issued by the Institute of Independent Auditors in Germany (IDW), as it is currently routinely applied in Germany for statutory audits.

#### **3.1.2. Components of the internal control system**

According to COSO 1, the components of an internal control system include the control environment, risk assessments, control activities, information and communication, and monitoring of the internal control system.

#### **3.1.2.1. Control environment**

The control environment covers the monitoring and managerial functions as well as the attitude, awareness and measures of the persons responsible for monitoring and the persons with managerial functions with respect to the internal control system and its significance within the (administrative) unit.

The control environment shapes the basic attitude of an organisation by influencing how aware employees are of controls – understood to be the voluntary commitment to integrity and actions according to ethical values. This environment includes the definition of structures and responsibilities within the organisation, the definition of rights of instruction within the organisation and the imposition of accountability.

#### **3.1.2.2. Risk assessment process**

Risk assessment process means the identification and assessment of risks in respect of meeting targets for the respective processes, whether as a result of errors by the acting persons or IT systems involved or as a result of fraudulent activities. Risks can arise from changes in the environment, new or reorganised IT systems that perform the processes or assist employees to perform the processes or restructuring within the organisation. An example of changes in the environment is the end of hard coal mining; examples of restructuring are the transfer of existing (administrative) tasks to new agencies or authorities.

#### **3.1.2.3. Information and communication**

The information and communication component of the internal control system supports the functioning of all other components in order to attain the objectives of the (administrative) unit. The controls contained in this component support the capability of the (administrative) unit to use the correct information when performing tasks as part of the internal control system.

The relevant information system that also includes the cash management system consists of the procedure and records which have been developed and set up in order to generate, process as well as report on payment-relevant administrative transactions of the (administrative) unit and also be able to account for the funds associated with these transactions. Furthermore, the information system deals with processes and measures to rectify the possibility of incorrect processing of administrative transactions relevant for payments and to ensure that opportunities to deliberately deactivate systems or to bypass controls are identified and appropriate measures are implemented to minimise these possibilities.

#### **3.1.2.4. Control activities**

Control activities mean those regulations and measures that help to ensure that instructions issued by persons holding managerial positions within the (administrative) unit to reduce risks are carried out. Control activities are carried out at all organisational and functional levels of an (administrative) unit which are incorporated in the relevant administrative process.

A distinction is made between the different types of control activities. Authorisation always takes the form of authorisation by a higher administrative level or by checking and approving whether the administrative transaction is valid. A check is understood to mean the comparison of two or more items against each other or the comparison of one item with a specific rule and the implementation of follow-on measures, if the two items do not correspond or if the item does not correspond to the specific rule. Controls of master data relate to the processes for recording, updating and maintaining master data – in other words, data that contains comparatively static basic information about relevant objects under administrative law such as companies. Finally, monitoring controls are understood to mean those regulations and measures that are carried out to assess whether the other control activities described above are carried out in full, correctly and in accordance with the applicable rules and measures.

In addition to these control activities, the organisational principle of the separation of roles or the principle of dual control – also known under the English term "segregation of duties" or "SoD" for short – also supplements control activities. This is specified as an organisational measure in which for organisational purposes there is a separation of roles between the persons who carry out the tasks for processing administrative processes and those persons who carry out the control activities in relation to these tasks. This ensures that the same person cannot at the same time initiate, record, process and enforce an administrative act. As a result, potential conflicts of interest are avoided and opportunities to commit fraudulent activities are significantly curtailed.

The effectiveness of the segregation of duties and the other control activities is limited if there is collaboration between two or more persons or bodies to make the separation of duties and/or control activities ineffective through collusion (to be understood as joint and deliberate activities to bypass control mechanisms). The probability of such collusion is influenced by the opportunities people have to act accordingly, the incentive to gain personal advantages, if the possible consequences of such a conduct seem acceptable, and the attitude and/or inner justification of people to consciously violate the regulations and measures of which they are aware.

