

**CIPFA** The Chartered Institute of Public Finance & Accountancy

**EITI Assurance Data and Quality Review**  
Preliminary Findings

Strategy Committee 11 April 2012

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## Contents

- CIPFA's brief
- How EITI should "ideally" work
- Observations on EITI in practice
- CIPFA suggestions to improve EITI assurance
  - clarifying current requirements and guidance
  - modified approaches
  - an augmented model of EITI reconciliation

Appendix  
Potential areas of risk with the "ideal"

2

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## CIPFA's brief

### Objectives

- A professional view of the current EITI operation
- Concrete suggestions on practical and viable ways to increase assurance of EITI quality of data and reports.
- Adjustments to the current EITI system and existing practices dealing with quality assurance and data/reports reliability, specifically, how to improve:
  - the body of directives (criteria, requirements and guidance);
  - the set of processes (MSG assessment, TORs for Reconcilers, TORs for Validators); and
  - key outputs (EITI templates and reports).
- Look at practice in six countries – Norway, Nigeria, Central African Republic, Niger, Liberia and Mongolia

3

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## How EITI should "ideally" work...

### Key characteristics

<b>GOVERNMENT</b> Rule of law      Democracy      Public Governance Systems          Accounts          Templates Internal assurance      General control      Control over EITI receipts Auditing standards      Independently assured accounts      Independently assured templates	<b>EXTRACTIVE INDUSTRIES</b> Rule of law      Ethical business behaviour      Company Governance Systems          Accounts          Templates Internal assurance      General control      Control over EITI payments Auditing standards      Independently assured accounts      Independently assured templates
<b>STAKEHOLDER GROUP / Government / Civil Society / Extractive Industries</b> Balanced discussion      Understand EITI      Understand country context Determine coverage      Determine scope of flows      Determine materiality Develop laws      Educate other parties      Specify type of EITI report	<b>EITI PROCESS / Country Secretariat / Validators / Reconcilers</b> Independent      Competent      Understand EITI Access to data and people      Agreement of figures      Resolution of discrepancies Government assurance      Company assurance      Engagement standards

**EITI REPORT**

Can be read and credibility checked by third parties  
 Compared with other government information  
 Compared with other country information  
 Compared with other company information  
 Compared with related company info

Note reflects CIPFA's interpretation of "ideal"

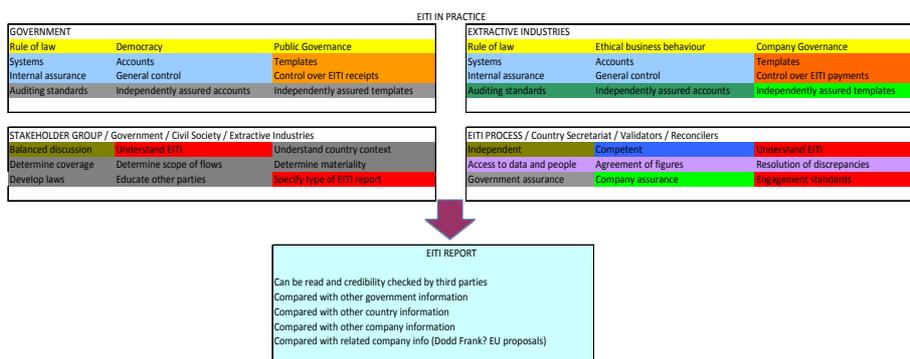
4

## Even an "ideal" approach would have limitations...

- None of the building blocks of EITI provide 100% assurance
- Audit has inherent limitations
- Collusive fraud cannot be reliably detected by audit
- Verification issues for non-monetary transfers
- Verification issues for flows to third parties
- The most effective approaches to improving assurance and related reporting are governance, systems, accounting and internal control, but they are harder to verify
- Very detailed disaggregation may result in information overload while insufficient disaggregation may not provide transparency

5

## There are a wide range of other potential risks...



See appendix for details on each of these potential risks

6

## Observations on EITI in practice..

Practice doesn't fit with the ideal.

