

19TH EITI BOARD MEETING, WISTON HOUSE, 14-15 FEBRUARY 2012

Board Paper 19-5-D

Secretariat Review: Peru

For decision

Validation Committee

Oslo, 18 January 2012

SECRETARIAT REVIEW: PERU

Recommendation

The Validation Committee recommends that the Board agrees the following:

The EITI Board designates Peru as EITI Compliant as of 15 February 2012. In accordance with the EITI Rules:

- *Peru must be revalidated within 5 years (i.e., by 14 February 2017);*
- *Stakeholders in the process may call for a new validation at any time within that period if they think the process needs reviewing; and*
- *Where valid concerns exist that a country has become EITI Compliant, but its implementation of the EITI has subsequently fallen below the standard required for Compliance, then the Board reserves the right to require the country to undergo a new validation or face delisting from the EITI;*

And in accordance with the transition procedures for the 2011 edition of the EITI rules agreed by the EITI Board on 9 June 2011, Peru is encouraged to make the transition to the 2011 edition of the EITI rules as soon as possible. In particular, Peru is required to produce EITI reports annually. EITI reports should cover data no older than the second to last complete accounting period (e.g. an EITI report published in calendar/financial year 2013 should be based on data no later than calendar/financial year 2011);

The Board congratulates the government of Peru for its commitment to the EITI process. The Board also congratulates the Comision Nacional of the EITI for its strong collaboration and effective oversight of EITI implementation, especially in the past few months to respond to the concerns of the Board. The Board also welcome the Government of Peru's commitment to further strengthen transparency in the Peruvian extractive sector and advancing transparency regionally.

Background

The Board considered the final validation report from Peru on 14 December 2010. Peru had a deadline of 12 June 2011 to complete three corrective actions and request a secretariat review. The required corrective actions included: demonstrating that all material payments and revenues are covered in the 2008 report, agreeing an approach for covering subnational and social payments, and increasing company participation. On 11 June, Peru requested a secretariat review.

The Secretariat conducted its review, including visiting Peru on 23-26 August. The Secretariat sent a draft review to the Comision Nacional for comments on 30 September and received feedback on 18 October. The Secretariat Review concluded that it was not possible to demonstrate that all material payments and revenues have been disclosed in the 2008 EITI report. The Review is attached – see Board Paper 19-5-D-ii.

Taking into account the imminent publication of the second (2008 -2010) EITI Report, the Validation Committee requested that the Secretariat analyse the 2008 – 2010 Report following its publication. This assessment is presented in Board Paper 19-5-D-i, below.

SECRETARIAT REVIEW: PERU

Contents

1	Background.....	Error! Bookmark not defined.
19-5-D-i	Additional Information to Secretariat Review: Peru	4
1	Introduction.....	4
2	Analysis of Peru’s 2008-2010 EITI report	5
19-5-D-ii	Secretariat Review: Peru (Dated: 30 September 2011).....	8
1	Introduction.....	8
2	Peru’s response to the Validator’s findings	8
3	Secretariat Review of Remedial Actions and Assessment of Indicators.....	8
3.1	Remedial Action 1	9
3.2	Remedial Action 2	14
3.3	Remedial Action 3	16
4	Conclusion	18
	Annexes	19

19-5-D-i ADDITIONAL INFORMATION TO SECRETARIAT REVIEW OF PERU

1 Introduction

The Validation Committee in its session of 8 December 2011 agreed to revisit the case of Peru following the publication of their second reconciliation report covering payments and revenues from 2008 - 2010 which has been produced by Ernst and Young (E&Y). The final report was approved by the Comision Nacional (MSG) on 9 January 2012 and published on 11 January 2012.

The Secretariat has reviewed the report, with a particular focus on the coverage of all material payments and revenues. Our analysis of the report is that the report covers:

- All revenues accrued to the Peruvian state and reported by the Government's agencies, including:
 - o Income tax paid by mining and hydrocarbons companies to the tax authority SUNAT;
 - o Royalties collected from the mining sector (by the Ministry of Finance) and the hydrocarbon sector (by Perupetro);
 - o Right fees paid by mining companies to the regulator Ingemmet.
- Payments by 51 companies representing 86% of total payments in 2008 87% in 2009 and 85% in 2010 (and 87% in 2008, 85% in 2009 and 85% in 2010 of total value of production¹)
- The coverage reached in each year conforms to the definition of materiality agreed by the MSG and instructed to E&Y in the terms of reference for the reconciliation. All government's revenues have been disclosed. Additionally, the final version of the report will indicate the number of companies that were above 2% of value of production in oil and 1% in the gas sector that did not participate in the 2008-2010 reconciliation. Three companies met these criteria. According to additional information provided to the Secretariat by the reconciler (based on publically available information) these three companies were Aguaytia, BPZ and Sapet. In terms of total value of production, none of these companies account for > 1% of the total value of production;
- In the Secretariat's view, the definition of materiality with reference to value of production (total or sector-specific) is not optimal. A definition focussing on the size of the payments and related thresholds is preferable. However, the figures from the 2008-2010 report show a positive correlation between total value of production and the share of payments (re-confirming the assessment in the Secretariat Review which indicated that value of production provides a reasonably reliable proxy for the size of the payments). As none of the non-reporting companies account for >1% of the total value of production, the Secretariat considers it reasonable to conclude that the non-reporting companies account for only a small percentage of payments. Moreover, as noted above, the government has reported the revenues from these companies, and the result discrepancies are clearly

¹ Value of production is obtained by multiplying the volume of production by an average price for each commodity. Both figures are extracted from the Ministry of Energy and Mines 'statistics available in its website.

identified in the report.

