

# **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 fourth D-EITI report



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**Latest Update**

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# Table of Contents

|           |  |           |
|-----------|--|-----------|
| <b>1.</b> | <b>Instruction</b>   | <b>1</b>  |
| <b>2.</b> | <b>Concept and vision of the pilot regarding payment reconciliation</b>  | <b>2</b>  |
| 2.1.      | Classification of this work report .....   | 2         |
| 2.2.      | Systematic approach and vision of the pilot.....   | 2         |
| 2.3.      | Procedure and knowledge gained from implementing the first part of the pilot.....  | 3         |
| 2.4.      | Information and findings from continuing the pilot in the second year .....  | 5         |
| <b>3.</b> | <b>Ensuring payment flows are correct</b>  | <b>7</b>  |
| 3.1.      | General understanding of internal control systems.....   | 7         |
| 3.1.1.    | Basics .....   | 7         |
| 3.1.2.    | Elements of the internal control system .....  | 7         |
| 3.2.      | Assessment by the Multi-Stakeholder Group whether the regularity of the payment flows is at risk .....   | 10        |
| 3.2.1.    | Identification of government agencies relevant for D-EITI .....  | 10        |
| 3.2.2.    | Control environment relevant for risk assessment.....  | 10        |
| 3.2.3.    | Risk assessment in relation to minesite and extraction royalties.....  | 14        |
| 3.2.4.    | Risk assessment in relation to corporation tax .....   | 19        |
| 3.2.5.    | Risk assessment in relation to trade tax .....   | 24        |
| 3.2.6.    | Process-independent controls of internal audits, Audit Offices and the role of the representatives for efficiency in public administration ..... | 27        |
| 3.2.7.    | The process of MSG's assessing the overall risk of incorrect payment processes .....   | 31        |
| 3.3.      | Plausibility check of reported payment flows .....   | 32        |
| 3.3.1.    | Minesite and extraction royalties .....  | 32        |
| 3.3.2.    | Income taxes .....   | 33        |
| 3.3.3.    | Overall assessment of plausibility .....   | 34        |
| 3.4.      | Payment reconciliation in exceptional cases .....  | 35        |
| 3.4.1.    | Full payment reconciliation in the event of significant risks .....  | 35        |
| 3.4.2.    | Partial payment reconciliation for remaining implausibilities.....   | 35        |
| 3.4.3.    | Payment reconciliation on a random basis .....   | 36        |
| <b>4.</b> | <b>Final comments</b>  | <b>37</b> |

## Annexes



## Annexes

- Annex 1 Representation of the processes and controls relevant for collecting corporation tax on the part of the government agencies
- Annex 2 Representation of the processes and controls relevant for collecting minesite and extraction royalties, based on information from the Landesamt für Bergbau, Energie und Geologie (LBEG) (State Office for Mining, Energy and Geology) in Hanover
- Annex 3 Representation for the higher-order controls for collecting minesite and extraction royalties for the Landesamt für Bergbau, Energie und Geologie (LBEG) (State Office for Mining, Energy and Geology) in Hanover
- Annex 4 Representation of the pilot's systematic approach
- Annex 5 Representation of the process for the MSG's overall assessment for minesite and extraction royalties
- Annex 6 Excursus: Information on the frequency of company audits



# 1. Instruction

Under an agreement signed on 19 August 2021 and a supplement to the agreement dated 20 September 2021, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH engaged us, Warth & Klein Grant Thornton AG auditing firm of Düsseldorf (referred to below 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 to below 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 production of the German EITI report for the calendar year 2019. The IA's duties include the following aspects:

- Identification of extractive companies that make material payments to government bodies in accordance with requirement 4.1 (d) of the EITI standard
- Collection of payments made by these companies to government agencies for 2019, the year under review
- Continuation of the work started with the third German EITI report to develop an alternative procedure to safeguard the quality of the payment data collected ("Pilot for payment reconciliation").
- Representation of findings and results from the pilot as a contribution to the wider national and international discussion about the development of an alternative procedure for payment reconciliation

The purpose of this report is to summarise and document the work carried out and present information that in parts continues our work report dated 14 January 2021, which was produced during the preparation of the third German EITI report.

## 2. Concept and vision of the pilot regarding payment reconciliation

### 2.1. Classification of this work report

The EITI Standard 2019 demands comprehensive publication of all material payment flows 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, among other processes, ensured by the “standard procedure” of a direct reconciliation of the payment flows reported by the participating companies with the payments received by the government agencies (“payment reconciliation”). These did not – as is known – produce any or any noteworthy differences between payments made and payments received between companies and government agencies.

During the preparation of the third German EITI report for the 2018 reporting period, it was agreed with the international EITI secretariat to start the development of an alternative quality assurance procedure for the payment flows to the government agencies reported by the extractive industry (“Part 1” of the pilot). This work is being continued by the Multi-Stakeholder Group (“MSG”) and the Independent Administrator (“IA”) as part of the current fourth German EITI report (“Part 2” of the pilot). This work report follows on from the IA’s work report of 14 January 2021 for the 2018 reporting period, brings together the systematic considerations on which the pilot is based and summarises the findings and results from carrying out the pilot.

### 2.2. Systematic approach and vision of the pilot

From a theoretical audit perspective, the payment reconciliation as a standard procedure to assure the quality of the payment flows reported by companies is a test of details for the information provided by the participating companies. The accuracy of information associated with a test of details contrasts with the much more limited information in that the result it produces is always selective information that is limited to the relevant specific payment transaction. There is no inclusion and assessment of the processes and controls associated with the payment flows, meaning that the knowledge gained from the standard procedure is limited right from the outset to the payment flows that are actually examined. The added value from continuing the standard procedure will always be limited, in particular against the background of the positive results from the payment reconciliation processes carried out previously in the course of the first and second German EITI report.

Finally, there is the question of whether it is proportionate for all those parties involved (government agencies, contact persons in companies and IAs) to devote

the time and therefore also the financial outlay required to carry out the payment reconciliation to obtain the resulting information for the parties for whom the EITI report is intended. It must also be assumed that, even when repeated, the standard procedure only offers limited potential to reduce the time and financial outlay required, because the actual reconciliation process that is part of the payment reconciliation has very little scope to reduce the work required for the IA and the companies or government agencies involved.

In view of these observations the pilot is systematically replacing the test of details for payment flows with a multi-stage system-based approach of obtaining information and the analysis of processes and controls relevant for EITI. The aim is to put the MSG in a position where they can provide a well-founded assessment of whether or not there are sufficient signs of risks to indicate that payment flows to government agencies related to raw minerals are not being properly processed during the respective reporting period. Depending on the result of this risk assessment, the process for making a specific analysis of the companies' reported payments will then be carried out. If there are sufficient signs to indicate that (payment) processes or controls relevant for EITI are not entirely compliant, further investigations of the payment flows concerned will initially be carried out and ultimately a return to payment reconciliation will be considered. Otherwise, the actual analysis of payment flows can be limited to plausibility assessments and thus the overall outlay in terms of time and money can also be reduced.

See Annex 4 for the system used for the pilot.

From a theoretical audit perspective, the systematic approach of the pilot 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, the key business processes and control processes as well as the control environment are combined with tests of details in order to obtain sufficient audit assurance to submit the audit opinion.

The results of the previous payment reconciliations are therefore an integral part of the pilot. On the basis that it can be assumed that the Internal Control System is appropriate and effective, taking account of the positive results of the payment reconciliations it is permissible to reduce the scope of the substantive audit procedures (= payment reconciliations processes) without this having a detrimental effect on the quality of the audit opinion. As a result, it is possible to reach a more detailed opinion more quickly and cost-effectively by using this combination.

### **2.3. Procedure and knowledge gained from implementing the first part of the pilot**

The pilot for payment flows builds on a comprehensive analysis of the system of processes and controls, which may be relevant for the different reported payment flows on the part of companies and state agencies. It is about gaining an understanding of the existing internal and external control mechanisms as an integral part and starting point for the risk assessment (see the representation in Annex 4 for this).

For this purpose, members of the Multi-Stakeholder Group (MSG) provided us with a written overview on the workflows and controls used by the government agencies responsible for minesite and extraction royalties and corporation tax to ensure the proper assessment and collection of payments. These workflows 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 the 2019 year under review, it handled approx. 98% of all minesite and extraction royalties. In deviation of this procedure, the representation of workflows and controls for the corporation tax payment flow is based on an approach, which largely abstracts from the circumstances of a specific tax office in order to ensure a statement that is generally valid. This is necessary in view of the federal structure of financial administration and the many tax offices in Germany as well as what is a 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 get our own impression 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. The results are documented in various forms including the figures for the minesite and extraction royalties and the corporate taxes included in Annex 1 and Annex 2.

The aspects already stated in the previous D-EITI reports on assessing the quality assurance measures on the part of the reporting companies remain valid for the fourth 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 collection of payment flows addresses this matter accordingly and requires a statement as to whether the payment reports have been subject to a separate audit by an independent third party. Due to the legal form and the size of the participating companies the annual financial statements based on data reporting are always subject to an annual audit or audit review.

In our final comments on the work report dated 14 January 2021 we assessed the established systems and controls for the proper collection of payment flows, in combination with the positive results from the payment reconciliations already undertaken, as well suited to ensure that the relevant payment flows are reliably disclosed.

At the special meeting on 12 February 2021 the MSG adopted our report and requested that items be added to the continuing work on the pilot, including in respect of the role and duties of process-independent control bodies (internal audits, Audit Offices and financial supervisors at municipal level). The MSG is of the opinion that added value has been gained for the MSG and the D-EITI report through

systematically considering and describing the offices responsible for administering payments. The procedure developed from assessing the risk and further downstream investigations will be continued within the second part of the pilot.

## **2.4. Information and findings from continuing the pilot in the second year**

The system of processes and controls was analysed with the relevant MSG representatives with regard to changes and the need for adjustments (“follow up”). The outcome was that the statements and information from Annexes 1 and 2 were assessed as still being valid when compared to the first part of the pilot so that no changes relevant for risk assessment needed to be raised or assessed in the workflows described.