There are many potential risks to the EITI process, but the effect varies.

- Some fully addressed by existing EITI process and not realised in practice
- Some are very serious and validation cannot be completed unless they are addressed.
- Some affect Stakeholder and Validator understanding of what EITI allows or is trying to achieve
- Others are addressed by Stakeholder Groups and Validators in a variety of ways

Commonsense approaches are taken but in some cases may satisfy the letter of EITI rather than the spirit.

- Result is diverse implementation of EITI and some lack of clarity about what the EITI report provides
- EITI compliance means different things in different countries
- EITI reports provide differing degrees of reporting, assurance and transparency in different countries
- Extent to which EITI is supported by government audit is variable, and many countries where this EITI principle is not fully satisfied
- Support provided by company audits also varies, and may relate to company account figures with little relation to figures in the EITI report.

**Overall – it is not clear that this diversity is justified, and it detracts from the EITI “brand”**

7

## Improving EITI assurance...

The potential areas of risk have informed our consideration of how EITI assurance might be improved.

Some areas of risk, in line with our brief, were not addressed, either because our analysis did not provide any indication that there was a significant problem, or because we felt that existing EITI processes and procedures address the problems and risks. For example, we have not commented on measures to ensure the participation of civil society, even though we recognise that this can be a very difficult issue in some countries.

We would also note that some issues can only be fully addressed through capacity development. We have not commented on the long term solutions which could be applied to improving socio-economic context, or developing capacity in the areas of public financial management, government audit, company management and company audit.

8

## Suggestions for improving EITI assurance...

The remaining areas of risk mainly relate to clarifying the requirements and guidance of EITI, to government and company audit assurance and to the specifics of the EITI reconciliation assurance product.

We have some suggestions which mainly involve **clarifying** the current **requirements** of EITI.

We have also pursued whether there are variant approaches which achieve assurances which are consistent with the EITI Principles. The EITI Rules provide guidance which seeks to achieve this, but in some cases they may provide too much flexibility, while in other cases the requirements may discourage solutions based on local institutions and standards which might be good enough.

We have therefore suggest exploring

- **modified approaches** where ideal assurance of government and companies is not available, and
- an **augmented model of EITI reconciliation** where the Reconciler obtains assurance directly through methods normally associated with 'audit'

9

## Clarifying current requirements and guidance...

### Problems with the word 'audit' and its cultural context

- the word 'audit' is used differently in different countries and by different accountants ; and its meaning changes over time
- audit sits in law and in professions differently in different countries, even across Europe
- audit has a specific meaning in international standards for statutory audits of companies
- it has a slightly different meaning for international standards for the public sector
- most countries distinguish between accounting standards and auditing standards (whatever these refer to)
- BUT some countries deal with accounting and audit together, and may include auditing in accounting standards/guidance
- some countries use the term 'accountant' to mean auditor/assurer
- professional accountancy bodies can be audit-only, can exclude audit, or cover a wide range
- government audit in some countries is more related to law than to accountancy whereas in France the role of the Cour des Comptes has widened from fiscal irregularity, this is not generally the case in Francophone Africa
- roles and relationships of internal and external audit vary, especially in government, as do other control, inspection and assurance activities.

10

## Clarifying current requirements and guidance...

### EITI principles, criteria and rules are not as clear about audit as they could be

- Some high level references not consistent with international standards terminology
- Lower level rules more precise, but some still confusing or difficult for us to confirm that they are correct.
- EITI refer to 'international auditing standards' applied to government revenues, reconciliation and company payments
- Main international standards for auditing are set by the International Auditing and Assurance Standards Board (IAASB)
- Their auditing standards are International Standards on Auditing (ISAs), which primarily focus on financial statements
- SAIs also governed by International Standards of Supreme Audit Institutions (ISSAIs)
- Need to interpret 'audits' to apply to the multiplicity of payments and revenues in an EITI report
- Referring to ISA audits of relevant company financial statements is one way, but doesn't focus on EITI numbers
- ISAs do not apply to engagements like EITI reconciliation reports
- There are standards for other engagement types which do including
  - International Standard on Assurance Engagements (ISAE) 3000; and
  - International Standard on Related Services (ISRS) 4400

