

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

Report on the nature and scope of the work of the Independent Administrator in the context of the pilot on payment reconciliation for the fifth D-EITI report



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# 1. Instruction

Under an agreement signed on 22 September 2022 and a supplement to the agreement dated 22 November 2022, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH engaged us, Grant Thornton AG auditing firm of Düsseldorf (referred to below as: GT), to support GIZ in the implementation of the Extractive Industries Transparency Initiative (EITI) in Germany.

GT 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 2020. 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 2020, the year under review
- Continuation of the work started with the third and fourth German EITI reports to develop an alternative procedure to safeguard the quality of the payment data collected (“Pilot for payment reconciliation”) including an in-depth analysis of the trade tax situation
- 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 16 February 2022 which was produced during the preparation of the fourth German EITI report. To avoid repetition, general explanations or more detailed information on assessment processes have been deleted from this working report and replaced by references to the previous working report.

## 2. Concept and vision of the pilot on 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 reports of 14 January 2021 and 16 February 2022 for the 2018 and 2019 reporting periods and provides an in-depth analysis of the findings made so far in the area of trade tax. It summarises the systematic considerations underlying the pilot and the findings and results from its implementation. The pilot project is hereinafter referred to as the "system-based approach" as opposed to "payment reconciliation".

### 2.2. System-based 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.

In view of these observations the pilot is systematically replacing the test of details for payment flows with a multi-level 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 natural resources were 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 effort in terms of time and money can also be reduced.

From a theoretical audit perspective, the system-based 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.

Therefore, the results of the previous payment reconciliation have been explicitly taken into account in our work on the pilot. To the extent it can be assumed that the (internal and external) control system is appropriate and effective, and taking account of the positive results of the payment reconciliation it is permissible to reduce the scope of the substantive audit procedures (= payment reconciliation 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 of methods.

For detailed information about the system-based approach, see also Annex 4.

### 2.3. Procedure and knowledge gained from implementing 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.

A summary of the approach previously developed as part of the pilot, as well as findings from implementation to date, are contained in our comments in sections 2.3 and 2.4 of our working report dated 16 February 2022, which was prepared in the course of the fourth German EITI Report.

## 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. During the pilot and/or the development of the system-based approach, 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 still 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. For general explanations of the respective components, we refer to our (unchanged) explanations contained in the same sections of our working report of 16 February 2022, which was prepared in the course of the fourth German EITI Report.

### 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 fifth 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:

- mine site 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
- 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 (see Section 3.1.2 including further references) 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.

For further details, we refer to our (unchanged) explanations contained in the same sections of our working report of 16 February 2022, which was prepared in the course of the fourth German EITI Report.

#### **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. The budget then needs to be passed by parliament as a budget law. For this purpose, the budget is first intensively examined by the relevant committee of the parliament (usually called the budget committee); at the end of this process, the committee submits resolution recommendations to the plenum of the 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.

**Example of the primacy of parliament in the reporting year**

- The parliament of Lower Saxony has dealt with the proposed amendment to the Lower Saxony ordinance on mine site and extraction royalties (NFördAVO) and a settlement agreement between the State of Lower Saxony and various oil and gas production companies (as reflected in the document Lower Saxony Parliament - 18th legislative period, printed matter 18/8286). The background to this was the planned conclusion of individual agreements between the State of Lower Saxony and said companies to settle a difference of legal opinion, which goes back to a decision of the Federal Administrative Court from December 2018 (BVerwG 7 BN 3.18). In the opinion of the Federal State government the agreement is expedient and economical accordance within the meaning of Article 58(1) no. 2 of the State Budget Code (LHO). However, the agreement as well as the amendment of the Lower Saxony ordinance on mine site and extraction royalties required the approval of the State parliament due to their fundamental or considerable financial significance as well as their direct legal effect for third parties (article 40(2) of the State Budget Code (LHO)). An exemption from the extraction royalties was agreed retroactively for the 2020 financial year, as well as an amendment to the Lower Saxony ordinance on mine site and extraction royalties with a new determination of the royalty rates until 2030. The parliament of Lower Saxony was informed that an amount of approx. €30.3 million (58.3% of the €52 million collected in the 2020 financial year) would be refunded in the 2021 calendar year. After the parliamentary committees "Economy, Labour, Transport and Digitalisation" and "Budget and Finance" were informed by the government of the Federal State, they recommended that the parliament adopt the government's motion unchanged. The parliament of the Federal State approved this motion in its 96th session on 27 January 2021.