#### **3.1.2.5. Monitoring of controls**

The monitoring of controls by the (administrative) unit is understood to mean the organisational and process-driven measures that are used to assess the effectiveness of the internal control system over time. Against the background of the continuity of processes and controls it must be ensured that the controls are in place at all times and are implemented. Accordingly, monitoring of controls include the continuous assessment of the effectiveness of controls and the adoption of the necessary remedial measures, where defects or failures in the implementation of controls are identified. Monitoring controls includes the requirement that superior departments within the (administrative) unit must be able to track control activities; however, it also includes audits by independent bodies, e.g. the existing independent government Audit Offices.

## **3.2. Application of the general understanding of internal control systems to government agencies relevant for D-EITI**

### **3.2.1. Identification of government agencies relevant for D-EITI**

The total number of government agencies that generate revenues from the extractive industry in Germany stem directly from the payment flows that were defined for this third D-EITI report. No central recording of the relevant payment flows is possible, however, due to the federal structure of the administration in Germany. The following individual government agencies are responsible for:

- Minesite and extraction royalties:  
The responsible mining authorities of the Federal States in which the approved/licensed site is located
- Corporation tax:  
The responsible tax offices at the respective headquarters of the companies
- Trade tax:  
The municipalities in the territory of which the taxable operating facilities of the relevant companies are located (without further consideration)
- Lease payments and payments to improve the infrastructure:  
government agencies at State or municipal level, depending on the type of payment (without further consideration)

The federal structure of the administration in Germany means that the internal control systems of the respective relevant government agencies and/or (administrative) units are not identical: they reflect the respective special features of the federal structure of the Federal Republic of Germany and the statutory regulations that arise from this, on the one hand, and the efforts of efficient administrative activity, on the other. Independently of this, however, it can be ascertained that the components of an internal control system explained in Section 3.1.2 can be found in the identified relevant government agencies. These will be presented below.

### **3.2.2. Control environment of relevant government agencies**

The control environment of the relevant government agencies is largely shaped by the German Civil Service Law, a separate field of law which governs the particular rights and obligations of civil servants. On the one hand, civil servants have an obligation to be neutral when carrying out their work, they are banned from striking and they are required to uphold the constitution: on the other, they have the right to life-long employment with appropriate pay and retirement benefits within a publicly defined career structure. Furthermore, the general principle applies within the relevant government agencies that the criteria according to which civil servants are selected to fill vacant positions are exclusively based on their suitability, expertise and professional performance.

The respective organisational structure is clearly governed through job descriptions and administrative instructions within the relevant government agencies.

Whereas the responsibilities of the job holder concerned within the assigned administrative processes result from the internal administrative job descriptions, authority to give instructions and the supervision obligations of the respective line managers are derived from the administrative instructions. Within the administrative organisation special attention is paid to strict compliance with the principle of segregation of duties when carrying out administrative processes, on the one hand, and the organisational separation of assessment and collection processes, on the other, i.e. the enforcement of payment claims by the relevant government agencies and the receipt of payments due from the parties liable to pay.

In addition to this, the relevant government agencies within the administrative structure of the municipalities, the Federal States or the Federal Government are subject to monitoring by the responsible departments and/or ministries which, as part of the executive, are subject to control by the respective councils and/or parliaments and thus, ultimately, civil society as the sovereign authority.

Breaches by civil servants of the obligations that result from the relevant employment relationship are subject to disciplinary law, a sub-area of civil service law which governs how to proceed in the event of possible breaches of obligations and what the consequences may be for the respective civil servant if they are found to be culpable. Besides breaches of duty in the area for which they are responsible professionally, e.g. deliberate infringements of service regulations, breaches of duty may also arise from the behaviour of the civil servant concerned outside the relevant government agency, if these breaches are likely to have a significant detrimental effect on the trust of citizens in the relevant government agency or the civil service as a whole. The disciplinary measures range from a reprimand or a fine to a reduction in salary for a limited period to a demotion in the career structure and the associated reduction in salary and, in the last resort, removal of civil service status, in other words dismissal of the civil servant concerned.