The second part of the work on the pilot is focused on gaining a greater understanding of the content and transparency of the work of the relevant inspection agencies. With the minesite and extraction royalties being the only actual natural-resource-specific payment flow in Germany, discussions, amongst others, were held with the representative of the Lower Saxony Ministry of Economic Affairs, Employment, Transport and Digitalisation as the responsible supervisory authority for the State Office for Mining, Energy and Geology, Hanover and independent research was also carried out. The results are shown in Annex 3 and more detailed explanations are provided in Section 3.2.3.3. In addition to this, a procedure for checking plausibility has been developed, which is based exclusively on publicly available data and data from the data collected from participating companies (see Section 3.3.1.).

It can be seen that the work of process-independent control bodies relevant for D-EITI are based, similarly to the pilot, on a risk-based approach. Building on obtaining and processing information, the work involves a risk assessment of the work areas for which they are responsible in order to establish the type and scope of the audit procedures. Important conclusions on risk assessment in the pilot can therefore be drawn by looking through available reports made by the control bodies. We therefore looked at publicly available reports by different external inspection agencies to ascertain whether they could contain indications of weaknesses in process and control structures relevant for the pilot. It is particularly important to ensure that information is supplied consistently to the MSG (information collection and processing) so that the pilot procedure can be implemented and developed further. Furthermore, the MSG members themselves are urged to consider critically information from their specific area of expertise with regard to its relevance for the pilot and to make this available to all other MSG members. The technical requirements for this have been created via appropriate settings within the data portal that is already provided. No such information or indications have been placed on the data portal by MSG members at the time this work report was signed.

Against the backdrop of the existing statutory limitations of access to information of the relevant inspection agencies, the question can nevertheless be asked to what extent this will have implications for assessing the correctness of payment flows that are relevant for EITI. However, in Germany it is subject to the interaction

between executives and parliaments set out in constitutional law via the instrument of budgetary law to safeguard the necessary and sufficiently detailed control of budgets and expenditure accounts (see Section 3.2.2.2.). This includes in particular that all payment claims legally legitimised by parliament are claimed by the executive and deviations between the planned values and the actual values are justified by the executive and this justification is examined and assessed by the parliament. Based on the work undertaken, we were able to satisfy ourselves of the actual implementation and importance of this control function, in particular for the payment flow of minesite and extraction royalties in the State of Lower Saxony (also see Section 3.2.3.3.). As a result, in our opinion the primacy of parliament ensured that, in spite of the statutory limitations that existed in each case regarding access to the relevant inspection agencies' information, the relevant payment flows, i.e., the incoming payments due in each case, were adequately monitored. Accordingly, in our opinion the limited access to the individual inspection agencies did not have any direct effects on MSG's necessary risk assessment of the relevant payment flows.

## 3. Ensuring payment flows are correct

### 3.1. General understanding of internal control systems

#### 3.1.1. Basic considerations

An internal control system is generally understood to mean a system comprising technical and organisational rules that is used to steer process workflows and control 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 understands 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 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 audit reviews.

#### 3.1.2. Elements 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 it is as a result of errors by the actors involved or IT systems 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) units. 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 segregation 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 there is a segregation 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 segregation 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 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 includes 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. Assessment by the Multi-Stakeholder Group whether the regularity of the payment flows is at risk**

### **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. Due to the federal structure of the administration in Germany, there is no central recording of the relevant payment flows.

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 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 relevant government agencies. These will be presented below.

### **3.2.2. Control environment relevant for risk assessment**

#### **3.2.2.1. German civil service law**

The control environment of the relevant government agencies, which is significant for the process of risk assessment by the MSG, is initially largely shaped by 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 dual control when carrying out administrative processes, on the one hand, and the organisational segregation 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. These, in turn, as part of the executive within the context of the principle of separation of powers, are subject to control by the legislative (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 also 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. Apart from the general rules of criminal and civil law, infringements are also prosecuted according to the regulations of disciplinary law.

### **3.2.2.2. Parliamentary public budget law and financial control**

Furthermore, the control environment significant for MSG's risk assessment process is largely shaped by the current budgetary law and the associated primacy of parliament. The following presentation applies in principle equally to the Federal

Government, the states, the local authorities and local authority associations and thus covers all government agencies that generate revenues from the extractive industry in Germany.

A fundamental distinction must be made between the budget on the one hand and the budget legislation or the budget statutes at municipal level on the other. Apart from the budget expenditure, the budget prepared by the relevant executive also includes the planned or expected revenues that are planned in detail for the budget of the year in question. Revenues are planned separately and therefore transparently in a dedicated item, depending on the significance of the expected revenues for budget planning overall. Therefore, the expected revenues for the budget year are set out in each case, for example, in the 2019 budget plan for the State of Lower Saxony in departmental budget 13 “Allgemeine Finanzverwaltung” (General financial administration) in Section 1302 “Allgemeine Bewilligungen” (General approvals) under the items 122-12-6 “Einnahmen aus Förderabgaben und Förderzins aufgrund von Gewinnungsverträgen” (Revenues from minesite royalties and extraction interest based on mining contracts) or 122-13-4 “Einnahmen aus Feldesabgaben” (Minesite royalties). For this purpose, before the budget was drawn up the responsible Lower Saxony Ministry of Economic Affairs, Employment, Transport and Digitalisation produced a forecast for the expected revenues, taking into consideration the existing knowledge of the companies that pay the royalties, estimates of market developments and other relevant parameters. The budget then needs to be passed by parliament as a budget law. As part of this process, the budget is first examined in detail by an appropriate parliamentary committee, which is generally called the budget committee; after the committee has finished examining the budget it presents appropriate recommendations for resolutions to the plenary session of parliament. Parliament passes a resolution on the budget law and so the budget in question is approved and gains its democratic legitimacy. At the same time, the executive is empowered and also under an obligation to implement the budget thus legitimised in the relevant budget year, which corresponds to the calendar year.

After the end of the budget year, the executive accounts to parliament to ensure control over implementation of the budget – via the “budget submission”. This involves listing the actual revenues and the actual expenditure according to the classification in the budget and indicating the specified level of detail and comparing these with the planned values. In the case of the example chosen here, this means that the payments actually received from extraction and minesite royalties are compared by the executive with the values originally expected, as shown in the budget. This budget submission is not only examined by the appropriate committee of the parliament concerned – for example, by the Auditing Committee at Federal Government level and at the sub-committee for examining budget submissions at the level of the State of Lower Saxony – but it is also examined beforehand at Federal Government and state level by the responsible Audit Offices in each case (for greater detail here, see Section 3.2.6.2.). Based on the audit results, the committee concerned makes preparations for the plenary session of parliament to approve the actions of the executive. This resolution by parliament confirms to the respective executive that the budgetary and economic administration has been conducted in an efficient and correct manner.

The MSG's assessment of a possible risk relating to the correctness of payment flows – in other words, the receipt of payment by the relevant government agencies in each case – assigns central importance to the control environment of parliamentary budgetary law with the budget and budget legislation and financial control of parliament via the budget submission and approval resolution, as this ultimately reflects all the respective actions by the relevant government agencies.

### 3.2.3. Risk assessment in relation to minesite and extraction royalties

#### 3.2.3.1. Upstream assessment process

For the MSG to assess the risk that payment flows may or may not be correct, a basic understanding of the upstream assessment process is required, even if this has to be differentiated from the collection process in terms of administrative law or administrative capacity and even if the relevant EITI standard do not apply to the assessment 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 arrangements 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. The calculation, fixing and collection of minesite and extraction royalties are in general 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).

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. This way the authorities satisfy themselves that the payment amount calculated by the taxpayer is correct 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 adjusted, if required, 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 post appropriately and with as little friction as possible. Because of the nature of self-assessment, this applies in particular to the holders of the post who carry out on-site audit within the context of external audits.

As has already been described in Section 2.3, 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.

In line with the nature of self-assessment, a central element of the process of fixing the royalties by the LBEG is the examination of the royalties paid by the company through external audits. According to information received, because of the situation with personnel the external audit is not seamless but is carried out by establishing audit priorities.

### **3.2.3.2. The collection process and the controls embedded in it**

The organisational precautions taken ensure strict segregation 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 pre-payment notices for each quarter of the calendar year. 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., special regulations) 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 administrative department (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 administrative department issues the payment notices to companies and creates the cash desk instructions (receipt/disbursement orders) that are transferred via the electronic records system to the responsible section at the main office in Hannover for checking and approval.

The check of cash desk instructions is based on the documents from the section responsible for the administration that justify the payment. Once checking and approval are complete, the cash desk instructions are posted 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. The amount in the suspense account is permanently monitored, the payments are allocated as appropriate and the differences between the target position and the payment amount are clarified by consulting the administrative function.

In 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.

### **3.2.3.3. Controls above the collection process**

The figure developed in the first part of the pilot to represent the processes for assessing and collecting the minesite and extraction royalties (see Annex 2) has been supplemented. After consultations, a further figure has been added to the second part of the work to show and explain the controls above the collection process in greater detail (see Annex 3).

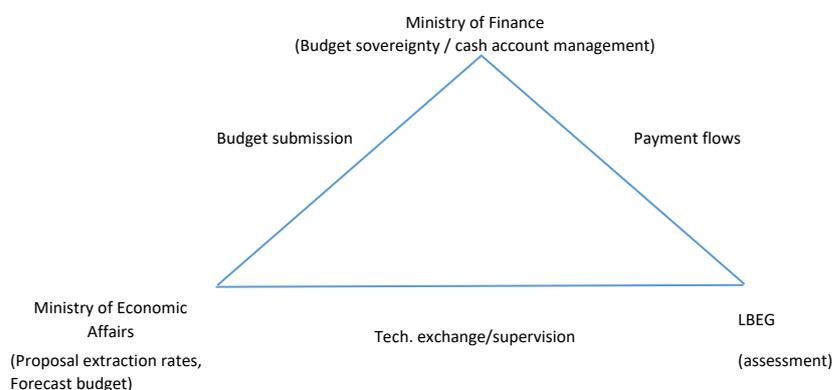
The section in the Lower Saxony Ministry of Economic Affairs, Employment, Transport and Digitalisation responsible for overseeing the State Office for Mining, Energy and Geology (LBEG) receives quarterly reports from LBEG on the movement in revenues from extraction royalties. These reports are based on the extraction royalty pre-payment notices from the individual companies and contain the following information for each company that pays the royalties:

- The current assessment rate
- The amount extracted and subject to royalties
- The amount of the extraction royalty to be paid

These reports also contain information on the changes compared to the previous quarter and the same quarter of the previous year. This information allows the Ministry of Economic Affairs to make a continuous analysis of differences compared to the previous reports and compared with their own forecasts of revenues as part of budget-related reporting. In addition to this, the Ministry of Economic Affairs receives quarterly reports from LBEG on the development of the cross-border value (for natural gas). In October, LBEG consolidates the quarterly reports to create an annual report on the basis of the companies' annual declarations which shows corresponding additional amounts due and overpayments.