A more detailed analysis of the report is presented below.

In light of the above, the International Secretariat's assessment is that Peru's Final 2008-2010 EITI report covers : (1) all revenues (material and immaterial) received by the government from oil, gas and mining companies, and (2) all material payments to government from oil, gas and mining companies.

2 Analysis of Peru's 2008-2010 EITI report

Table 1 shows the total of all revenues obtained by the Government of Peru in 2008, 2009 and 2010 from income taxes, royalties and right fees paid by all oil, gas and mining companies. The value of the total production is also provided as a reference.

Table 1- Government revenues from extractive sector (2008-2010)

Government revenues	(All figures are in USD)					
	2008	%	2009	%	2010	%
Total Revenues reported by the Government						
Mining						
<i>Income Tax (SUNAT)</i>	2 436 713 260,42	93 %	2 137 365 537,85	94 %	3 103 176 928,52	92 %
<i>Royalties (Min of Finance)</i>	155 372 522,21	6 %	112 208 167,33	5 %	227 252 653,93	7 %
<i>Right fees (Ingemmet)</i>	39 402 000,00	1 %	35 663 000,00	2 %	46 272 000,00	1 %
Total Mining	2 631 487 782,64	100 %	2 285 236 705,18	100 %	3 376 701 582,45	100 %
Hydrocarbons						
<i>Income Tax (SUNAT)</i>	390 326 042,38	26 %	257 021 912,35	23 %	461 014 862,00	26 %
<i>Royalties (Perupetro)</i>	1 131 300 000,00	74 %	860 318 000,00	77 %	1 316 498 000,00	74 %
Total Hydrocarbons	1 521 626 042,38	100 %	1 117 339 912,35	100 %	1 777 512 862,00	100 %
Total Mining	2 631 487 782,64	63 %	2 285 236 705,18	67 %	3 376 701 582,45	66 %
Total Hydrocarbons	1 521 626 042,38	37 %	1 117 339 912,35	33 %	1 777 512 862,00	34 %
Total payments (revenues)	4 153 113 825,02	100 %	3 402 576 617,53	100 %	5 154 214 444,44	100 %
Total Value of production²						
<i>Mining</i>	21 360 787 878,68	80 %	18 161 827 319,09	83 %	23 412 898 359,70	80 %
<i>Hydrocarbons</i>	5 469 782 912,62	20 %	3 764 019 398,81	17 %	5 687 106 187,72	20 %
Total Value of production	26 830 570 791,30	100 %	21 925 846 717,90	100 %	29 100 004 547,42	100 %

Table 2 shows all payments reported by the 51 companies included in the second EITI reconciliation report for the same years and by the corresponding revenue streams. These 51 companies represent all large and medium operators (i.e. none of the non-participating companies has a share above 1% of the value of production).

² Value of production is obtained by multiplying the volume of production by an average price for each commodity. Both figures are extracted from the Ministry of Energy and Mines' statistics available in its website.

Table 2- Payments by EITI reporting companies

Total EITI reporting companies			
EITI reporting mining companies			
<i>Value of production</i>	18 571 667 437,25	15 330 224 405,13	19 531 240 178,23
<u>Payments</u>			
<i>Income Tax</i>	2 204 257 689,68	1 938 219 455,51	2 639 840 764,33
<i>Royalties</i>	119 045 796,31	110 938 579,02	200 477 353,15
<i>Right fees</i>	7 758 000,00	7 450 000,00	8 716 000,00
Total payments mining	2 331 061 485,99	2 056 608 034,53	2 849 034 117,48
EITI reporting hydrocarbons companies			
<i>Value of production</i>	4 816 484 594,53	3 377 548 732,00	5 137 416 902,55
<u>Payments</u>			
<i>Income Tax</i>	288 971 291,87	177 250 996,02	370 250 530,79
<i>Royalties</i>	953 665 000,00	731 510 000,00	1 138 863 000,00
Total payments hydrocarbons	1 242 636 291,87	908 760 996,02	1 509 113 530,79
Total reported payments	3 573 697 777,85	2 965 369 030,54	4 358 147 648,27

Finally, Table 3 compares both total revenues and total value of production to the total payments reported by the participating companies and the value of production they represent. This allows assessing that Peru's 2008-2010 EITI report covers 86% of payments accrued to the state in 2008, 87% in 2009 and 85% in 2010, which correspond to coverage of 87% in 2008, 85% in 2009 and 85% of 2010 of the extractive sector value of production. On this basis, the Secretariat notes that the value of production and value of payments seems to be reasonably correlated for these three years covered in the report.

Table 3 – Coverage of the 2008-2010 EITI report

Coverage (% of total represented by EITI reporting companies)				
	Mining	2008	2009	2010
<i>By production</i>		87 %	84 %	83 %
<i>By payments</i>		89 %	90 %	84 %
Hydrocarbons				
<i>By production</i>		88 %	90 %	90 %
<i>By payments</i>		82 %	81 %	85 %
Total Extractive sector				
<i>By production</i>		87 %	85 %	85 %
<i>By payments</i>		86%	87 %	85 %

The reconciliation done with the reached coverage produced discrepancies between the total revenues reported by the official entities and the total payments disclosed by all those 51 participating companies. These discrepancies are shown in Table 4.

Table 4 – Discrepancies between total revenues and payments from participating companies

Discrepancies between total revenues and payments from participating companies			
	2008	2009	2010
Total revenues USD (government)	4 153 113 825,02	3 402 576 617,53	5 154 214 444,44
Total payments USD (51 participating companies)	3 573 697 777,85	2 965 369 030,54	4 358 147 648,27
Difference explained by the non-reporting companies (USD)	579 416 047,16	437 207 586,99	796 066 796,18
Difference in %	13,95 %	12,85 %	15,44 %

The Secretariat has confirmed with the reconciler E&Y and the MSG that these differences are predominately arise due to the non-participation of small operators.