11

## Clarifying current requirements and guidance...

### There are problems arising in the interpretation of EITI references to audit

EITI Reconcilers take a number of approaches to standards, variously commenting on

- compliance with ISAs (standards on auditing)
- compliance with ISAE 3000 (which relates to assurance engagements which are not audits)
- compliance with ISRS 4400 (which relates to agreed upon procedure engagements)
- no compliance with anything in particular (but clearly stating what they have done)

Underlying this, Reconcilers often do relatively similar work.

Less clear what Validators and Stakeholders think about application of standards.

- Some Validation reports seem confused about the application of standards
- Some cases where international auditing standards seem conflated with accounting standards (especially in countries which use unified guidance on accounting and auditing)
- Some cases where international auditing standards (which are mainly about the conduct of assurance work) are confused with the cash measurement basis used for the reconciliation work
- Some may leave it to Reconcilers to do the right thing, and accept plausible reports when they see them.

Although Stakeholders, Validators and Reconcilers often get to a sensible position, **we believe<sup>12</sup> that confusion does arise, and this sometimes impacts adversely on the EITI process.**

## Clarifying current requirements and guidance...

### How could the guidance be improved?

Changing the principles and criteria may be difficult but is necessary

- need to be formally agreed through transparent process
- may also reduce usefulness of 'audit' branding
- but need to make sure it is not seen as 'wrong', and appropriate standards apply

Scope for more clarity and coherence in Rules and Requirements

- seek to eliminate confusing and inconsistent language
- briefly address accounting issues so that they are properly differentiated
- the definition and approach to materiality including coverage and payment type as well as size of payment.

Provide more guidance on the options available when the ideal isn't satisfied

- need to determine EITI Board view on what may be acceptable for different models of government audit, local rather than international standards, and proportional application of company audit requirements to small operators or companies
- some options may only be acceptable as temporary fixes
- others may be worth considering as permanent alternatives

13

## Modified approaches...

### What sorts of modified approaches might be considered?

Improving / amending the EITI Rules may allow achievement of EITI transparency objectives in more cases. However, we expect there will still be cases where the country may not be able to provide the necessary assurances for government revenues or for company payments.

Where the 'ideal architecture' assurance for government and companies is not available, it is worth exploring whether there are alternative approaches which achieve a sufficiently similar result. This may be easiest to implement and less costly where the approach can be modified through work done by similar parties to the normal EITI model.

This might involve a greater focus on the EITI figures, particularly where there are gaps in the overall financial reporting of government, or gaps in the coverage of government auditors, or gaps in company audit or reporting.

It might also involve assurance from parties other than the relevant auditor.

It may also be worth considering if 'assurance gaps' can be compensated for by additional measures designed to enhance governance or control.

14

## Modified approaches...

### Reconciliation and agreement are very powerful but don't do everything

The underlying EITI approach of reconciliation is very powerful, especially where disaggregated figures are directly agreed by Reconcilers and are made publicly available

Much of the benefit could in theory be obtained from a successful reconciliation in the absence of the ideal support through good accounts/templates and formal audit, AS LONG AS it were possible to be confident that the figures provided by government and by companies were truly independent and sufficiently complete.

The main threats to independence of data and completeness which reconciliation is vulnerable to are

- collusive fraud resulting in co-ordinated omission or misstatement of data in company and government information
  - dependency of one data provider on the other due to lack of accounting capacity and/or budget constraints reflected in Reconcilers' ToR
- (of course, these factors as identified in page 5 are also difficult for ideal EITI process to detect)

Another issue is that reconciliation focuses on agreeing the amount of flows which occurred, without addressing whether tax etc was paid at the right amount.