The Ministry of Finance provides the Ministry of Economic Affairs with a monthly overview of revenues and expenditure for the extraction royalties based on the Cashier Office's data and this is subsequently also passed on to LBEG. In May and November the Ministry of Economic Affairs produces a forecast of extraction royalties for the Ministry of Finance's tax estimate and explains excess amounts/shortfalls to the Ministry of Finance. In addition to this, the Ministry of Economic Affairs gives an annual report to the Ministry of Finance on the situation of the oil and gas industry in Lower Saxony, which also contains information on the amount and development of extraction royalties.

Below we have summarised in a chart the structure of the process workflows and controls between the parties involved:



The change in the budget sovereignty for minesite and extraction royalties from the Ministry of Economic Affairs to the Ministry of Finance resulted in a distribution of responsibilities and must be viewed as a positive move from the point of view of control. At the suggestion of Lower Saxony's Ministry of Economic Affairs, the government of Lower Saxony passes resolutions to make changes to the Lower Saxony ordinance on mine site and extraction royalties (NFördAVO) (incl. the amount of the levy rates). Lower Saxony's Ministry of Economic Affairs produces forecasts on how much revenue the extraction royalties will generate for the State's budget. With regard to the payment flows, as already explained the focus is on the strict segregation between the assessment (LBEG) and the collection (cash account management/state cashier's office). The Ministry of Economic Affairs has technical oversight over LBEG and, among other tasks, is involved in clarifying different opinions on the application of NFördAVO.

Section 43 of the Ministry of Finance is responsible for Internal Audits for the automated budget implementation system for the Ministry of Finance itself but also for all State authorities (and therefore for LBEG as well). It has oversight of the appropriateness and effectiveness of the control systems, including the bookkeeping and accounting system and the business processes handled by this system. Rules of procedure describe the work of the budget implementation system's Internal Audit unit. The section of Lower Saxony's Ministry of Economic Affairs responsible for supervising LBEG is not aware of any findings of this Internal Audit unit that are relevant for the correctness of the payment flows during the period under review.

#### **3.2.3.4. Assessment of the risk level by the IA**

We have described the existing elements of the control environment that are important for minesite and extraction royalties. Furthermore, we have described the controls embedded in the collection process and the higher-level controls above the collection process and examined as an example via the relevant agencies for the State of Lower Saxony in cooperation with a member of the Multi-Stakeholder Group whether there were identified or suspected weak control points concerning the relevant payment process for the minesite and extraction royalties during the year under review; this was not the case.

In addition to this, we have inspected the reports from the Federal Audit Office and the State Audit Office for Lower Saxony for the period under review to ascertain if there are any appropriate reports or indications (also see Section 3.2.6.2.); here, too, we were not able to find any relevant weak control points in relation to the relevant payment processes. We are also not aware of the relevant parliaments not having approved the actions of the respective responsible executives for the budget year during the period under review.

On the basis of our understanding of the processes and controls as well as the information available to us and the information provided, as the IA we assess that the risk of breaches in the correctness of the payment flows in relation to the minesite and extraction royalties can be assessed as being minimal for the period under review.

### **3.2.4. Risk assessment in relation to corporation tax**

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

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 segregation between taxation of the distributing corporation on the one hand and their members on the other. Therefore, with the payment of corporation tax (KSt) 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 (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.

#### **3.2.4.2. Upstream assessment process**

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 (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, the information provided is checked by the tax authorities responsible for the area and the nature of the tax and the tax is set via the tax assessment notice. The 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 is only set when the tax assessment notices are sent by the responsible tax authorities.

A distinction must be made between the risks in the assessment process 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. These could be produced, for

instance, from collected expertise of staff who played an integral part in both the assessment and collection process. The risk is dealt with both 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 also the fact that the party liable to pay can settle what they owe with a cashless payment, i.e. via transfer: a cash payment is not possible. The segregation of functions ensures that the contracted staff 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.

The distinction between the assessment process and the subsequent collection process explained in Section 3.2.3.2 also applies to corporation tax.

The organisational segregation 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 segregation in the official table of contents as follows:

- Fourth part: Implementation of taxation (Sections 134 – 217 AO)
- Fifth part: Collection process (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.

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.

The administrators in the assessment unit are always 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 in terms of the business, sales or profit or are classified as legally complex cases by the system or manually, 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 administrators 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 audit). Large companies and corporations are always subject to the follow-on 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 the annual revenue and/or profit of a business exceeds a certain threshold, the government tax audit is carried out by the audit department responsible for large businesses and groups. 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 cross-check principle 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.

### 3.2.4.3. Controls embedded in the collection process

The purpose of the collection office is to process payment flows and other issues relating to tax collection legislation. As a rule, the collection process is automated.

The administrators in the collection office 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 office cannot access the assessment unit's programme for technical reasons. Thus, it can be ruled out that the collection office can make any change to the target position. The same applies analogously in the opposite direction. Therefore, the segregation of the assessment unit from the collection office is not only organisational: procedural segregation, is also ensured through appropriate design of the IT systems used for implementing the administrative processes (separate 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 procedure or submit a simple change application, responsibility for checking lies with the relevant assessment unit and not the collection office.

In the event of objections by the taxpayer concerning the tax collection process (for example, incorrect offsetting of a tax debt against a claim for reimbursement of another type of tax), subject matter jurisdiction lies with the collection office shall have subject matter jurisdiction. In collection offices 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 segregation between the collection office 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 office 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 office (i.e. its department dealing with enforcement) starts to implement recovery measures in accordance with the current provisions for execution and enforcement instructions.

We would like to point out by way of a precaution 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, there are no impacts on the presentation and conclusions based on them.

#### 3.2.4.4. Controls above the collection process

The **regional tax directorates** (also called State Offices for Tax in some Federal States) are in charge of the tax offices in their district. They have technical and administrative oversight over the tax offices and therefore do not have authority to carry out the administrative functions of 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.

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. Apart from “general control”, the purpose of business audits is to ensure that taxation is applied uniformly (all tax offices are supposed to treat the same facts in the same way), identify technical or organisational shortcomings, explore training requirements, prevent errors in the future and improve workflows.

In other respects, the sections at the regional tax directorates also act as an expert point of contact for tax offices in order to provide support for difficult legal questions and 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 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. Please see our explanations in Section 3.2.6.1. for more details about the work of internal audits.

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.

#### 3.2.4.5. Assessment of the risk level by the IA

We have described the existing elements of the control environment that are important for corporate tax. We have also shown the controls embedded in the collection process and the controls above the collection process. On the basis of the

sources of information available to us, we have not found any indications that there were identified or suspected weak control points concerning the relevant payment flows from corporate tax during the period under review.

In addition, for the existing process-independent controls under budgetary or financial legislation (for this, see Section 3.2.2.2.) we have inspected the reports from the Federal Audit Office and the State Audit Office for Lower Saxony and Hesse to ascertain if there are any appropriate reports or indications; here, too, we were not able to find any relevant weak control points in relation to the relevant payment processes. We are also not aware of the relevant parliaments not having approved the actions of the respective responsible executives for the budget year during the period under review.

On the basis of our understanding of the processes and controls as well as the information available to us, as the IA, we assess that the risk of breaches in the correctness of the payment flows in relation to the corporate tax can be assessed as being minimal for the period under review.

### **3.2.5. Risk assessment in relation to trade tax**

#### **3.2.5.1. Information on the assessment and collection process**

With regard to the assessment of trade tax, on the one hand, the procedural work-flows 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. In this context, declarations on the assessment process for corporation tax can be transferred to trade tax. As a taxable company may have operating facilities in several municipalities, in these circumstances trade tax is apportioned between all municipalities in which such operating facilities exist. Furthermore, it is always the responsibility of the respective municipalities to collect trade tax in its entirety with the result that 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.

Nevertheless, a legal framework with a comparable content for organisation at local territorial authority level is safeguarded via the respective local bylaws as a fundamental element of local governance law. Local bylaws form the basis for work of everyone employed in local government and local politics and contain, among other things, fundamental regulations for the organisation of financial accounting and the processing of payments at the municipalities (see, for example, Section 93 of the NRW local bylaws or Section 126 of the Lower Saxony local governance law).

The following overview indicates to the group of companies who take part in D-EITI the government agencies to which trade tax payments of at least EUR 2,000,000 were made in the year under review (2019) in accordance with data reporting:

| Company                                | Recipients of trade tax payments<br>(> EUR 2,000,000) | Amount<br>(EUR thousand) |
|--|---|--------------------------|
| BEB Erdgas und Erdöl GmbH & Co. KG     | Großenkneten local authority                          | 2.556                    |
| ExxonMobil Production Deutschland GmbH | City of Hamburg                                       | 30.134                   |
|  | City of Hanover                                       | 16.900                   |
|  | City of Cologne                                       | 6.759                    |
|  | Flecken Steyerberg local authority                    | 4.432                    |
|  | Town of Sulingen                                      | 2.924                    |
|  | Großenkneten local authority                          | 2.295                    |
| Quarzwerke GmbH                        | Town of Frechen                                       | 4.406                    |
| Südwestdeutsche Salzwerke AG           | City of Heilbronn                                     | 4.124                    |

According to information from the Federal Ministry of Finance, the proportion of trade tax made up around 40.8% of municipalities' tax receipts during the reporting period (2019). If one ignores the municipalities' share of income tax and VAT not administered by the municipalities themselves, the share even increases to around 75%. Because of the great importance of trade tax for the municipalities' finances and the clear assignment of responsibility to the municipalities for collection, it can however be assumed, in spite of the described heterogeneity, that every single municipality is sure to establish appropriate processes and controls for ensuring that the payment flows generated by trade tax are correct. Furthermore, all processes for collecting taxes are subject to the control processes associated with the budget legislation of the local territorial authority and the process-independent audit offices represented in Section 3.2.5.3.