The term of reference approved by the MSG for the reconciliation exercise states that the report should:

Identify the number of companies (from the non-participating companies) by sub-sector, whose production value exceeds the average of:

- 2% of the total value of domestic mining production
- 2 % of the total value of domestic oil production
- 1 % of the total value of domestic gas production

The final report approved by the Comision Nacional (MSG) on 9 January 2012 and published on 11 January 2012 does not list the number of companies that met these thresholds. However, it has been reported that the report will be updated to address this issue³.

Drawing on other publicly available data, the reconciler has confirmed (see annex 1) that one company in the gas sector (Aguaytia) was above 1% of value of gas production and two companies (BPZ and Sapet) above 2% of the value of liquid oil production. However, when compared to the total value of production of the extractive sector (i.e. mining, oil and gas) none of these companies represents more than 1% of the total value of production. In the secretariat's view, it is reasonable to consider these companies as small, immaterial operators. In the case of Aguaytia, for example, its share of the gas production is declining (12% in 2008, 10% in 2009 and 4% in 2010) and it is expected to continue declining.

Finally Table 5 shows that the reconciliation of 2008-2010 payments from the 51 participating companies and the revenues the government disclosed from these companies. The discrepancies are negligible.

Table 5 – Discrepancies between revenues from participating companies and payments disclosed by those companies

Discrepancies between revenues and payments from participating companies				
	Revenues disclosed by government (in nuevos soles)	Difference to the figures disclosed by companies	% difference by revenue stream	% difference to total revenues
Income tax	22 173 503 360	-	-	-
Mining royalties	1 249 024 351	110 764	0,009	0,001
Hydrocarbons royalties	8 212 158 923	-42 414	-0,001	-0,001
Right fees	69 770 833	-2 800 048	-3,939	-0,001
<i>Total</i>	31 704 457 467	-2 731 698	-0,009	-0,009

³ Following a suggestion from the Secretariat, the MSG has instructed E&Y to add a table to the report indicating the number of companies above the thresholds defined in the terms of reference. The table will only indicate the number of companies and will not specify the name of those companies, as this was not required in the terms of reference.

19-5-D-ii SECRETARIAT REVIEW: PERU

Dated: 30 September 2011

1 Introduction

The Government of Peru committed to implement the EITI in May 2005. Peru was formally admitted as an EITI Candidate on 27 September 2007. The Board established a deadline of 9 March 2010 to complete the Validation process. Peru issued its first EITI Report in 2009, covering company payments and government receipts from 2004-2007. Preparations for the second report covering 2008-2010 are underway.

Peru's validation commenced in June 2010. A final report endorsed by the Comision Nacional was submitted to the EITI Board on 3 September 2010. Having reviewed the validator's findings, on 14 December 2010 the EITI Board designated Peru as Candidate country. Based on a thorough assessment of the specific circumstances, Peru was designated 'close to compliant'. The Board decision is presented at Annex A.

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". It provides a mechanism whereby the Board can designate a country as Compliant based on a review undertaken by the EITI International Secretariat. The EITI Board decision of 14 December 2010 sets out a series of remedial actions that need to be addressed in order to attain compliance. The Secretariat's assessment of progress is presented in section 3, below.

The EITI International Secretariat conducted its review in August-September 2011, including a field trip to Lima from 23 to 26 August. A list of stakeholders consulted during the review is presented at Annex B. Documentation was collected during the Secretariat mission on 23-26 August and submitted by the Comision Nacional on 12 September 2011. The Secretariat transmitted findings to the Comision Nacional on 30 September 2011. On 18 October 2011, the Technical Secretary of the Comision Nacional wrote to the Secretariat expressing no objections to the facts and information provided in the review and also conveying their worries about what they perceived as lack of sufficient recognition of the progress recently made, notably the production of the 2nd reconciliation report (covering 2008 to 2010).

2 Peru's response to the Validator's findings

Following validation and the EITI Board decision on 13 December 2010, the Peruvian government and the Comision Nacional undertook a number of actions aimed at strengthening the EITI process.

- Acknowledgment of Board decision
- Renewing mandate of Comision Nacional (Supreme Decree DS 028-2011 EM of 11 June 2011)
- The Comision Nacional agreed the terms of reference for the reconciliation report 2008-2010 including a definition of materiality
- The Comision Nacional has agreed to select Ernst and Young as reconciler for the Second Reconciliation Report for 2008 to 2010.
- The Ministry of Energy and Mines has convened companies all companies in the Sociedad Nacional de Minería y Petróleo with 50 committed to participate in the second report.

3 Secretariat Review of Remedial Actions and Assessment of Indicators

As set out in Annex A, the EITI Board agreed three remedial actions and tasked the Secretariat with

reassessing validation indicators 9, 11, 14 and 15. The Secretariat's assessment below addresses the corrective actions in turn, with reference to the relevant validation indicators as appropriate.

3.1 Remedial Action 1

The Comision Nacional should agree a clearer definition of materiality, and demonstrate that "all material oil, gas and mining payments to government" and "all material revenues received by governments from oil, gas and mining companies" are covered in the 2008 report. In agreeing a definition of materiality, the Comision Nacional is encouraged to consider a specific figure that defines a material payment.