15

## Modified approaches...

### Modified approaches based on modified assurance

Possible modified approaches to existing EITI reflecting country specific approaches to assurance include

-alternative assurance approaches by the normal assurers. For example, government or private sector auditors could provide assurances on an EITI template even in the absence of accounts audited to an international standard.

-the normal government auditors could provide a credibility check or a high level review rather than an audit. This only works if there is the right sort of information available to credibility check or review. It might be an approach which can be used to add to Francophone and other approaches to audit where these do not focus on financial statements.

-assurance provision by internal audit or inspectorates which are not formally independent. Under Anglophone, Francophone and former Soviet regimes there may be 'internal' assurers who could provide this. In some cases there may be sufficient safeguards for this to be a long term solution. In other cases it may be acceptable as a short term measure.

16

## Modified approaches...

### Modified approaches which move away from a pure assurance focus

Other possible modifications to existing EITI include

-systems/governance based solutions: one approach would be to accept strong systems of control or governance as a substitute for audit verification. There would need to be strong grounds for believing that these operate effectively which might include a systems review or audit. We would be uneasy about these being used in the long term. We would not expect this to apply to companies.

-attestation by responsible persons: similar to the above, some comfort might be drawn from representations by senior officials. Again we see this as mainly a stopgap measure.

17

## Modified approaches – conclusion...

### Initial view on modified approaches

In some countries which are having difficulty with full EITI compliance, fraud is a known problem, and some of it is collusion between companies and public officials. Care needs to be taken not to implement approaches which are more aspirational than effective.

Some of the approaches we have considered are quite similar to the standard assurance process. In countries where Francophone style Cour des Comptes audit or other styles of audit do not address standard financial audit issues under ISSAIs, it might be possible to supplement these with additional work rather than have them perform a full audit.

Officially endorsed departures from the existing EITI process carry a number of risks, particularly where they make a qualitative change by replacing assurance with governance, control or attestation; however they might be credible on a transitional basis (and we know they are already used in some countries).

**In summary, modified approaches may in practice help achieve EITI outputs and be relatively low cost, but may continue to carry a measure of risk to the EITI "brand".**

18

## Augmented model of EITI reconciliation...

### Augmenting the work of Reconciler firms

An approach based on augmenting the EITI reconciliation process would differ from the 'modified approaches', in that it would always seek to obtain very similar assurances to those provided by the ideal model architecture

It would however focus mainly on EITI figures rather than government and company accounts.

The work would be mainly done by the EITI Reconciler firm, and would involve substantive evidence gathering and review of the type normally associated with audit.

If there were gaps in both government and company information, it would involve direct testing of both sets of information. For some EITI flows, it would be possible to incorporate tests on the completeness and correctness of revenue flows.

19

## Augmented model of EITI reconciliation...

### Key aspects of possible Augmented EITI Reporting

Although the work would be more in line with the principles of financial audit, we do not expect that the EITI report could be construed as a 'special purpose financial statement' and audited under ISAs and reported upon using ISA 800 'Special Considerations - Audits Of Financial Statements Prepared In Accordance With Special Purpose Frameworks'. Depending upon circumstances, the Augmented Model could be structured as an 'assurance engagement' or an 'agreed upon procedures engagement', and applicable international standards would be ISAEs or ISRS 4400.

This work has limitations, which are similar to those attached to audit:

- The work would not provide 100% assurance (it might provide reasonable assurance and an 'opinion' in line with audit, or limited assurance and a correspondingly limited opinion, or a report of findings).
- Nor would it be proof against fraud, particularly collusive fraud. Especially in countries with weak governance and systems.
- Non-monetary flows and hard currency payments would still present verification issues.

However, it could in many cases be a substantial improvement over existing arrangements.

20

## Augmented model of EITI reconciliation Conclusions...

### Costs and benefit of possible Augmented EITI Reporting

#### Costs

There would be significant additional costs.

For countries with very diverse flows, multiple sectors and many companies the costs could be very large, especially if checking includes confirmation of the correctness of payments.