The civil servants of the relevant government agencies are working within a control environment that is based on the framework conditions outlined above and shaped by the self-image of the German civil service. Because of their special legal status civil servants are required to subscribe to a commitment to act with integrity, in particular with regard to adherence to and/or implementation of legal regulations, and to act in a way that observes values derived from civil service law, including the requirement to uphold the law and the constitution. Infringements are prosecuted according to the regulations of the well-known disciplinary law – if necessary, with the involvement of the courts.

### **3.2.3. Risk assessment process of relevant government agencies**

When considering the risk assessment process, at the level of the relevant government agencies – in line with the remarks on the control environment – it is necessary to distinguish between risks in the assessment process and risks in the collection process.

The minesite and extraction royalties are based on self-assessment by those who have an obligation to pay, in other words the units mining the resource and/or the respective taxpayer. The provisions in the relevant statutory regulations are that the party with an obligation to pay first calculates the amount due to be paid and informs the relevant government agency of this.

It is inherent in the self-assessment procedure that the parties due to make the payment may make mistakes. This can range from a clerical or input error when entering the data in the self-assessment form or unintended incorrect interpretation of the relevant legal rules to a deliberate failure to observe the legal regulations. Ultimately, the potential mistakes in respect of self-assessment lead to risks in respect of the amount to pay. As a rule, in case of doubt the risk that the amount to pay is calculated at too low a level is probably more likely than the risk of the amount to pay being too high. Accordingly, all relevant government agencies have extensive auditing rights to carry out inspections to ascertain whether the self-assessments provided by the taxpayers are correct and complete and thus ultimately to check the payment amount calculated by the taxpayer in order to identify and correct errors and thus to calculate the requisite amount legally due to be paid to the relevant government agency. The control risk assessment is continuously changed by the relevant heads of department or their line managers in the course of an ad hoc process. This means that there are no written regulations on a regular risk assessment but these have evolved from observations as part of daily administrative practice. Among the risks that are currently mentioned on a regular basis are the departure of the current job holder because they have reached pension age and the associated challenges of filling the now vacant job appropriately and with as little friction as possible, in particular in respect of audits on site with taxpayers within the context of external audits.

In contrast to minesite and extraction royalties, income taxes (corporation tax/trade tax) are not based on self-assessment, as companies do not have to file self-assessments, Section 150 (1) sentence 3 of the German Tax Code (Abgabenordnung, short AO). The companies liable to pay tax have a statutory obligation to file income tax declarations that must be submitted every year because of period taxation and which will allow the tax authorities to fix the tax or determine the taxable amounts.

Once the income tax declarations have been submitted, information provided is checked by the tax authorities responsible for the area and the nature of the tax. Once the authorities have approved the income tax declarations submitted, income tax assessment notices are sent to the companies as the recipients.

From the point of view of procedural law the difference to self-assessments is essentially that the tax assessment notices are sent by the responsible tax authorities. The tax assessment can only become effective once the corresponding tax assessment notice has been delivered to the taxpayer.

A distinction must be made between this and possible risks in connection with the collection of the due payment as calculated by the taxpayer and collected by the relevant government agencies or, if applicable, the administrative units otherwise engaged. Initially, the risk is dealt with organisationally by strict segregation of functions within the relevant government agency between the party responsible for the assessment and the party responsible for collection and the fact that the party liable to pay can settle what they owe with a cashless payment, i.e. via transfer: it is not possible to make a cash payment. The segregation of functions ensures that the civil servants who undertake the assessment do not have access to the relevant government agency's (bank) accounts to which the taxpayers make the calculated and estimated payment via bank transfer. Differences between the



estimated payment due (target position) and the actual payment received (actual receipt) must be clarified by the relevant collection office.