Relevant EITI Rules

The EITI Rules (validation grid approved in Oslo Conference 2006 and published in February 2006) empower multi-stakeholder groups to agree a definition of materiality. Grid indicator No.9 states "EITI templates will therefore need to define by agreement of the multi-stakeholder group what these material payments and revenue comprise, and what constitutes 'material'".

The Source Book published in March 2005 provided guidance on which benefit streams should be reported and refers to "percentage of total production value" as a possible approach. This section of the sourcebook focuses how the MSG should decide what types of taxes and payments should be reported (income tax, dividends, royalties, etc.). As some of these payments are in-kind, e.g., the host government's production entitlement, the % of production value is a relevant metric. However the Sourcebook does not recommend that countries set a production based threshold for which companies should participate. It encourages the MSG to define what types of payments are material, and then to ensure that "all companies participate".

In relation to which companies should report the Source Book states that "EITI reporting must apply to all extractive industry companies...operating in that country. An entity should be exempted from reporting only if it can show with a high degree of certainty that the amounts it reports would in any event be immaterial". It goes on to suggest that "Governments may wish to report on the combined benefit stream from such small operators".

The EITI Rules (Validation grid) ratified this requirement in Grid Indicator No. 11 "The government will need to take all reasonable steps to ensure that all companies do report. This might include the use of voluntary agreements, regulation or legislation. It is recognised that there might be good (albeit exceptional) reasons why some companies cannot be made to report in the short term. In this situation, government must demonstrate that they have taken appropriate steps to bring these companies in to the reporting process in the medium term, and that these steps are acceptable to other companies".

The Board has recognised that in some cases it is practically impossible to cover "all companies", especially in the mining sector where there are often a large number of small operators. To address this issue, several countries have established "materiality thresholds", so that only companies making payments in excess of the threshold are required to participate in the reporting process. The Board has accepted this approach, but has taken care to consider whether the threshold is reasonable, i.e., the size (materiality) of the payments from non-participating companies relative to the total.

Validator's findings

For the 2004-2007 report, Peru defined materiality by companies representing at least 75% of total national production by value of production. The validator noted that the report covers 72% of national oil production, and 59% of national gas production. In terms of national mining production volume, the report covered 95% of copper, 70% of gold, 53% of zinc, 54% of silver, 40% of lead, 100% of tin and 100% of molybdenum. It was reported in the Validation report that of the 31 non-participating companies, four seem to account for a significant proportion of national production (Validation Report p.35 of English version). The validator reported that 'we understand that the flows taken into consideration for the 2004-2007 EITI Report include the principal payments which extractive sector companies make to the State'

(Validation Report p.39 of English version).

The validator did not specify: (1) when this definition was agreed, (2) what alternatives the Comision Nacional considered, (3) whether this definition has the full support of the Comision Nacional or (4) whether there were any dissenting views from stakeholders on this matter. Although the Comision Nacional subsequently provided supplementary information, the Board concluded in December 2010 that *“the approach adopted in Peru for the first EITI report [did] not sufficiently comply with the requirement to cover all companies and all material payments and revenues”*.

The following section discusses how reporting templates were agreed including how the Comision Nacional determined what constitutes “material” revenues and payments.

Reporting templates (including definition of materiality)

In June 2005, Peruvian stakeholders (initially grouped in the tripartite Working Group, later established by the Government as Comision Nacional in May 2006) approved the Work Plan to implement the EITI. From the outset it was agreed that the EITI process would be voluntary. Recognising that some companies would refuse to participate, stakeholders sought a pragmatic approach to establish the EITI process and improve it over time. The 2005 work plan, addressed the issue of what criteria would be adopted in order to consider the “EITI exercise” a valid one. The adopted criteria was based on setting an agreed target constructed after the relative importance of the participating companies measured by the value of their production in relation to the total mining production being extracted in Peru.

The Comision Nacional has confirmed in the document submitted on 12 September 2011 that the value of production is calculated by multiplying the volume of production according to the annual production as recorded in the Ministry of Energy and Mines’ website by the average international price of each commodity. Reference prices are obtained from public information available in the websites of the Ministry of Energy and Mines, Perupetro (hydrocarbon sector regulator), the Central Bank and SNMPE. The Comision Nacional confirmed in the document submitted on 12 September 2011 that this target was initially identified as 75% of total production value. This figure was later incorporated in the reporting templates agreed by the Comision Nacional on 15 June 2009 (for the 2004-2007 Reconciliation report).

In the meeting with the Comision Nacional held on 23 August 2011 the Comision argued that this figure of 75% of the value of production followed largely the structure of the mining sector in Peru. The large and medium scale mining sub-sector represents approximately 75% of the mining value of production with the remaining 25% coming from a more spread-out small-scale and artisanal mining. The large and medium-scale mining sector is organised through a mining association that consists of the 60+ largest companies called *“Sociedad Nacional de Minería, Petróleo y Energía (SNMPE)”*. The body responsible for national mining cadastre, Ingemmet, confirmed during a meeting held on 24 August 2011 that there are 48,000+ mining rights (i.e. a mining right entitles the owner to exploit minerals in a certain specified area) with 11,536 registered owners of those rights. The structure of the hydrocarbon sector is more concentrated with five big companies accounting for approximately 85% of the value of production from 2004 to 2010.