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. 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 mine site 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. For further details, we refer to our (unchanged) explanations contained in the same sections of our working report of 16 February 2022, which was prepared in the course of the fourth German EITI Report.

#### **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 mine site 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 mine site and extraction royalties). Self-assessment is made in accordance with Section 2 of the Lower Saxony ordinance on mine site 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 mine site 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 mine site 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 Hanover 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 mine site 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**

An overview of the processes for assessing and collecting mine site and extraction royalties is provided in the chart in Annex 2. The controls overriding the collection process are shown and explained in more detail in the chart in 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:

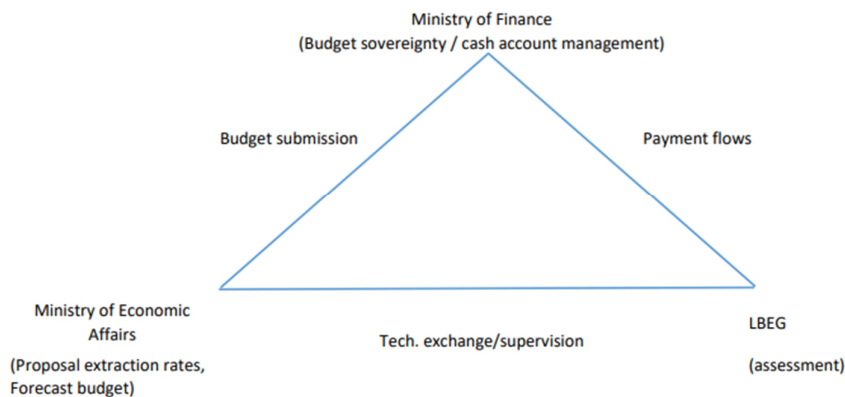
- The current assessment rate
- The amount extracted and subject to royalties
- The amount of the extraction royalty to be paid

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 for 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 for 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 for 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 for 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 for 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 mine site and extraction royalties from the Ministry for 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. Amendments to the Lower Saxony ordinance on mine site and extraction royalties (including the amount of the rates) are decided by the government of Lower Saxony on the proposal of the Lower Saxony Ministry for Economic Affairs (for any special aspects concerning the 2020 reporting year, please refer to our comments in section 3.2.2.2 of this report). Lower Saxony's Ministry for 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 assessment (LBEG) and collection (cash account management/state cashier's office). The Ministry for 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 for 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 mine site 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 any weaknesses in the controls of the payment process for mine site and extraction royalties were identified or suspected during the year under review. This was not the case.

The retroactive adjustment of the mine site and extraction royalties for the year 2020 (please see the explanations in Section 3.2.2.2 of this report) had no effects on the quality assurance of the actual payments in the reporting year 2020. On the contrary, due to the timing, it can be assumed that the payment flows reported by the participating companies for the reporting year 2020 actually accrued in the amount reported to the state parliament by the state government.

In addition to this, we have inspected the reports from the Federal Audit Office and the State Audit Office of 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 could not 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 mine site 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 Tax Code) and from mine site and extraction royalties described under Section 3.2.4.2.

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

The following comments have been shortened compared to our work report of 16 February 2022, as they relate exclusively to the upstream assessment process. For details of the upstream assessment process, we therefore refer to our (unchanged and still valid) explanations given in the relevant sections of our previous report.