If payments of corporation tax are too low, automatic reminders are sent in accordance with the statutory regulations or these payments are recovered by the enforcement office (as a special part of the collection office) within the framework of current legal regulations. If payments are too high, they are initially held safely (suspense account) and offset against any possible other open positions owed by the taxpayer from other kinds of tax or other periods. If any difference remains after this, the taxpayer is reimbursed.

The appropriate assessment notice is corrected, if the assessment for the payment due needs to be corrected because the taxpayer has submitted objections that justify this. In administrative terms, the process on which the correction is based corresponds to the process for the original assessment.

### **3.2.4. Information and communication and control activities of relevant government agencies**

The relevant processes and controls for corporation tax and minesite and extraction royalties are described below; these are used to initiate, record, process and control payment-relevant administrative acts.

With respect to corporation tax, we note that the details of procedural workflows, in particular in a tax determination office, can definitely vary between the different German Federal States. However, in our opinion, information provided below, and conclusions drawn hereupon remain unaffected.

We have dispensed any comments about the relevant processes and controls in relation to trade tax. On the one hand, the procedural workflows between tax determination offices and municipal tax offices interact when it comes to fixing the uniform base amount of trade tax that forms the basis for calculating trade tax. Thus far, declarations on the assessment process for corporation tax can be transferred to trade tax. On the other hand, it is always the responsibility of the municipalities to collect trade tax in its entirety so it is almost impossible to make generalised statements about the organisation of the payment processes in the municipalities because of the heterogeneous nature of local self-government.

#### **3.2.4.1. Corporation tax**

##### **3.2.4.1.1. Basic principles of the corporation tax system**

The information and communication of relevant government agencies in connection with corporation tax are shaped by their legal nature.

The corporation tax as such has the character of a personal tax for the corporations, associations of individuals and assets stated in Section 1 (1) of the corporation income tax act (KStG). As a direct assessment tax, it is attached to the growth in income of a legal entity. The recognition of corporations as independent tax subjects with their own capabilities and thus as attributive subjects of economic

activity is reflected in the procedural separation between taxation of the distributing corporation on the one hand and their members on the other. Therefore, with the payment of corporation tax (KStG) a corporation settles its own tax debt and is not making a pre-payment towards the tax debt of its members.

According to Art. 105 (2) in conjunction with Art. 106 (3) sentence 1 of the German Basic Law (Grundgesetz, short GG), competing legislative competence for regulating corporation tax is the domain of the German Federal State. According to Art. 105 (3) in conjunction with Art. 106 (3) sentence 1 of the German Basic Law (GG) corresponding federal laws are subject to the approval of the German Federal Council (Bundesrat). Under constitutional law corporation tax is a shared tax and the amounts received are shared, half each, by the German Government and the Federal State (without any provision for a share to the municipalities). It is administered by the authorities of the Federal States, who act on behalf of the German Government.

In view of the character of corporation tax as an assessment tax, when considering the procedural workflow it must be distinguished from self-assessments as defined by Section 150 (1) sentence 3 of the German Tax Code (hereinafter referred to as AO) and from minesite and extraction royalties described under Section 3.2.4.2.

#### **3.2.4.1.2. Information and communication in a tax determination office in relation to corporation tax**

##### **3.2.4.1.2.1. Organisational separation between assessment and collection departments in a tax determination office**

The distinction between the assessment process and the subsequent collection process explained in Section 3.2.3 also applies to the corporation tax.

The organisational separation of the "assessment unit" from the "collection department" within the tax determination office also results from the statutory regulations in the German Tax Code (AO), which already makes this separation in the official table of contents as follows:

- Fourth part: Implementation of taxation (Sections 134 – 217 AO)
- Fifth part: Collection procedure (Sections 218 – 248 AO):

By way of an example, the information and communication from relevant government agencies can be explained on the basis of the procedural workflow of a corporation tax declaration that has to be produced annually by legal entities.