### 3.2.5.2. Local auditing of accounts

On the basis of the democratic legitimacy of the council, the local auditing unit takes control of the financial practices of the administrations led by the mayor within the framework of the right of municipalities to self-government guaranteed under constitutional law. The local audit is carried out by the municipality's own body as a form of in-house control of their own performance so that certain dependencies necessarily exist in the context of regulations governing public services because of the organisational integration of the respective body in the local authorities. Local auditing of accounts is based on regulations in the local bylaws and the tasks are performed by persons/offices who vary in different cases, depending on the relevant municipal regulations (see, as an example, Sections 102-104 of the NRW local bylaws):

- Municipal council
- Audit committee
- Audit office
- Suitable members of staff appointed by the municipality as auditors
- Other municipal auditors

Local auditing of accounts is firmly integrated in the process of accountability to local representative bodies and is thus part of the annual auditing routine. One of the mandatory tasks of local auditing is to audit the annual and consolidated

accounts of the local authority in question and to continually monitor payment activities. In addition to this, the council can assign additional tasks to the local auditors, e.g. to audit the suitability and cost-effectiveness of the administration.

Audit reports by local auditors are always subject to their right to access information on the basis of the Freedom of Information Acts of the respective Federal States, because the local auditing work (in contrast to State audit offices and government offices for auditing accounts) is an administrative activity (see, for example Section 2 (1) sentence 1 of the Freedom of Information Law (IFG) of NRW).

### 3.2.5.3. Supra-local auditing of accounts

Financial control at the level of the Federal Government and States through the institutional guarantee of the audit offices has its equivalent at municipal level in the form of a two-stage control system made up of local and supra-local auditing. Supra-local auditing of accounts is carried out by a state or association-based audit office and in relation to the municipalities to be audited is an independent, supra-municipal state external audit. Implementation lies with its own municipal audit offices (e.g. NRW's municipal audit office) or the Audit Offices of the Federal States or the offices for auditing accounts at district level.

As a rule, they are conducted at intervals of several years. Apart from compliance audits, the audit focuses primarily on examining efficiency and organisation and providing advice with the aim of strengthening local self-government. In terms of the method, the work of the supra-local audit unit is based on comparable inter-municipality studies using key indicators and benchmarks. The aim is to take this as a basis to make differences in the use of resources transparent and identify potential for improvement.

The following table shows each responsible supra-local audit office (audit agency/State audit office) for the government agencies listed in Section 3.2.5.1. with trade tax payments of at least EUR 2,000,000 for the year under review (2019):

| Company                                | Recipients of trade tax payments (> EUR 2,000,000) | Responsible supra-local audit office               |
|--|--|--|
| BEB Erdgas und Erdöl GmbH & Co. KG     | Großenkneten local authority                       | President, State Audit Office for Lower Saxony     |
| ExxonMobil Production Deutschland GmbH | City of Hamburg                                    | Audit Office of the Free Hanseatic City of Hamburg |
|  | City of Hanover                                    | President, State Audit Office for Lower Saxony     |
|  | City of Cologne                                    | NRW municipal audit office                         |
|  | Flecken Steyerberg local authority                 | Audit Office of Nienburg Weser District            |
|  | Town of Sulingen                                   | Audit Office of Diepholz District                  |
| Quarzwirke GmbH                        | Großenkneten local authority                       | President, State Audit Office for Lower Saxony     |
|  | Town of Frechen                                    | NRW municipal audit office                         |
| Südwestdeutsche Salzwerke AG           | City of Heilbronn                                  | Baden-Württemberg municipal audit office           |

The results of the supra-local audit of accounts are published in annual municipal reports by the audit agencies responsible (e.g. NRW's municipal audit office).

#### **3.2.5.4. Assessment of the risk level by the IA**

We have described the existing elements of the control environment that are important for trade tax. We have also shown the controls of the local and supra-local auditing of accounts above the collection process. The collection of general statements obtained by questioning relevant inspection agencies involving one or more MSG representatives cannot even start to be implemented. This is not only within the context of the information already provided for trade tax, which is similar to corporate tax, with regard to the lack of a clear relationship between the income contribution from the extraction of natural resources and the amount of trade tax paid but also, more especially, the large number of relevant local authorities or local authority associations. In spite of this, for the existing process-independent controls we have looked at examples of reporting for State audit offices in Lower Saxony and Hesse and individual supra-local audit offices for corresponding reports or indications; here, too, we were not able to find any weak control points in relation to the relevant payment processes. We are also not aware of the relevant local representative bodies not having approved the actions of the respective local administration, in whose local authority a company that takes part in EITI reports has its registered office, for the budget year of the period under review.

On the basis of our understanding of the processes and controls as well as the information available to us, as the IA we assess that the risk of breaches in the correctness of the payment flows in relation to the trade tax can be assessed as being minimal for the period under review.

#### **3.2.6. Process-independent controls of internal audits, Audit Offices and the role of the representatives for efficiency in public administration**

##### **3.2.6.1. Internal audits**

As an element of internal control systems, the internal audit function is part of the process-independent monitoring measures within companies and authorities. The internal audit assists the management to perform their control and monitoring tasks and ensure the efficiency and effectiveness of the (administration's) actions and compliance with requirements and regulations currently in force. Besides "conventional" control and monitoring tasks, precautions also play a preventative role. The purpose is to assist specialist departments by providing advice and making recommendations in order to be able to detect and prevent undesirable developments, fraud or corruption.

In order to carry out their tasks, it is absolutely essential that the auditors are sufficiently distant from the technical business processes. Commingling with technical tasks jeopardises the professional independence of those involved in the internal audit and may bring the work closer to a "collaborative decision". In organisational terms, the internal audit unit should be positioned at the top level of organisation in the company or authority and take the form of a corporate unit (in other words, be

outside the system of line managers). It should report directly to management level and also only receive instructions from management. This is the only way of ensuring that information can bypass all levels of the hierarchy and be fed back to management; without this, the information would not reach management or at least not in unfiltered form (“bypass function”).

There is no statutory obligation in Germany to establish internal audit units in public administration. In 2007, the Federal Ministry of the Interior issued recommendations for internal audits in the federal administration, but it was not legally binding. Consequently, the decision on setting up and structuring internal audits was the responsibility of the management of the respective authority. A series of regulations have recently been issued at Federal State level and the list below is an example of these:

- Recommendations on internal audits in the administration of the Federal State of Lower Saxony (2021)
- Recommendations on internal auditing in the administration of the Federal State of Hesse (2016)
- Administrative regulation by the Saxon State Ministry of the Interior regarding internal audits of its business area (2021)

One can see that internal audits are increasingly being named in State regulations as instruments to prevent corruption (e.g. administrative regulation on anti-corruption by the government of the State of Saxony dated 11 December 2015). The aim is that authorities will designate an organisational unit which must carry out tasks such as the ones listed below to prevent corruption:

- Identify jobs/positions at risk of corruption
- Conduct risk analyses based on this
- Make suggestions for suitable preventative measures

The recommendations on corruption prevention as stated by the federal administration on 9 February 2012 identified the following areas as being a particular risk of corruption:

- where others can receive significant advantages through of the attitude of employees who are material for decision-making and
- who are associated with at least one of the following activities:
  - Activities that are associated with frequent external contacts, particularly through control and supervisory activities,
  - Management of large amounts of budgetary funds, awarding of public contracts, subsidies, funding or other grants,
  - Stipulating conditions and issuing concessions, authorisations, permits and similar, setting and collecting fees,
  - Processing cases using the authority's internal information that is not intended for other parties.

In a similar way to the procedures for audit offices, audit planning is based on a systematic and targeted approach for determining risk factors where the scope of possible negative effects of administrative actions and the likelihood that they occur may play a role. Those involved in internal audits therefore appear to be even more important as contacts for the purpose of gaining information as part of the pilot procedure for payment reconciliation.

The results of internal audits are intended for the audited department itself and the relevant managers. According to the current legal position, the Freedom of Information Act always applies to official information in documents within the internal audits carried out for national and Federal State authorities, assuming the Federal States have adopted the appropriate regulations in the Federal Government's Freedom of Information Act. Access to information can be limited in an individual case, as the advisory role of the internal auditors, in particular, could be disrupted by the publication of the audit report, when the internal auditors can no longer entirely fulfil their role as contacts for employees working in public authorities, if there is a threat that of subsequent publication of information. Therefore, the management of the authority could lose an important instrument for identifying errors and control. Consideration can therefore be given to classifying the material as confidential and therefore excluding access to information in accordance with Section 3, No. 4 of the Freedom of Information Law.

### **3.2.6.2. Federal Audit Office (Bundesrechnungshof) and states' audit offices**

Audit offices examine the entire budgetary and financial management of the Federal Government and the States, including their special funds and businesses. This task is carried out by the Federal Audit Office for the Federal Government and it is handled by the States' audit offices for the Federal States.

Audit offices are in part designated as a "sui generis" institution and are not affiliated to either the legislature, the judiciary or the executive. They therefore set themselves apart from internal audits which are integrated in the respective authority. The work of audit offices is therefore designated as an external financial control of the Federal Government or the Federal States. As an independent institution of financial control, audit offices are only answerable to the law. The members benefit from the protection of judicial independence which is anchored in constitutional law.

The core task of the audit offices is to audit the budgetary and financial management of the Federal Government and/or the Federal States and to check their administrations for correctness and legality and ensure that funds are used efficiently. The legal basis is essentially the regulations in the budgetary code at Federal or State level and audit regulations of the audit offices. The purpose of audits is, firstly, to ensure the legality of administrative actions and, secondly, to improve the performance of administrations as regards efficiency and prevention. Rights to carry out audits also extend to agencies outside public administration at Federal and State level, if these agencies receive funds from the national government or Federal States.

Audit offices therefore also have the task that extends beyond their auditing duties to advise the national government or Federal States on the basis of their auditing experience and knowledge and to reduce structural deficits or prevent undesirable developments before they occur. The advisory nature of the work of audit offices is part of a modern understanding of external financial control in which, besides the criteria of correctness (correct vouchers/correct calculations), consideration is also given to aspects of the efficiency of administrative actions. Awareness efficiency of processes and measures as an issue is therefore becoming increasingly important. In this context, audit offices can propose changes to legislation, including if the aims of the legislator could be efficiently satisfied through this.