It is recognised in the Work Plan 2005 that using the “value of production” as a guiding criteria to anticipate the significance of each company’s payments could be distorting due to different cost and pricing structures but it was nonetheless adopted as it was considered the best information available ex-ante (for more detail see Section 5.2 of the 2005 Work Plan, p.18). The Constitution prevents tax authorities from revealing individual tax-related information (called in Spanish *“Reserva Tributaria”*). This legal limitation was confirmed by the Comision Nacional in its document submitted on 12 September 2011 that *“to identify all material companies from the universe of all relevant companies, the value of production is the only public available figure, as the current regulation on tax confidentiality prevents the disclosure of tax flows”*. The Comision Nacional reasserted in the same document that *“even if there could be a difference between value of production and actual payments, the National Commission had agreed that such difference does not have a material influence in the results of the reconciliation”*. This

agreement was confirmed with several stakeholders consulted separately.

The International Secretariat understands that this agreed definition was adopted in light of the Government's approach to implement the EITI on voluntary basis, rather than making reporting mandatory for extractive companies. The Comision Nacional then agreed a threshold based on a target for the actual coverage in light of the uncertainty of achieving full coverage under a voluntary scheme and with the expectation that the coverage could be increased over time. The Secretariat understands that this was considered to be a pragmatic solution, allowing the process to move forwards instead of paralyzing implementation all together.

What percentage of payments did the first reconciliation report (2004-2007) cover?

The definition of materiality adopted in the 2005 Work Plan established that payments and revenues were material if they represented the universe of large and medium scale mining (defined as the largest companies which cover at least 75% of the value of total production) and largest hydrocarbon companies (similarly defined as covering 75% of the value of hydrocarbon production).

33 companies (24 mining, 9 hydrocarbons) participated in the 1st reconciliation report (2004-2007). The government only disclosed revenues from the participating companies (i.e., it did not disclose all revenues). According to figures from SUNAT, Perupetro and Ingemmet (compiled in the document submitted by the Comision Nacional on 12 September 2011), the participating companies accounted for 77% of total revenues accrued to the Peruvian treasury from the extractive sector (see Table 1). The report covered 81.24% of income tax, 72,96% of mining royalties, 64.44% of hydrocarbon royalties and 20% of mining rights,

Table 1 - RELATION BETWEEN TOTAL REVENUES FROM EXTRACTIVE SECTOR AND EITI REPORT

(1st RECONCILIATION REPORT 2004-2007)

	(I)	(II)	(II)/(I)
	<u>TOTAL REVENUES</u>	<u>1st EITI RECONCILIATION</u>	
INCOME TAX (USD)	8 426 698 971,85	6 845 507 836,26	81,24 %
MINING ROYALTIES (USD from Soles)	371 349 116,70	270 934 765,73	72,96 %
HYDROCARBONS ROYALTIES (USD)	2 474 071 600,00	1 594 408 142,00	64,44 %
MINING RIGHTS INGEMMET (USD)	103 493 269,00	21 402 072,87	20,68 %
TOTAL (USD)	11 375 612 957,55	8 732 252 816,86	
	EITI (II)/TOTAL		76,76 %

Based on calculations made by the reconciler Ernst and Young, the following non-reporting companies each represented a "value of production" greater than 2%:

Mining:

In 2004: Ares and Volcan

In 2005, 2006 and 2007: Volcan

Oil:**In 2004: Savia, Aguaytia and Sapet****In 2005, 2006 and 2007: Savia, Aguaytia, Sapet and Interoil****Gas (above 1%)****In 2004: Pluspetrol, Savia, Petrobras, Sapet, GMP and Olympic****In 2005 in 2006: Aguaytia, Savia, Petrobras, Sapet and GMP****In 2007: Aguaytia, Savia, Petrobras and GMP**

Due to the privacy constraints mentioned previously, the Secretariat has not been able to access data regarding the size of the payments made by these companies. However, it is noteworthy that “total value of production” appears to provide a reasonable indicator as to the size of their payments. The 33 companies participating in the 1st reconciliation represented 68% of the value of production according to ex-post calculations made by the reconciler Ernst and Young while they represented 76.76% of the total revenues. This suggests that there were a significant number of companies that made substantial payments that were not covered in the 2004-2007 Report.

As noted above, the Board recommended that the Comision Nacional agree a clearer definition for the 2008 report based on the materiality of payments and revenues, not total value of production.

Progress since validation

The Comision Nacional agreed the terms of reference (ToR) for the 2nd reconciliation report covering the years 2008-2010 report on 10 June 2011. The ToR set out the following definition of materiality:

The 2008-2010 report should reflect the value of payments made by companies that have signed up to EITI. These payments comprise income tax, royalties and mining rights which have all been agreed as material revenue streams. The 2008-2010 report must reflect the participation of companies in each of the sub-sectors which

- i) Represent a share of no less than 75% of the value of national mining production*
- ii) Represent a share of no less than 85% of the value of national hydrocarbon production*

The Government has agreed to unilaterally disclose all revenues obtained from these agreed revenue streams. To this effect, it is required that the report will:

- i) Reflect the aggregate amount of total payments made by non-signatory companies, in taxes and non-tax payments, deducted from the total amount collected in each fiscal year by the tax collecting agencies, depending on the type of payment in question;*
- ii) Identify the number of companies (from the non-participating companies) by sub-sector, whose production value exceeds the average of*
 - 2% of the total value of domestic mining production*
 - 2% of the total value of domestic oil production*
 - 1% of the total value of domestic gas production*

This definition continues to define materiality with reference to value of production. The definition does not include the Board’s recommendation of establishing a specific figure that defines a material payment. However, the definition acknowledges the need to cover all revenues, with the government committing to disclose the aggregate amount of total payments made by non-signatory companies.

The Comision Nacional ratified Ernst and Young as the reconciler for the second reconciliation report for the years 2008-2010. The cost of this second report is being funded by the Swiss Cooperation (SECO).