##### **3.2.4.1.2.2. The assessment unit**

Companies that are liable to pay corporation tax regularly send corporation tax declarations by means of a program interface to the tax determination office that is responsible for the area of business. Responsibility of the tax determination office is guided according to the district of the tax determination office where the company management and/or the company headquarters are located.

The assessment office responsible for corporations examines the information in the corporation tax declaration. It can accept the declared information or, in the event of a different legal interpretation, fix a corporation tax amount that differs from the declaration data, giving explanations in the tax assessment notice.

Before a corporation tax assessment notice is issued, any legal issues concerning the granting of due process are discussed between the company and the assessment unit, if required.

In the majority of cases, the administrators in the assessment unit are responsible for the definitive signature on tax assessment notices, in accordance with the provisions of the rules of procedure for tax offices (FAGO).

In the case of companies which are either larger than a certain size or are classified by the system or manually as legally complex cases the definitive corporation tax notice is signed by the responsible senior tax inspectors for the assessment unit or a quality assurance department based in the same tax determination office. The corporation tax notice is approved electronically. Where a reservation regarding signature exists because of the circumstances mentioned above, the administrator cannot on their own approve the case electronically. Approval is routinely granted by the senior tax inspectors.

As soon as a corporation tax notice has been approved by the assessment unit, the payment due or the claim for reimbursement, as appropriate, arising from the corporation tax notice is officially set in the responsible collection department to a target via electronic data processing (hereinafter described as the "target position"). The collection department is not included in the overall process until the corporation tax notice has been issued as part of what is generally an automated administrative process.

In addition to this, companies may be investigated via a government tax audit. Depending on the size of the company, the choice is made randomly, based on an event because of a suggestion by the assessment office or seamlessly (called a follow-on tax audit). Large companies and corporations are always subject to the follow-on tax audit. Corporation tax notices for companies where a government tax audit is planned always contain the auxiliary provision that it is subject to review (Section 164 of the German Tax Code (AO)). Small and mid-sized businesses are generally audited by the tax office's internal tax audit. If certain threshold (e.g. annual turnover, annual profit) are exceeded, the Groß- und Konzernbetriebsprüfer (tax audit department for large companies and groups) perform the tax audit. Depending on which German Federal State is involved, those responsible for the government tax audit are either connected to the respective tax office or organised as a separate tax office. Specialist auditors can be brought in for cases to cover certain issues (e.g. pension provisions, foreign relationships). These specialist auditors are generally assigned to a central tax office or intermediate authorities of German Federal States. Section 19 of the Tax Administration Act (FVG) states that the Federal Government can take part in the external tax audits of the Federal States' tax authorities via the Federal Central Tax Office.

The administrators in the assessment unit inform those responsible for the government tax audit of possible anomalies observed when processing the tax case. The office that carries out the government tax audits is therefore practically "an extension" of the assessment unit for auditing the companies on site. The involvement

of auditors and their senior inspectors (who are not the same people and who don't have the same roles as the senior inspectors in the assessment unit) illustrates the segregation of duties in respect of the tax fixing procedure.

As a rule, the assessment unit accepts the findings reflected in the government tax audit report, in particular if the audit findings have been discussed consensually with the taxpayer. Then, the assessment unit implements the findings in the form of a change notice (= changed target positions). The definitive decision on audit findings is always made by the assessment unit.

#### **3.2.4.1.2.3. The collection unit**

After the tax fixing procedure described above has been completed, the purpose of the collection unit is to process payment flows and other issues relating to tax collection legislation. In general, the collection process is automated.

In certain cases, the administrators in the collection unit can intervene manually in the collection process. However, such interventions do not have any implications for the corporation tax notice issued by the assessment unit, as the collection unit cannot access the assessment unit's programme for technical reasons. Thus, it can be ruled out that the collection unit can make any changes to the target position. The same applies analogously in the opposite direction. Therefore, the separation of the assessment unit from the collection unit is not only organisational: procedural separation is also ensured through appropriate design of the IT systems used for implementing the administrative processes (separated access rights).