Statutory rights exist in respect of reporting, being heard and participation so that audit offices can actually perform their duties (e.g. Sections 102, 103 Lower Saxony State budgetary code). The administration must advise the audit office if new rules influence the management of public funds or if organisational or other changes cause significant financial effects. This will allow indications to be given of inefficient aspects and to bring about changes.

Audit offices alone are responsible for determining the content, timescale and nature of the audit and in the form of a risk-oriented auditing approach (see as an example Section 16 (1) PO HRH). Here the actual auditing activity is preceded by an audit planning and systematic risk analysis (financial significance or incidence of errors) and this is based on extensive collection and evaluation of information.

The audit offices summarise the results of audits in audit reports which are only ever sent to the organisations audited. Here the audit offices do not have any executive powers, i.e. they cannot instruct the organisations audited to follow their recommendations but instead must convince them through their arguments.

The audit offices brief the parliaments and governments on the most important audit results via their annual reports (partly described as “Comments” of the respective audit office). The annual reports form an important basis for decisions by parliaments on ratifying the actions of the governments. Annual reports are presented to the public at a press conference and are freely available to the public.

In November 2012 the Federal Constitutional Court decided in the last instance with regard to the Federal Audit Office that this body is subject to the Federal government’s Freedom of Information Act. As a result of this, comprehensive new arrangements regarding information access to the Federal Audit Office’s audit findings have been made in Sections 96 (4), 97 (5) and 99 sentence 3 of the German Federal Budget Code (BHO) in the law to amend the Fiscal Equalisation Law and the Federal Budget Code. As a result, the change to Section 96 (4) of the German Federal Budget Code implements a two-track system to divide access to information to the Federal Audit Office’s audit results into a not public and – if applicable – a public section: There is no access to information for the public (“third parties”) until parliamentary deliberations are complete. If audit results are subsequently approved or subsequently discussed by parliament, an application can be made to pass on the audit results to a third party, at the discretion of the Federal Audit Office.

In order to protect the audit and deliberations of the Federal Audit Office and the financial control of parliament, third parties are not allowed to consult the audit and consultation files and corresponding files for the audited organisations, even after

the end of the process. The consultation and decision-making process of the Federal Audit Office and its auditing files therefore cannot be accessed by the public. Every request for information concerning the audit results are decided by the Federal Audit Office on a case-by-case basis.

At a Federal State level, budgetary regulations contain some regulations that are similar to Section 96 (4) of the German Federal Budget Code (BHO) so that the comments on the transparency of audit results apply in this respect to the audit offices of the respective State in a similar way (see as an example Section 94 (4) of the Lower Saxony State Budget Code). It is currently possible to assert the right to access information in 13 Federal States on the basis of the regulations in the respective State Freedom of Information Acts.

### **3.2.6.3. Representatives for efficiency in public administration at Federal and State level**

The post of the Federal Commissioner for Efficiency in Public Administration is traditionally filled by the President of the Federal Audit Office. On the same basis as the practice at Federal level, at state level the Presidents of the State audit offices can be appointed by the relevant State governments to the post of State Commissioner for Efficiency in Public Administration. The Commissioners provide suggestions, expert appraisals and statements to work towards satisfying the economic tasks of the Federal or State governments and organising the administrations, accordingly, thus contributing their experience from the audit offices' auditing activities.

Publications by the Commissioners require the agreement of the relevant ministries, if previously unpublished information or results of collections are used which can be identified from their business area. The regulations of the Freedom of Information Act remain unaffected.

### **3.2.7. The process of MSG's assessing the overall risk of incorrect payment processes**

In Sections 3.2.3., 3.2.4. and 3.2.5., the IA explained his findings on existing processes and controls of relevant government agencies to ensure the correctness of the payment process and presented a possible assessment of the risk of non-compliance.

In view of the fact that the MSG alone is responsible for making the overall assessment of the risk of non-compliance, the MSG members appraise the findings obtained from the IA, they scrutinise these for plausibility and possible contradictions regarding the other information of which they are aware on the basis of their own knowledge within the context of their relevant professional backgrounds. On the basis of the resulting overall picture, they finally define the risk assessed in the reporting period regarding the possibility that the payment processes are not correct, if applicable separated according to the respective payment flows.

We have graphically illustrated the process of the overall assessment by the MSG in Annex 5 as an example for minesite and extraction royalties. Looking to the future, we recommend transferring the work of obtaining information to a "standard

process” that can be used to ensure that information can be exchanged as part of an ongoing process between the sources of information considered as relevant by the MSG or individual MSG members with access to these sources of information and the MSG overall.

Depending on the result of MSG’s overall assessment, further quality assurance measures continue in the next step depending on the payment flow (cf. Annex 4).

- Where there are sufficient indications of risks that payments are not being properly processed for a specific payment flow, a plausibility check is undertaken for the payments reported by the company for the year under review in order to come to a conclusive assessment as to whether or not they are correct.
- If there are indications for individual payment flows being incorrectly processed, further investigations are commenced. Where the existing doubts about whether or not the payments are properly processed also cannot be resolved after this, the MSG can decide to return to the payment reconciliation for the payments in question (also see Section 3.4).

### **3.3. Plausibility check of reported payment flows**

#### **3.3.1. Minesite and extraction royalties**

As stated in Section 3.2.7, the plausibility of the payments reported by the companies is assessed, replacing the standard procedure used to date of an (extensive) reconciliation of payments made and payments received, if there are no sufficient signs to indicate that payment collection for the respective payment flow is not entirely correct. From a theoretical audit perspective, the procedure for checking plausibility is an analytical assessment of the item being considered via suitable key indicators and trends. Here the analytical assessment does not consist of a positively formulated statement in respect of the absolute amount of the minesite and extraction royalties but rather whether the amount of the payments can be viewed as being plausible under the statutory framework conditions and the other information available.

For the natural resource "natural gas", the total value was chosen as the reference value for the plausibility check. This is the product of

- the amounts extracted in the year under review (2019) for Lower Saxony,
- the standard rate of the extraction royalties for each natural resource and
- the cross-border value

The extraction royalties actually paid for natural gas per company for the years under review (2016 to 2019) have each been set in relation and the movement of this key indicator analysed over this period. A consideration of other Federal States could be dispensed with, as by far the greatest proportion of extraction royalties are due to Lower Saxony.

The reference value was selected for the natural resource of “oil”. This is the product of:

- the amounts extracted in the year under review (2019) for each Federal State,
- the market value of oil calculated by the German Federal Office of Economics and Export Control (BAFA) per calendar year and
- the standard rate for extraction royalties

The extraction royalties actually paid for oil per company for the years under review (2016 to 2019) were then each set in relation to each other and the development of this key indicator analysed.

The following annual reports are essentially used to calculate the stated key indicators:

- LBEG / oil and natural gas in the Federal Republic of Germany
- Bundesverband Erdgas, Erdöl und Geoenergie e. V. / statistical report

The reports are publicly available for downloading on the respective website.

Based on the selected key indicators and using the data from the publicly available documents above, the development of extraction royalties for oil and natural gas appear plausible for the period under review.

The fact that the Ministry of Economic Affairs is directly involved in the plausibility checking process at a professional level proved to be very helpful for clarifying factual queries and for exchanging information at a technical level. In our opinion, it may be necessary in the course of future plausibility checks to involve the companies themselves in the clarification process if there are queries.

We point out that the database reported by companies was not suitable for calculating the key indicators in all cases, as it did not apportion the total amounts reported for minesite and extraction royalties between oil and natural gas. The data reporting should therefore be adapted for future reporting periods and questions asked about the corresponding apportionment. We are also of the opinion that the existing database is an adequate basis for our assessment.

### **3.3.2. Income taxes**

In contrast to the minesite and extraction royalties, the income tax payments reported by the companies are, for various reasons, only of limited use for the plausibility considerations.

Income taxes relate to a payment flow that is not specifically derived from natural resources. They are actually calculated on the basis of an individual tax assessment basis which is calculated according to tax assessment regulations on the basis of a uniform (corporate tax) or a local authority (trade tax) rate of tax. Activities other than natural resources extraction are included in the tax assessment basis. This is particularly true if other value creation processes follow the actual extraction of natural resources. Furthermore, it is possible that a company reporting data does not have an obligation to pay tax itself on the basis of an existing company agreement (called a “profit transfer agreement” in accordance with Section 291 of the Joint Stock Corporation Act (AktG), applied analogously if necessary) but

instead combines its individual tax assessment basis with other companies from a higher-order company (= parent company); in such cases, the company reporting data routinely reports no payment streams derived from income taxes (“zero report”). Due to tax secrecy and the exceptional possibilities to publish the annual financial statements – please refer to Section 264 (3) of the German Commercial Code (HGB) – it is possible that no source of data is available that would allow for a sufficiently accurate estimate of the individual tax assessment basis to be made.

However, it also appears – even taking account of the existing state controls in this connection (see Section 3.2.4.3.) – that it is possible in principle to carry out a plausibility check of income taxes as part of a time series. Due to the sector-specific framework conditions, it appears to be reasonable to assume that in the case of a clearly positive economic development, data reports can be expected to increase and in the case of a clearly negative economic development, data reports can be expected to decrease and, incidentally, in a time series analysis, data reports can be expected to remain constant. High fluctuations that are independent of this, which indicate special factors in the individual tax assessment basis, can be checked for plausibility by questioning the company concerned. A plausibility check of zero reports attributable to company agreements can also be carried out by inspecting the Commercial Register, as these company agreements must be registered both when they are first concluded and when they are finally terminated (“constitutive”).

### **3.3.3. Overall assessment of plausibility**

Based on the plausibility check we have carried out for the extraction royalties during the period under review (2019), we are coming to the conclusion that, taking account of the low risk assessment that we consider to be acceptable, the results of the plausibility check provide an adequate basis for MSG to be able to close the required quality assurance with a positive result in accordance with Requirement 4.9 of the EITI standard.