The Ministry of Energy and Mines invited all companies from the large and medium scale sector (grouped under SNMPE) to participate in this second reconciliation report. A first meeting with most of the companies was held on 10 July 2011 and was followed up with letters to each company from the Comision

Nacional. As of 31 August 2011, 50 companies have confirmed their participation in the second report. They have all signed a binding form in which:

- Each company commits to report income tax, royalties and mining right payments if applicable.
- Each company authorizes the tax agency SUNAT to disclose the revenues corresponding to them (i.e. to waive the confidentiality right)
- Each company indicates under which modality of disclosure (disaggregate, aggregate) wishes to participate.

The Comision Nacional has provided a copy of these forms to the International Secretariat.

Based on the participation of these 50 committed companies, the International Secretariat asked the reconciler Ernst and Young to assess whether the definition of materiality was met according to the MSG agreed production-based definition of materiality.

Ernst and Young has estimated that the 2008-2010 reconciliation report will cover:

Value of production

	<u>Mining (%)</u>	<u>Hydrocarbons (%)</u>
2008	80.57	88, 60
2009	78.32	90, 33
2010	77.02	91, 20

In addition, the International Secretariat asked the reconciler Ernst and Young to provide an indication of how many non-participating companies were above the production-based thresholds. Ernst and Young have reported that following non-participating company is above the agreed thresholds:

Mining: Volcan: 4.92% in 2008, 4.48% in 2009, 4.34% in 2010.

Oil:

In 2008: BPZ (2.71%), Aguaytia (3.37%) and Sapet (3.50%)

In 2009: BPZ (3.87%) and Sapet (4.18%)

In 2010: Sapet (4.34%) and BPZ (5.72%)

Gas:

In 2008: Aguaytia (12%)

In 2009: Aguaytia (10%)

In 2010: Aguaytia (4%)

Based on total (mining and oil and gas) production value, one company represents a share above 1%:

Volcan: 4,14% in 2008, 4,02 in 2009 and 3,81& in 2010

The Secretariat did not have access to data that estimates the coverage of the second reconciliation report as expressed in terms of total payments. Furthermore, the Secretariat did not have access to data that estimates the size of the payments from the non-participating companies. The tax agency SUNAT confirmed to the Secretariat that they were not legally allowed to disclose individual tax information. SUNAT administer the income tax, which account for around 75% of total revenues accrued to the Peruvian state.

The expected participation rate of companies in the second report is larger than the first report, especially in the oil and gas sector where no significant company (measured in accordance to the production-based thresholds) is not participating. However, the mining company Volcan remains out of the reconciliation process while account for around 4% of the value of production for the 2008-2010 period.

Secretariat's Assessment

In 2005 Peru decided to adopt a voluntary approach to implement the EITI. Recognising from the outset that not all companies would participate, the MSG agreed to define materiality based on a target of covering 75% of total value of production. They also agreed to focus on the largest companies (large and medium companies) accounting for 75% of the value of production. They recognised the limitation of this approach, but were constrained by the constitutional provision for confidentiality of individual tax information.

Based on this approach the first EITI Report reconciliation report for the years 2004 to 2007 covered 77% of total revenues. Further investigation revealed that the first reconciliation did not include a number of companies that individually represented >2% of total production value, and thus likely made significant payments. In light of this, the Board concluded that *"the approach adopted in Peru for the first EITI report does not sufficiently comply with the requirement to cover all companies and all material payments and revenues"*.

To remedy that situation the Board asked the MSG to adopt a clearer definition of materiality based, preferably, on what constitutes a material payment (as oppose to define materiality based on production) and ensure that all material payments and revenues are covered accordingly. The Comision Nacional's revised definition is still based on targets for coverage based on value of production. The Comision Nacional's position is that, due to constitutional constraints on tax disclosures, this approach is still the best available proxy to determine what constitutes a material payment.

The corrective action also requires that Peru *demonstrate[s] that "all material oil, gas and mining payments to government" and "all material revenues received by governments from oil, gas and mining companies" are covered in the 2008 report.*

The Secretariat notes the following:

- The 2008-2010 Report is not yet complete. A reconciliation progress report was submitted by Ernst and Young to the MSG on 27 October 2011. All 50 companies that had committed to participate have reported;
- Company participation is voluntary, but has increased considerably, as noted in previous point;
- One company, Volcan, accounting for approximately 4% of the production value (and, it can be assumed, a similar share of revenues) is not yet participating. In October 2011, the company indicated that, subjected to the confirmation by the company's Board, Volcan will participate in the reconciliation report. Volcan's Board is due to meet in the 3rd week of November.
- The Government has committed to disclose all payments, so in that sense the 2008-2010 report is expected to be comprehensive.

The corrective actions did not specifically require the 2008 report to be published. The question arises as to whether Peru has sufficiently demonstrated coverage of all material payments. The still unconfirmed participation of Volcan, a company that have made material payments as it was established in this review, implies that not all material payments can be guaranteed to be reported in the 2nd reconciliation report at the time of writing this review.

With respect to indicators 9, 11, 14 and 15:

- Compliance with indicator 9 is discussed in section 3.2 (remedial action 2).
- Compliance with indicators 11 and 14 is intertwined. The non-participation of Volcan is problematic. However, indicator 11 states that:

"it is recognised that there might be good (albeit exceptional) reasons why some companies cannot be made to report in the short term. In this situation, government must demonstrate that they have taken appropriate steps to bring these companies in to the reporting process in the medium term, and that these steps are acceptable to other companies".