Should a taxpayer file an objection against the contents of a corporation tax notice within the framework of an out-of-court remedial procedures or submit a simple change application, responsibility for checking lies with the relevant assessment unit and not the collection unit.

If the taxpayer's objections relate to the tax collection process (for example, incorrect offsetting of a tax debt against a claim for reimbursement of another type of tax), the collection unit is competent.

In collection units of a tax determination office, the collection administrators are always responsible for the final approval of a decision.

If certain amount thresholds are exceeded or if there are special legal factors relating to the collection, the definitive approval is reserved for the competent senior tax inspectors or, in cases where higher-order interests are involved, for the senior manager in charge of a tax determination office.

In order to guarantee organisational separation between the collection unit and the assessment unit, the senior tax inspectors in the two units must not under any circumstances be one and the same person.

Where the company that owes the corporation tax does not meet its payment obligations correctly, the collection unit regularly sends automatic reminders about the payment arrears. If the payment is not received even after a notice of enforcement has subsequently been served, the collection unit (i.e. its department dealing with enforcement) starts to implement recovery measures in accordance with the current provisions for execution and enforcement instructions.

### 3.2.4.2. Minesite and extraction royalties

The calculation, assessment and collection of minesite and extraction royalties are always in accordance with the Federal Mining Act (BBergG) and the Extraction Royalties Ordinance of the Federal States concerned in conjunction with the relevant regulations in the German Tax Code (AO).

As has already been described in Section 2.2, the State Office for Mining, Energy and Geology (LBEG) with its headquarters in Hanover is responsible for by far the largest share of tax revenues for minesite and extraction royalties in Germany. It is supervised by the Lower Saxony Ministry of Economic Affairs, Employment, Transport and Digitalisation.

Even seen against the background of the manageable number of companies that pay the royalties and the self-assessment procedure, the competent sections at the LBEG for fixing the minesite and extraction royalties cannot be compared with the situation in a tax office in terms of the available personnel and its organisational structure. At the present time, in LBEG there are one administrator, two external auditors and one section leader responsible for fixing the minesite and extraction royalties in the Federal States of Lower Saxony, Schleswig-Holstein, Hamburg and Bremen.

Nevertheless, in a similar way as for corporation tax, the organisational precautions taken ensure strict separation between the administrative function (assessment/setting the target) and processing payments. The Chief Cashier's Office of the State of Lower Saxony, as an organisational unit of the State's Ministry of Finance, is responsible for the technical side of processing of payment flows. According to the information provided, the Chief Cashier's Office of the State is not responsible for clarifying the facts in relation to minesite and extraction royalties and is not involved in this.

The companies that owe the royalties record the data required for the extraction royalties via self-assessment using a web client system (VAS = Veranlagungssystem Feldes- und Förderabgabe/Assessment system for minesite and extraction royalties). Self-assessment is made in accordance with Section 2 of the Lower Saxony ordinance on minesite and extraction royalties (NFördAVO) in the form of monthly pre-payment notices for each quarter. A declaration on extraction royalties for the previous collection period is to be submitted to the LBEG by 30 September each year.

All master data relating to the accounts are managed for each company in the VAS system (e.g. information on tax advantages) and the amount of extraction royalties to be paid is calculated by the system from the information provided by the companies. VAS is not used for the minesite royalties but instead the amount is fixed using LBEG's electronic records system.

The administrator role (Section 2.1 at the Clausthal-Zellerfeld office) has the technical responsibility for the correctness and completeness in respect of fixing the minesite and extraction royalties ("target position"). The principle of dual control is safeguarded as the section leader co-signs any decision. Because of the system of self-assessment the process of fixing often takes place at a later point in time in relation to the (instalment) payments by the companies that owe the royalties. The administrator role issues the royalty notices to companies and creates the cash

desk instructions (receipt/disbursement orders) that are transferred via the electronic records system to Section Z.4 (as of 1 January 2021: Section ID 3) at the main office in Hanover for checking and approval.