However, many Reconcilers already do extensive testing in order to achieve reconciliation.

#### Benefits

Gaps in government and company assurance can be addressed (as long as the systems, data quality and access to information are sufficient for the reconciler to carry out the work).

It may be possible for the Reconciler to check some or all of the flows which should have been received.

It may be possible for EITI reports to have an 'opinion' which clearly signposts the overall outcome (although sometimes this opinion may need to be 'adverse' or 'disclaimed').

Even where the Reconciler reports on their findings from agreed upon procedures, these findings may be clearer because of the increased evidence available to the Reconciler.

**In summary an augmented model provides stronger assurance and would strengthen the EITI "brand", but would add significant extra costs.**

21

## Appendix – Potential areas of risk with the "ideal"

22

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## Socio economic risks...

EITI IN PRACTICE

GOVERNMENT			EXTRACTIVE INDUSTRIES		
Rule of law	Democracy	Public Governance	Rule of law	Ethical business behaviour	Company Governance
Systems	Accounts	Templates	Systems	Accounts	Templates
Internal assurance	General control	Control over EITI receipts	Internal assurance	General control	Control over EITI payments
Auditing standards	Independently assured accounts	Independently assured templates	Auditing standards	Independently assured accounts	Independently assured templates

STAKEHOLDER GROUP / Government / Civil Society / Extractive Industries			EITI PROCESS / Country Secretariat / Validators / Reconcilers		
Balanced discussion	Understand EITI	Understand country context	Independent	Competent	Understand EITI
Determine coverage	Determine scope of flows	Determine materiality	Access to data and people	Agreement of figures	Resolution of discrepancies
Develop laws	Educate other parties	Specify type of EITI report	Government assurance	Company assurance	Engagement standards

**EITI REPORT**

Can be read and credibility checked by third parties  
 Compared with other government information  
 Compared with other country information  
 Compared with other company information  
 Compared with related company info (Dodd Frank? EU proposals)

**Potential risks:**

Governance, rule of law, ethical behaviour, etc can be under stress due to civil unrest, war, poverty, endemic corruption...

23

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## PFM risks...

GOVERNMENT			EXTRACTIVE INDUSTRIES		
Rule of law	Democracy	Public Governance	Rule of law	Ethical business behaviour	Company Governance
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**Potential risks:**

PFM may be poorly developed, no taxation completeness checks, no finalised accounts, manual accounting systems, poor, ineffective or corrupted internal control or internal assurance processes (eg lack of internal audit, controllers, experts comptables)

24

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## Private financial management risks...

EITI IN PRACTICE

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**Potential risks:**

Company governance, internal control and assurance may not be well-developed, especially for smaller scale operators

25

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## Government reporting capacity risks...

EITI IN PRACTICE

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**Potential risks:**

Government systems may not be able to produce template information in a timely, efficient and effective manner.

Government systems may aggregate EITI information without an adequate audit trail

26

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## Company EITI reporting risks...

EITI IN PRACTICE

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 Compared with related company info (Dodd Frank? EU proposals)

**Potential risks:**

- Companies may decide not to participate.
- Company systems may not be able to produce template information easily in a timely fashion.
- Company systems may aggregate EITI information without an adequate audit trail.

27

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## Government audit risks...

EITI IN PRACTICE

<b>GOVERNMENT</b> Rule of law Systems Internal assurance Auditing standards	Democracy Accounts General control Independently assured accounts	Public Governance Templates Control over EITI receipts Independently assured templates
<b>STAKEHOLDER GROUP / Government / Civil Society / Extractive Industries</b> Balanced discussion Determine coverage Develop laws	Understand EITI Determine scope of flows Educate other parties	Understand country context Determine materiality Specify type of EITI report

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**EITI REPORT**

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**Potential risks:**

SAI or other appointed auditors may:

- be incapable of auditing accounts due to independence, training and other resource issues.
- not focus on financial statements.
- not conduct audit in accordance with appropriate standards (ISSAIs or adequate local ones).
- not provide a view on EITI templates.