The same also applies to the reported income tax payments, even if the degree of reliability of the plausibility check for the actually reported payment flows does not reach the standard of the plausibility check for extraction royalties because of the methodological limitations described. In spite of this, taking account of the low risk assessment that we consider to be acceptable, we believe that this plausibility check is also suitable for the MSG to be able to close the required quality assurance with a positive result in accordance with Requirement 4.9 of the EITI standard.

Besides the basis for carrying out the quality assurance, the work on the plausibility check has shown that the use of further data sources that are independent of the companies can provide a wider understanding in respect of the content and influencing factors of the payment flows than would be possible via a pure payment reconciliation.

## **3.4. Payment reconciliation in exceptional cases**

### **3.4.1. Full payment reconciliation in the event of significant risks**

Taking the previous comments as a basis, it can be assumed that the existing processes and controls can be seen as being adequate to ensure the correctness of the payment flows.

In spite of this, exceptional situations can be envisaged, which can essentially have an effect on the risk level for breaches of the correctness of individual payment flows. This could be the case, for example, if there were indications of considerable problems in introducing or migrating relevant IT systems, which could result in errors or delays in the receipt of payments due to government agencies. Significant weak control points could also arise if existing posts within the treasury system were not filled for a sustained period of time. Such facts could result in the MSG assessing the risk of breaches in the correctness of individual payment flows during the reporting period being assessed as significant rather than being classed as trivial.

The previous standard procedure that was used up to the 2017 reporting period involving an (extensive) reconciliation of payments made with the payments received uses a method based on the supposition of a risk of significant false representations associated with the processing of payment flows between companies and government agencies or an internal control system not or not adequately developed on the part of the relevant government agencies. Accordingly, Requirement 4.9 of the EITI standard on quality assurance has been ensured by a direct substantive reconciliation of the payments made with the payments received on the part of government agencies.

If the MSG were to assess the risk of non-compliance of individual payment flows for the reporting period as significant a reconciliation of the payments made and the payments received within the framework of the respective payment flow would be required for quality assurance as defined in Requirement 4.9 of the EITI standard.

### **3.4.2. Partial payment reconciliation for remaining implausibilities**

Even where the MSG assesses that the risk of breaches of correctness of individual payment flows in the reporting period is minimal, a reconciliation of individual payment flows for quality assurance could be required.

This could be the case if inspection of time series or payment flows, taking account of the relevant economic environment and underlying legal conditions (e.g. conclusion of new profit transfer agreements and thus no independent tax obligation for the reporting company), does not permit the MSG to assess the plausibility adequately and answers to possible questions to the company reporting the respective payment flow were not received or the answers received were not adequate and thus plausibility could not be confirmed. In this exceptional case, the MSG could consider that a direct substantive reconciliation of the payments made with the payments received on the part of government agencies is required for the respective reporting company and the payment flow that the plausibility check

cannot access in order to be able to close quality assurance as defined in Requirement 4.9 of the EITI standard.

### **3.4.3. Payment reconciliation on a random basis**

The MSG could consider it to be necessary from time to time to ensure through taking random samples that, in addition to the risk assessment to be verified each year and the relevant work for conducting the plausibility check of the payment flows in the case of an assessed low risk, alternatively or in addition to a direct substantive reconciliation of the payments made with the payments received on the part of government agencies. In this case, not all participating companies or all payment flows would be involved in each case in the payment reconciliation. This restriction of the companies or payment flows to be involved would represent an efficient and cost-effective way to proceed, which corresponds to international audit standards.

Such a course of action would also be acceptable, if the MSG were in exceptional cases able to assess the respective risk of breaches in the correctness of individual payment flows during the period under review as not being trivial but, at the same time, also not assessing the risk as being so significant that a complete payment reconciliation appears to be required.

## 4. Final comments

The continued pilot for the payment reconciliation was intended to replace on a trial basis the previous procedure (used until the 2017 reporting period) of payment reconciliation based on tests of details by a procedure that is based on a system-supported analysis of the processes and controls used by the relevant government agencies to ensure the quality of assessment and collection of the payment flows relevant to D-EITI.

We believe that, in the first part of the pilot 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 carried out.

In the context of the continued pilot no findings have arisen in this respect that differ from those of the previous year. In addition, we have not found any indications of weaknesses in relevant controls to ensure the correctness of payment flows relevant to EITI from the sources of information available to us and the information provided by MSG members. The work we have carried out to make plausibility checks of the data reports of participating companies have led us to assess that, on the basis of the continued pilot, the MSG can close the required quality assurance in accordance with Requirement 4.9 of the EITI standard.

In addition to this, we are of the opinion that this work report documents an approach for which the method has been fully described, which provides the required quality assurance on the basis of a risk-oriented approach, also without a full payment reconciliation by MSG or a payment reconciliation on a random basis.