Section Z.4 (as of 1 January 2021: Section ID 3) checks the cash desk instructions based on the documents from Section 2.1 that justify the payment. Once checking and approval are complete, the cash desk instructions are posted by Section Z.4 in the budget implementation system. Payments made by the companies that owe the royalties are recorded in a suspense account in the State's Chief Cashier's Office, as no transaction numbers are used for the company when the amount is fixed. Section Z.4 continuously monitors the amount in the suspense account, allocates payments as appropriate and clarifies differences between the target position and the payment amount by consulting the administrative function (Section 2.1).

In line with the nature of self-assessment, a central element of the process of fixing the royalties by the LBEG is the timely examination of the royalties paid by the company through external audits. According to the information received, a complete examination of the information from all companies that owe royalties is not possible due to a lack of auditors available, thus focus points for examinations are determined.

### **3.2.5. Monitoring controls of relevant government agencies**

#### **3.2.5.1. Corporation tax**

The **regional tax directorates** (in some Federal States, also called State Offices for Tax) are in charge of the tax offices in their district. They therefore have technical and administrative oversight over the tax offices. In Federal States with no intermediate authority, the State Finance Ministries, as the highest financial authority in the States, carry out this task. Administration and management are two fundamentally different tasks so that the managerial authority of the regional tax directorates is not permitted to carry out the administrative functions of the tax offices.

The regional tax directorates carry out controls on an annual basis in the form of business audits. These audits relate to both the areas of fixing and collection. As part of these controls, the regional tax directorates select cases for auditing, and these are then audited to ensure that they have been processed correctly. Beside this general control, those administrative audits shall ensure the uniformity of taxation (all tax offices shall trade the same kind of cases homogeneous), to identify professional or organisational deficiencies, to determine learning needs and to eliminate errors and improve processes in the future.

Furthermore, the sections at the regional tax directorates also act as an expert point of contact for tax offices in connection with questions that relate to tax collection in order to ensure that the taxation is applied uniformly.

The **State Ministries of Finance**, as the highest authorities in the Federal State responsible for financial administration, are in charge of financial administration at Federal State level. In Hesse, for instance, this includes the establishment of a separate "Internal Audit" unit, which reports directly to the most senior manager.

The work undertaken by the Internal Audit unit is based on the recommendations on standards for internal audits in the administration of the Federal State of Hesse ("Empfehlungen über Standards für Interne Revisionen in der Hessischen Landesverwaltung"). These standards form a uniform and cross-departmental work and legal basis for the administration's work and are based on the auditing standards of the German Institute of Internal Auditing (Deutsches Institut für Interne Revision e.V., DIIR) and the recommendations of the German Federal Ministry of the Interior for internal audits ("Empfehlungen des Bundesministeriums des Innern für Interne Revisionen"). The Internal Audit unit undertakes independent auditing and control functions by examining the administrative actions for discrepancies and irregularities. It also makes suggestions on how to rectify these as well as how to avoid these in the future and assists the efficiency and effectiveness of administrative actions.

As set out in Section 6.6 of the above recommendations, the Internal Audit unit produces an audit report on their work. A copy of this report is always submitted to the management of the organisational unit that has been audited for approval. The audited organisational unit is given a copy of this report. In accordance with Section 8 of the above recommendations, the Internal Audit unit submits a written report on their activities to the management of their authority at least once a year. The reports on audits issued in the course of the year are not affected by this.

Section 19 of the Tax Administration Act (FVG) states that the Federal Ministry of Finance can take part in the external tax audits of the Federal States' tax authorities via the Federal Central Tax Office (Federal Tax Inspection). In this way the Federal Ministry of Finance is made aware of matters such as tax developments that may be significant for legislative measures or administrative regulations.