The Secretariat has confirmed with the company constituency in the MSG that they are satisfied with the steps taken by the Government respect to bringing Volcan to the EITI process. The Secretariat understands that both the Government and the company constituency in the MSG have repeatedly invited Volcan to participate in the EITI process, to no avail. The Secretariat has also learnt that this company has equally opted for not participating in the voluntary contribution scheme in place since 2006 (“Programa Minero de Solidaridad con el Pueblo”). The situation surrounding Volcan’s reluctance to participate was also noted in the Validation Report (p.35 of English version).

- The decision to unilaterally disclose all revenues in the 2008-2010 reconciliation report indicates that indicator 15 will be satisfied.

In light of this it is the EITI International Secretariat’s assessment that the remedial action one has not been completed.

3.2 Remedial Action 2

The Comision Nacional should also clarify its agreed approach for coverage regional and/or municipal taxes, social security contributions and the Voluntary Contribution for the 2008 and subsequent reports.

Validator’s findings

The validator reported that ‘regional and/or municipal taxes, social security contributions and totals relating to the Voluntary Mining Contribution were not included within the scope of the Report (US\$500 million paid in three years)’. In its assessment of the final validation report (section 5 of Board Paper 14-4-D) the Secretariat noted that “it is sufficiently clear that the reporting templates have been agreed. However, there is insufficient information regarding the coverage of regional and/or municipal taxes, social security contributions, and the Voluntary Contribution. Further clarification is needed on these issues before concluding that indicator 9 is met”.

Voluntary Mining Contribution (Aporte voluntario minero)

The voluntary mining contribution (“Programa Minero de Solidaridad con el Pueblo” in Spanish) was a mechanism agreed in December 2006 between the mining companies and the Government of Peru. It was regulated by Government’s decree (Decree 071-2006/EM and 033-2007/EM). It is not a tax payment but rather a voluntary, extraordinary social contribution and limited to 5 years. Each company (39 agreed to participate) creates a trust fund where contributions are held until a civil association, created in each community/region, use those funds to execute social programs. 30% of each fund needs to be spent on nutrition, education and health projects. Each trust fund is of a private nature although its governance includes local authorities. In any case, it is not legally considered a revenue to the national treasury.

The program started in 2007 and it is expected to finish in 2011. In the first three years (2007-2009) the total amount contributed under this mechanism was US\$ 459 million⁴ (The accumulated contribution from 2007 to 2010 is US\$ 600 million -annual average of US\$150 million- as it is reported in the Bulletins issued by the Ministry of Energy and Mines).

The Comision Nacional agreed to exclude the voluntary contribution in the 1st reconciliation report (2004-2007). Among the reasons cited for that exclusion was that it applied only to one of the four years being reconciled in that report and that it was not a tax payment that could be reconciled as the other revenue

⁴ Soles 1,388 million. This was the reference figure taken by the validator CAC75 in the validation report. CAC75 wrongly calculated the amount of USD\$ 500. A more accurate amount is US\$ 459 after converting in accordance with the average annual exchange rate reported by the Central Bank of Peru

streams included in the report. The International Secretariat could verify that there is abundant public information available on the execution of this Voluntary contribution program (including disaggregated information), especially in the Bulletins issued by the Ministry of Energy and Mines. Based on this public information both industry (SNMPE) and civil society (Grupo Propuesta Ciudadana) publish regular monitoring reports (including a ranking that evaluate degree of execution of each program).⁵

Regarding municipal taxes and social security contributions, the Comision Nacional confirmed that these flows were excluded for the following reasons: first, in the case of municipal taxes, there are a couple of fees (construction and operating) that are collected in 1800+ municipalities and a land fee equally collected at municipal levels. Those fees are minor and not specific applicable to the mining or hydrocarbon sector. Reconciliation of these flows would be extremely costly for a very minor total contribution. In the case of social contributions, they were excluded as they are not accrued to the Peruvian State but rather to individual private accounts.

Progress since validation

The Comision Nacional agreed to include in the 2nd reconciliation report additional information regarding the accumulated voluntary mining contribution until 2010. The Comision Nacional confirmed that the supplementary information will cover:

- Objectives, criteria and regulations that apply to this contribution
- Funds transferred by participating companies to the local and regional trust funds.
- Use of the monies transferred to each fund.

In addition to the Voluntary Contributions made in the period 2006-2010 by mining companies involved in the PMSP programme being disclosed in an annex to the 2008-2010 report, the ToR for the 2008-2010 report also states that the reconciler should take into account the revenue that is transferred to regional and local governments, universities and other public institution for the following revenue streams: Property fee, Canon (income tax distribution), Sobrecanon (windfall tax), Royalties and FOCAM (Socioeconomic Development Fund - a mechanism that distributes 25% of the royalties paid to the national government for the benefit of regional and local governments and universities in 5 departments).

Secretariat's Assessment

The International Secretariat is satisfied with the clarifications regarding the approach adopted for regional and municipal taxes, social contribution and the Voluntary mining Contribution. The inclusion of information about this voluntary contribution (i.e. a social transfer) is an step forward in the reporting of flows from the extractive sector and, although not binding in the case of Peru, in accordance with the 2011 version of the EITI Rules (Requirement 9-g). In view of the information provided by the Peru's MSG the Secretariat is satisfied that indicator 9 is met. The EITI International Secretariat's assessment is that remedial action two has been met.

3.3 Remedial Action 3

Increasing company participation through targeted outreach to the largest oil, gas and mining companies that are not yet participating in the process. An entity should be exempted from reporting only if it can show with a high degree of certainty that the amounts it reports would in any event be immaterial. The Comision Nacional may wish to consider requesting that the government unilaterally discloses the combined benefit stream from such small operators.