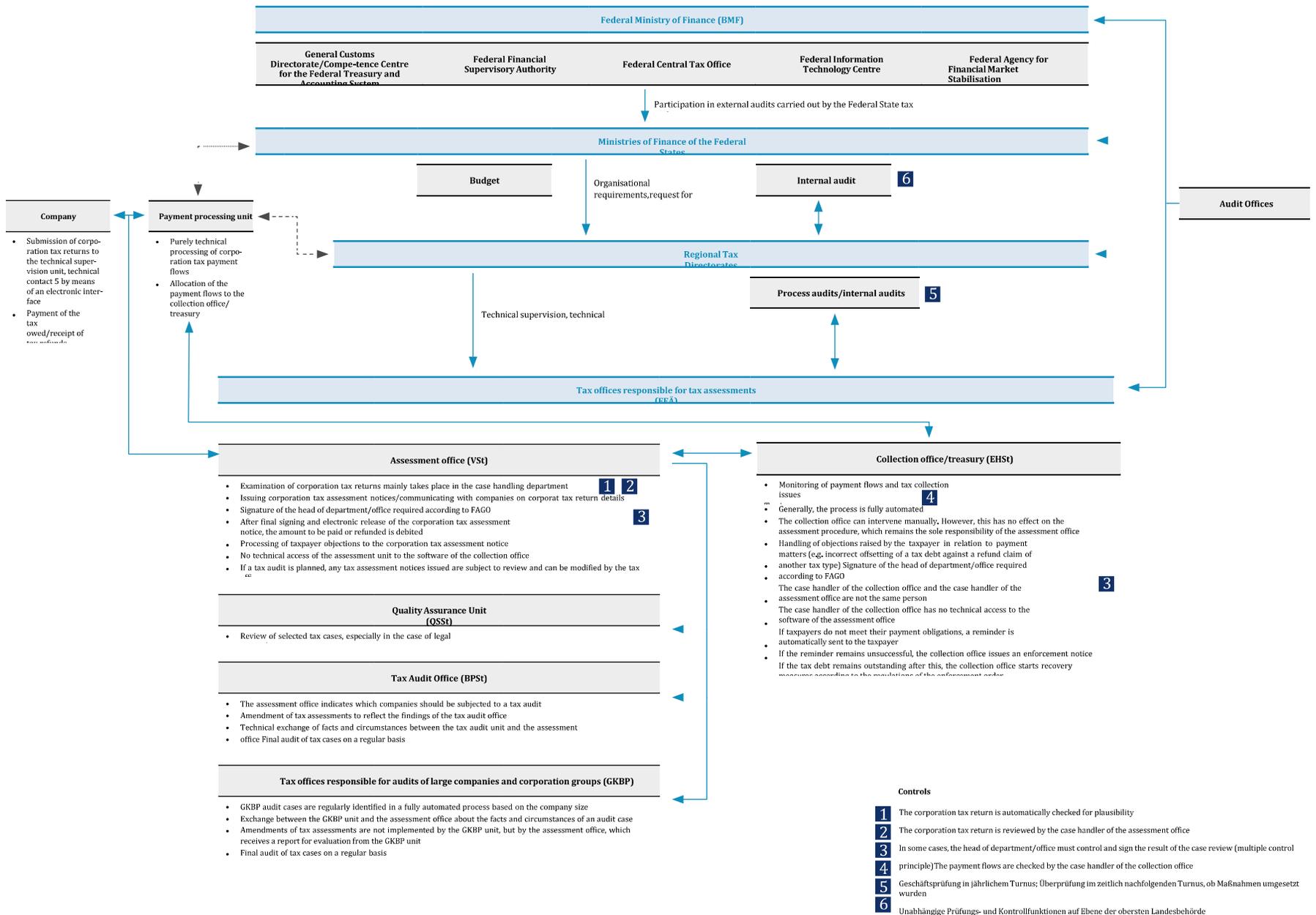
Düsseldorf, 16. February 2022

Warth & Klein Grant Thornton AG  
Auditing company

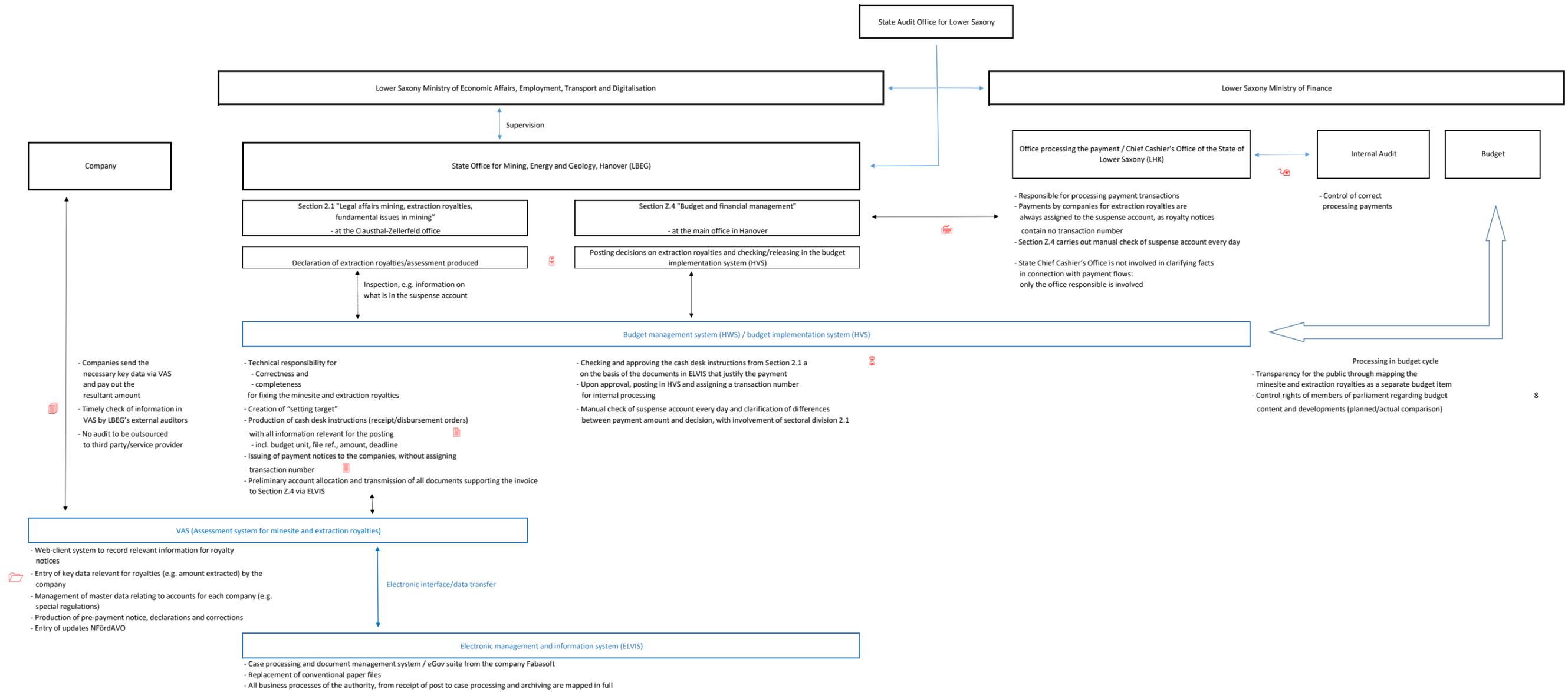
Ralf Clemens  
Wirtschaftsprüfer  
[German Public Auditor]

Christoph Heinrich  
Wirtschaftsprüfer  
[German Public Auditor]

# **Annex 1**



## **Annex 2**



- Companies send the necessary key data via VAS and pay out the resultant amount
- Timely check of information in VAS by LBEG's external auditors
- No audit to be outsourced to third party/service provider

- Technical responsibility for
  - Correctness and completeness
- for fixing the minesite and extraction royalties
- Creation of "setting target"
- Production of cash desk instructions (receipt/disbursement orders) with all information relevant for the posting
  - incl. budget unit, file ref., amount, deadline
- Issuing of payment notices to the companies, without assigning transaction number
- Preliminary account allocation and transmission of all documents supporting the invoice to Section Z.4 via ELVIS

- Checking and approving the cash desk instructions from Section 2.1 a on the basis of the documents in ELVIS that justify the payment
- Upon approval, posting in HVS and assigning a transaction number for internal processing
- Manual check of suspense account every day and clarification of differences between payment amount and decision, with involvement of sectoral division 2.1

- Responsible for processing payment transactions
- Payments by companies for extraction royalties are always assigned to the suspense account, as royalty notices contain no transaction number
- Section Z.4 carries out manual check of suspense account every day
- State Chief Cashier's Office is not involved in clarifying facts in connection with payment flows: only the office responsible is involved

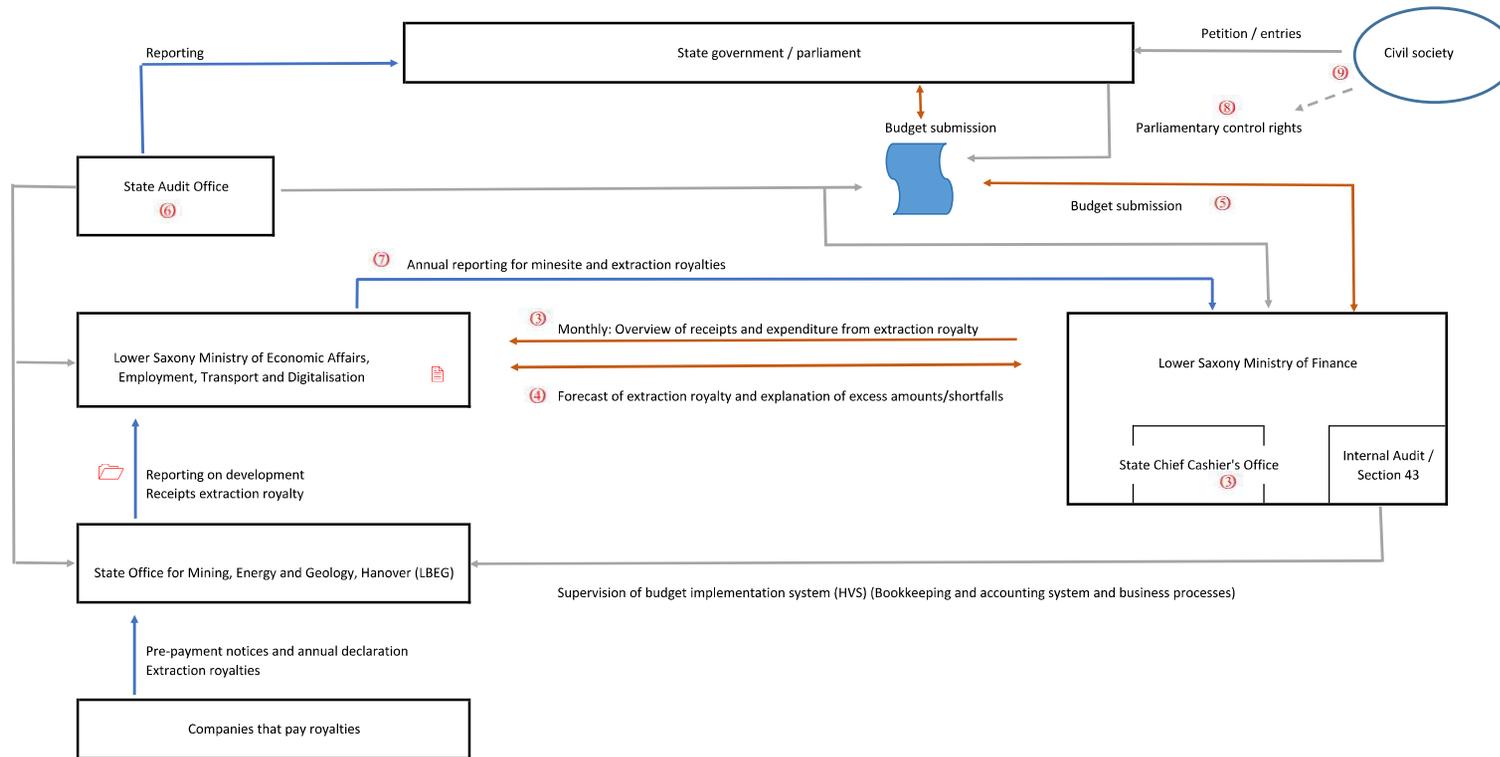
- Control of correct processing payments
- Transparency for the public through mapping the minesite and extraction royalties as a separate budget item
- Control rights of members of parliament regarding budget content and developments (planned/actual comparison)

- Web-client system to record relevant information for royalty notices
- Entry of key data relevant for royalties (e.g. amount extracted) by the company
- Management of master data relating to accounts for each company (e.g. special regulations)
- Production of pre-payment notice, declarations and corrections
- Entry of updates NFördAVO

- Case processing and document management system / eGov suite from the company Fabasoft
- Replacement of conventional paper files
- All business processes of the authority, from receipt of post to case processing and archiving are mapped in full

- Checks:**
- System-integrated audit of companies' entries for plausibility
  - Check of companies' entries by administrator
  - Staged approval system involving Section management/cross-check principle
  - Check of information provided by companies on the basis of external audits by LBEG employees
  - Segregation of duties between decision-making and posting decisions in HVS
  - Check of whether the posting entered with the declaration on extraction royalties and the payment transaction in the suspense account agree
  - Organisational separation of the payment processes from the offices that are responsible for producing and posting decisions
  - Control rights on the content and developments of the minesite and extraction royalties as a part of the State of Lower Saxony's budget
  - Technical oversight of the Chief Cashier's Office of the State of Lower Saxony

## **Annex 3**



- LBEG's quarterly reporting on the basis of the companies' pre-payment notices
- October: LBEG's annual report on the basis of the companies' annual declarations, stating retrospective and overpayment amounts
- Information for each company that pays royalties:
  - Amount extracted and subject to royalties
  - Current assessment rate
  - Amount of extraction royalty to be paid
  - Changes to previous quarter and the same quarter of the previous year

- Internal controls in Ministry of Economic Affairs (cross-check principle)
- Monthly transmission of receipts/expenditure from minesite and extraction royalties to the Ministry of Economic Affairs on the basis of data from the State Chief Cashier's Office
- In May and November: Royalty forecast on amount of extraction royalties for the current budget year by the Ministry of Economic Affairs to the Ministry of Finance
- Explanation of excess amounts/shortfalls by the Ministry of Economic Affairs to the Ministry of Finance
- Transparency through showing minesite and extraction royalties as separate budget items
- External financial control of budgetary and financial management and reporting to government and parliament; at the same time Obligations of the Federal State Authorities to notify the State Audit Office
- Annual reporting to the State government and Ministry of Finance on details of the minesite and extraction royalties by the Ministry of Water and Irrigation (MWi)
- Control rights of members of parliament regarding the budget content and developments (development of planned/actual)
- Direct exercise of control by the public through petitions to parliament, indirect possibility of exercising control by the public via the control rights of members of parliament

## **Annex 4**

Risk assessment process

Further measures for quality assurance

- Making sure that sufficient information on the relevant payment flows is available:
- Gaining an understanding of relevant processes and controls
  - Regular follow-up of the findings
  - Making use of/ establishing a routine for collecting information
  - Identification and assessment of any limitations of the information collection process