### **3.2.5.2. Minesite and extraction royalties**

The administrative processes of the minesite and extraction royalties are subject to comparable internal control processes within their administrative unit as apply to corporation tax, although the intensity of controls for these administrative processes is adapted to the relative significance of the minesite and extraction royalties. Also, this unit does not have a multi-level administrative structure with authorities both downstream and upstream that compares with the one for corporation tax.

For instance, in the State of Lower Saxony payments in connection with the minesite and extraction royalties are also shown with the relevant budget item in the budget implementation system, next to the "transaction number" classification criterion. As a result, the corresponding receipts within the budget implementation system are allocated to the corresponding budget item and allow the administrative unit responsible for the budget to reconcile the receipts planned in the budget with the amounts actually received. Should significant differences arise, the administrative unit responsible for the budget asks the administrative unit responsible for the assessments for information on the reasons for the difference between the planned budget and the actual budget figures. Within the administration this provides higher-order control of the payments within the framework of budget implementation.

As is appropriate for the significance of the minesite and extraction royalties for the respective budgets of the relevant German Federal States, a comparison can be made between the planned receipts from minesite and extraction royalties and the subsequent actual amounts even across periods. Ultimately, this allows interested members of the public to undertake a control function via the usual processes for political participation.

### **3.2.5.3. Additional independent controls**

Regardless of the controls implemented in the relevant administrative processes within the administrative units and the higher-order controls within the scope of the respective budget implementation, the relevant administrative units are subject to an audit by the municipal auditing bodies (e.g. the Municipal Audit Office of the Federal State of North-Rhine Westphalia (NRW)), the individual states' courts of audit and the Federal Court of Audit (Bundesrechnungshof) (referred to below as auditing bodies).

These auditing bodies are independent bodies of the financial control, subjected only by the law, with a right to perform audits guaranteed by the constitution, who are responsible to assess the fiscal and economic management of the public administration with respect to compliance (= abidance by the law) und cost-effectiveness. Members of these auditing bodies are protected by the principal of judicial independence.

The respective auditing bodies decide individually and independently about the administrative units to be audited in a financial year and also the timing and nature of the relevant audit. When selecting the administrative units to be audited, the auditing bodies adopt a risk-oriented auditing approach. Apart from the administrative areas that are particularly significant for the budget concerned, the auditing bodies also take account of indications from the relevant councils and parliaments, publications in publicly available media and information from civil society when selecting the units to be audited. Detailed audit findings are only provided to those in charge of the relevant administrative unit; more extensive reporting appears in condensed form in an annual report that covers the audit findings in relation to the individual departments.

Based on information provided, both the Federal Court of Audit and the individual states' courts of audit perform tests of details as part of their audit of the tax administration. This includes the audit of individual cases by inspecting the relevant administrative files. The question relevant in context of EITI of a compliant processing of payments of companies is, however, not assessed separately.



## 4. Final remarks

The pilot for the payment reconciliation aimed to replace on a trial basis the previous procedure of payment reconciliation based on tests of details by a procedure that is based on an analysis of the processes and controls with which the relevant government agencies ensure the quality of assessment and collection of the payment flows relevant for D-EITI.

We believe that, for the payment flows of corporation tax and minesite and extraction royalties, we have been able to gain a sufficient insight into the structure, the legal framework and the processes and/or controls on the part of government agencies on the basis of the documents made available to us and the work undertaken in accordance with Section 2.2 to make the assessment we have given below.

We consider that the concept of the pilot for the period under review in 2018 for assessing the processes and controls set up by the relevant government agencies for the correct collection of the payment flows, in combination with the knowledge gained from the payment reconciliations for the 2016 and 2017 years under review, are appropriate to satisfy the requirements of the EITI Standard 2019 regarding the reliable disclosure of the payments from the extractive industry. Therefore it can be considered as an alternative procedure when compared to the previous procedure of an extensive reconciliation of all material payment flows during a year under review within the context of tests of details.

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