⁵ See <http://www.snmpe.org.pe/portal/contenido/200/programa-minero-de-solidaridad-con-el-pueblo/id.200> and http://www.descentralizacion.org.pe/apc-aa/archivos-aa/3c6bb51ada688b58c57cb18308d59d73/transparencia_mineras4.pdf

Validator's findings

64 companies were invited to participate in the 2004-2007 reconciliation, of which 33 companies reported payments.

Progress since validation

As documented in Section 3.1.3, the Ministry of Energy and Mines together with Peru's MSG reached out to the largest companies grouped under the Sociedad Nacional de Minería y Petróleo. 50 companies have committed to participate in the 2008-2010 reconciliation report. This represents an important increase in participation from the first reconciliation exercise conducted in 2009 covering 2004 to 2007. Also, as discussed above, the Government has committed to disclose the combined revenues from small operators corresponding to the agreed benefit streams.

Secretariat's Assessment

While the 2nd report has not yet been published, the Secretariat is satisfied that the Comisión Nacional has taken appropriate steps to engage the largest oil, gas and mining companies. The government has also agreed to disclose the combined revenues from small operators corresponding to the agreed benefit streams. The EITI International Secretariat's assessment is that remedial action three has been met.

4 Conclusion

The Board decision stated that three remedial actions should be completed in order to achieve Compliance. It has not been possible to establish that all material payments and revenues have been covered as required by remedial action one. The Secretariat is satisfied that remedial actions two and three have been satisfactorily completed.

Annex A - EITI Board Decision on Peru's Validation, 14 December 2010

The EITI Board agreed the following statement:

The Board designates Peru as Candidate country as of 14 December.

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

The Board congratulates the government, companies and civil society organisations in Peru for the progress made in implementing the EITI and for completing validation.

In all decisions on Validation the Board places 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.

The validator found that all indicators are met. The Board found that the approach adopted in Peru for the first EITI report does not sufficiently comply with the requirement to cover all companies and all material payments and revenues. The following issues must be addressed in order to achieve Compliance:

1. The Comision Nacional should agree a clearer definition of materiality, and demonstrate that "all material oil, gas and mining payments to government" and "all material revenues received by governments from oil, gas and mining companies" are covered in the 2008 report. In agreeing a definition of materiality, the Comision Nacional is encouraged to consider a specific figure that defines a material payment.

2. The Comision Nacional should also clarify its agreed approach for coverage regional and/or municipal taxes, social security contributions and the Voluntary Contribution for the 2008 and subsequent reports;

3. Increasing company participation through targeted outreach to the largest oil, gas and mining companies that are not yet participating in the process. An entity should be exempted from reporting only if it can show with a high degree of certainty that the amounts it reports would in any event be immaterial. The Comision Nacional may wish to consider requesting that the government unilaterally discloses the combined benefit stream from such small operators.

When the Comision Nacional has completed these remedial actions, the EITI International Secretariat will reassess Peru's compliance with indicators 9, 11, 14 and 15. The Secretariat will consult widely with stakeholders during the review. The Comision Nacional 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 the outstanding requirements have been met, the country will be designated as EITI Compliant. In the interim, Peru will retain its Candidate status. The Board retains the right to require a new Validation if the remedial steps and Secretariat review are not completed within six months (i.e. 12 June 2011). The Board does not foresee granting any extensions beyond this deadline to complete remedial actions.

Annex B – Stakeholders Consulted

Government

- **Luis A. Espinoza Quinones, Vice-Minister , Ministry of Energy and Mines**
- **Jose Luis Carbajal, Director General at Ministry of Energy and Mines and Technical Secretary of Peru's Comision Nacional .**
- **Luis Barranzuela Farfan, Director, Mining Rights Directorate, INGEMMET**

- **Juan Carlos Lam Alvarez, Secretary General, INGEMMET**
- **Gustavo Vasquez Guevara, Treasurer, PERUPETRO**
- **Miguel Guzman Ramos, Administration, PERUPETRO**
- **Edwin Gutierrez, SUNAT**
- **Domingo Neyra, SUNAT**

Civil Society Organisations

- **Jaime Consiglieri, CooperAccion and member of Peru's MSG**
- **Victor Gamonal, CooperAccion and member of Peru's MSG**
- **Epifanio Baca, Grupo Propuesta Ciudadana and member of Peru's MSG**
- **Carlos Monge, Grupo Propuesta Ciudadana**
- **Carlos Wendorff, Catholic University and member of Peru's MSG**
- **Marco Zeisser P., Pacific University and member of Peru's MSG**

Companies

- **Carmen Mendoza, Sociedad Nacional de Minería y Petróleo and member of Peru's MSG**
- **Carlos Aranda, Southern Peru and member of Peru's MSG**
- **Pablo de la Flor, Antamina and member of Peru's MSG**
- **Edgar Zamalloa, Hunt and member of Peru's MSG**
- **Jose Jimenez, Hochschild Mining**

International partners

- **Mirco Kreibich, EITI consultant, World Bank office Lima**
- **Ousmane Dione, Sector leader, World Bank office, Lima**
- **Livia Benavides, Country Operations advisor, World Bank office, Lima**
- **Christian Robin, SECO, Swiss Cooperation**

Ernst and Young (reconciler)

- **Numa Arellano, Senior Partner, Advisory Services**
- **Paulo Pantigoso, Senior Partner, Advisory Services**
- **Tania Sanchez, Manage, Advisory Services**
- **Renzo Valera, Advisory Services**

Annex C – Document submitted by the Peru's National Commission on 12 September 2011 in response to questionnaire sent by the International Secretariat.

See separate file upon request

Annex D – Ernst & Young supplementary information

See separate file upon request