28

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## Company audit risks...

**EITI IN PRACTICE**

<p><b>GOVERNMENT</b></p> <table style="width: 100%;"> <tr> <td>Rule of law</td> <td>Democracy</td> <td>Public Governance</td> </tr> <tr> <td>Systems</td> <td>Accounts</td> <td>Templates</td> </tr> <tr> <td>Internal assurance</td> <td>General control</td> <td>Control over EITI receipts</td> </tr> <tr> <td>Auditing standards</td> <td>Independently assured accounts</td> <td>Independently assured templates</td> </tr> </table>	Rule of law	Democracy	Public Governance	Systems	Accounts	Templates	Internal assurance	General control	Control over EITI receipts	Auditing standards	Independently assured accounts	Independently assured templates	<p><b>EXTRACTIVE INDUSTRIES</b></p> <table style="width: 100%;"> <tr> <td>Rule of law</td> <td>Ethical business behaviour</td> <td>Company Governance</td> </tr> <tr> <td>Systems</td> <td>Accounts</td> <td>Templates</td> </tr> <tr> <td>Internal assurance</td> <td>General control</td> <td>Control over EITI payments</td> </tr> <tr> <td>Auditing standards</td> <td>Independently assured accounts</td> <td>Independently assured templates</td> </tr> </table>	Rule of law	Ethical business behaviour	Company Governance	Systems	Accounts	Templates	Internal assurance	General control	Control over EITI payments	Auditing standards	Independently assured accounts	Independently assured templates	
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**Potential risks:**

- Company audit may not be well developed.
- Smaller operators may not be subject to audit
- Audit may not be a regulated profession.
- Auditors may not be members of IFAC professional bodies.
- Auditors may not use International Standards on Auditing or adequate local standards for public audit work.

29

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## Company EITI audit specific risks...

**EITI IN PRACTICE**

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**Potential risks:**

- Company auditors may not provide a view on EITI templates

30

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## Risks that threaten independence...

EITI IN PRACTICE		
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**Potential risks:**

Civil society participation may be ineffective.  
 Government involvement may be inappropriate and not addressed effectively.  
 Local firms involved in reconciliation or validation may be too small to avoid conflicts of interest arising from the high proportion of their income arising from EITI work.  
 EITI secretariat may become over engaged and directive.

31

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## Risks from poor understanding of EITI...

EITI IN PRACTICE		
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**Potential risks:**

Stakeholders may have difficulty understanding the application of standards to EITI reporting, and the respective roles of auditing and accounting standards.  
 Validators may draw conclusions that meet the letter but not the spirit of EITI guidance.  
 Some Reconcilers may have difficulty understanding the application of standards to EITI reporting.  
 Stakeholders may develop alternative or temporary measures which are not fully aligned with EITI objectives.

32

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## Risks from the specification of EITI work...

EITI IN PRACTICE

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**Potential risks:**

Stakeholders may not consider all issues relevant to determining the scope of flows, company coverage and nature of EITI work.  
 Barriers to implementation may not be addressed in ToRs.

33

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## Risks from reconciler and validator competence...

EITI IN PRACTICE

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**Potential risks:**

Application of IAASB standards may be unrealistic if audit is not a regulated profession, and/or local professional bodies are not IFAC members, or sufficiently strong.  
 Reconcilers and Validators may have insufficient understanding of assurance and extractive industry issues.

34

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## EITI report process risks...

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**Potential risks:**

Reconcilers may face limitations on the scope of their work such as access to people (especially in government) and data.  
 Reconcilers may not be able to agree figures or resolve discrepancies due to inadequate disaggregation or other deficiencies.

35

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## EITI reporting risks...

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**Potential risks:**

An unreliable EITI report clouds transparency.  
 The utility of an EITI report is reduced if other government or company information is unavailable.  
 Insufficient disaggregation may reduce or cloud transparency  
 Too much disaggregated information may result in information overload unless tools to aid analysis are provided.

36