Evaluation of the information

Assessment and decision of the MSG

There are no indications of incorrectly processed payments

Plausibility check for reported payment flows

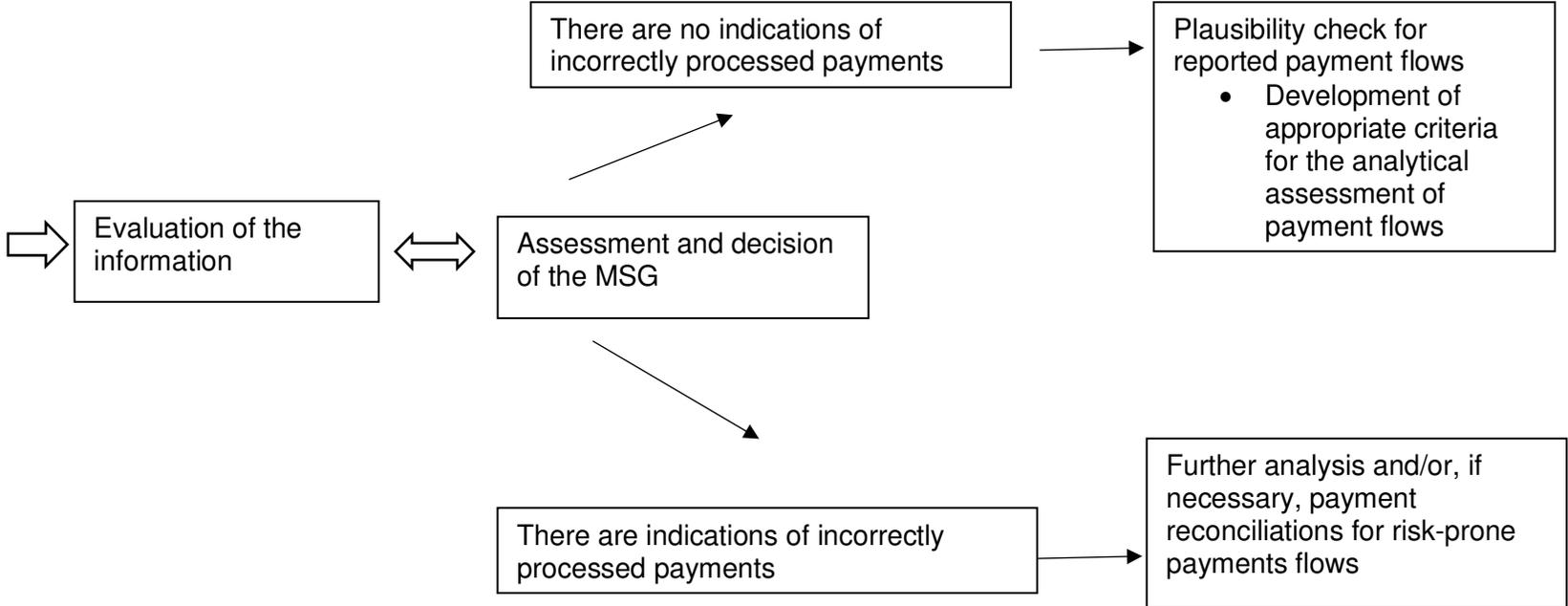
- Development of appropriate criteria for the analytical assessment of payment flows

There are indications of incorrectly processed payments

Further analysis and/or, if necessary, payment reconciliations for risk-prone payments flows

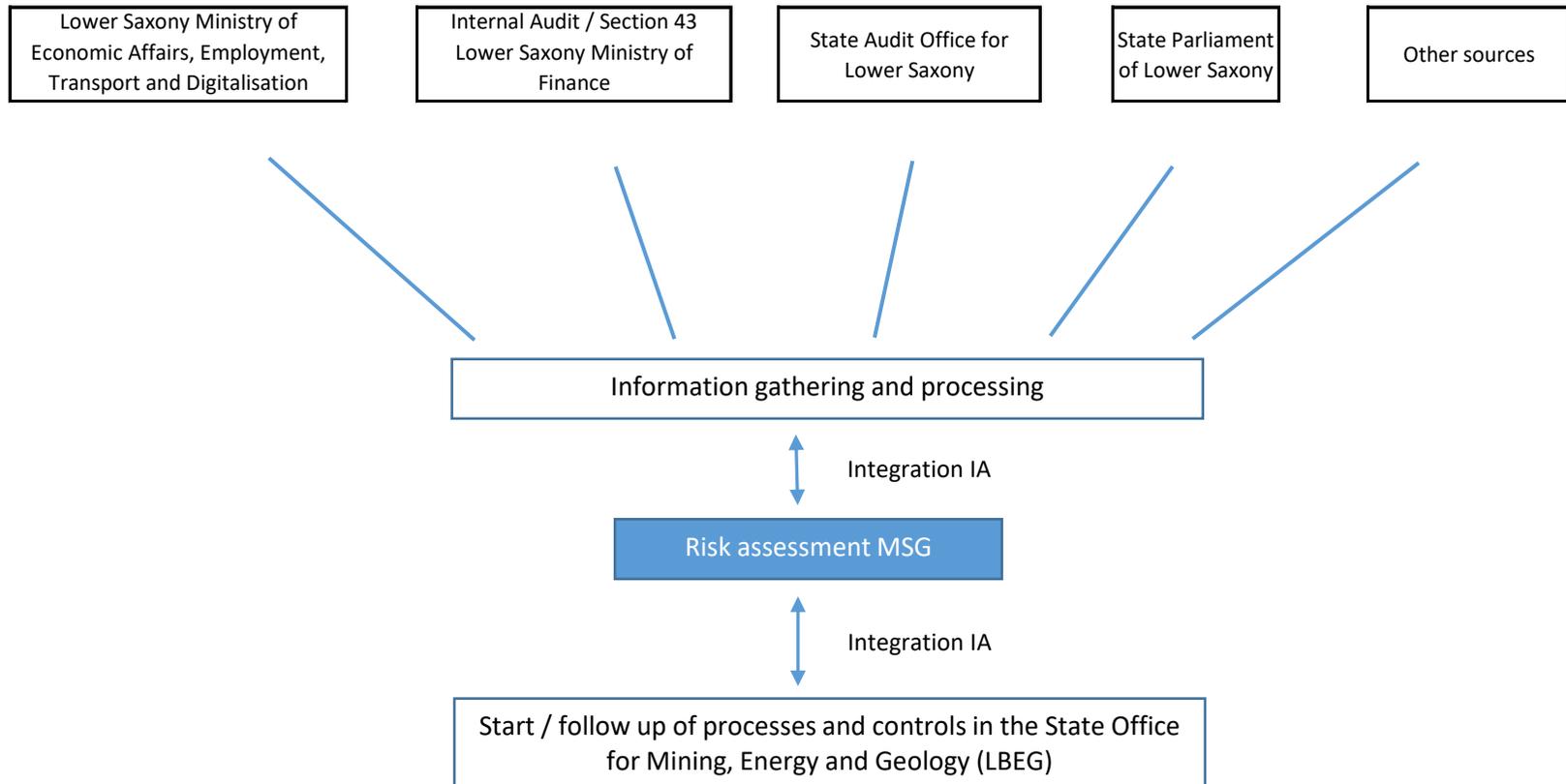
Engagement of the Independent Administrator

Engagement of the Independent Administrator



# **Annex 5**

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## **Annex 6**

## Excursus: Information on the frequency of government tax audits

Once a year, the Federal Ministry of Finance compiles statistics on the results of government tax audits for the previous budget year on the basis of reports from the Federal States. These statistics, which include only the taxes administered by the Federal States, are published in one of the monthly reports issued by the Federal Ministry of Finance. For the 2019 reporting period, the corresponding statistics were published in the report for October 2020 available on the [Internet](#).

The government tax audit is a final, retrospective review of an individual tax case and relates to specific tax types and specific taxation periods. The aim of a government tax audit is to verify the assessments by the respective tax office of tax-relevant facts that relate to the taxpayer and are included in the tax declaration. The government tax audit thus serves exclusively to verify the tax assessment of the respective taxpayer, but not to collect tax payments. The results of a government tax audit have at best an indirect effect on tax collection and thus possible tax payments. First of all, the original tax assessment notices, which determine the amount of tax to be paid, must be corrected by the assessment office following the government tax audit. Then, tax payments are only affected if the taxpayer either agrees with the assessment made by the government tax auditors or the taxpayer's deviating assessment of the tax-relevant facts is not conclusively confirmed by the fiscal jurisdiction (the fiscal court having jurisdiction or the Federal Fiscal Court). Accordingly, it is not possible to draw any conclusions from the government tax audit on the quality of the processes and controls of tax collection.

Taxpayers are grouped in four different size classes for the purposes of government tax audits conducted every three years as of the respective reporting date. The size classes valid for the 2019 reporting period were published in the Federal Tax Gazette in April 2018. The 18 companies or consolidated companies participating as part of the fourth German EITI report are all classed as "large enterprises" and thus are assigned to the highest size class. Companies of this size are always audited seamlessly so that the period of time being audited follows on from the previous audit period, thus achieving a continuous audit of all assessment periods. Experience shows that the respective audit period covers an average of three assessment years.

In 2019, a total of 8,225,244 businesses was recorded in the business register of the tax offices, of which 181,345 were audited. This number corresponds to an average audit rate of 2.2%. For businesses classified as large, the average audit rate was 20.3%. In 2019, 13,341 auditors participated in the government tax audits of all Federal States. The government tax audits resulted in additional tax revenues of about €15.2 billion, of which €11.6 billion or just over 76% came from audits of large companies. The largest share of these additional tax revenues for 2019 were attributable to trade tax and corporate tax (23.6 percent or €3.6 billion, each) - i.e. two relevant payment flows in the context of the EITI procedure.

The Institute of Independent Auditors in Germany (IDW) published a position paper in November 2021 on the topic of "Veranlagungsnahe Betriebsprüfung" (Government tax audits to be conducted shortly after the respective tax assessment period). According to this paper and current findings, government tax audits often begin many years after the end of the respective assessment period and last significantly longer than one year on average. In connection with their ideas for improvement, IDW suggests that the tax authorities should select taxpayers to be audited according to risk-oriented criteria, taking into account the information available to them from the e-balance sheet records and the submitted tax declarations. IDW draws the conclusion from their findings that the laws and regulations on external government tax audits are in need of reform, which is shown by the excessively long duration of the government tax audits and the resulting long-lasting legal uncertainty. As a result, this position paper is probably also related to the discussion on the increased use of data analysis by the tax authorities for risk assessments that can form a basis of a more targeted use of the government tax auditors who are a scarce resource.