In connection with the collection (by the relevant state agency or any other administrative unit used for the collection of payments) of any due payments calculated by the payer, risk result, among other things, from a concentration of competences with employees who would be part of both the assessment and the collection process. This risk is dealt with both organisationally by strict segregation of functions within the relevant government agency 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 described in Section 3.2.3.2 also applies to corporation tax.

#### **3.2.4.3. Controls embedded in the collection process**

The purpose of the collection office within the tax determination 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), 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 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 (being the highest financial authority in the Federal State) 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. The results of these audits are only available internally within the administration, i.e. they are not published.

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** (being the highest authorities in the Federal State responsible for financial administration) are in charge of financial administration at Federal State level. In Hesse, for instance, this includes the establishment of a separate "Internal Audit" unit, which reports directly to the most senior manager. The work undertaken by the Internal Audit unit is based on the recommendations on standards for internal audits in the administration of the Federal State of Hesse ("Empfehlungen über Standards für Interne Revisionen in der Hessischen Landesverwaltung"). These standards form a uniform and cross-departmental work and legal basis for the administration's work and are based on the auditing standards of the German Institute of Internal Auditing (Deutsches Institut für Interne Revision e.V., DIIR) and the recommendations of the German Federal Ministry of the Interior for internal audits ("Empfehlungen des Bundesministeriums des Innern für Interne Revisionen"). The Internal Audit unit performs 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. The reports of the internal audit are not publicly available (just as the internal audit reports of listed companies), but are exclusively addressed to a group of recipients within the public administration. Please see our explanations in Section 3.2.6.1. for more details about the work of internal audit units.

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 could not 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**

Commercial enterprises in Germany are subject to trade tax. The trade tax assessment procedure has two stages. Trade tax is levied on the trade income. The municipalities in which the respective company has permanent establishments are entitled to the trade tax. A permanent establishment can also extend over several municipalities. Accordingly, the recipients of trade tax payments are the individual municipalities and not, for example, the Federal Government or the Federal States.

From an administrative point of view, the tax authorities determine (based on the assessment basis determined for corporate income tax) an amount for tax assessment taking into account the provisions of the Trade Tax Act. The trade tax assessment amount is 3.5% of the trade income for all companies nationwide. The tax administration sends the tax assessment amount to the respective local authority in which the company has its permanent establishment. If the company has several permanent establishments or if a permanent establishment extends over several municipalities, the tax administration also divides the tax assessment amount among the municipalities according to a legally determined distribution key. The statements made in this chapter for the tax administration apply accordingly to trade tax for these sections of the administrative procedure.

Building on the upstream administrative procedure at the level of the tax offices, the respective municipality determines the amount of trade tax to be assessed and paid by the company to the municipality by multiplying the tax assessment amount notified by the tax authorities by the municipality-specific tax factor. The tax factor

is determined by the elected members of the municipal council. The assessment process, which is divided between two administrative units as described above, is followed by the collection process (the actual payment process) which takes place exclusively at the level of the municipalities.

With regard to the assessment of trade tax, the procedural workflows between tax determination offices and municipal tax offices interact when it comes to fixing the uniform base amount of trade tax that forms the basis for calculating trade tax. The statements made on the assessment process for corporation tax can be transferred to trade tax as far as the tax offices are competent for this process.

The local bylaws as fundamental elements of local governance law provide a comparable legal framework for the organisation at local authority level. 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 shows for the group of companies that take part in D-EITI the 20 government agencies to which the highest trade tax payments in the aggregate were made in the year under review (2020):

	Receiving municipalities	Trade tax payments 2020 (in TEUR)	Performing companies
1.	City of Hanover	5.162	ExxonMobil Central Europe Holding GmbH
			BEB Erdgas und Erdöl GmbH & Co. KG
2.	Großkneten (municipality)	3.649	BEB Erdgas und Erdöl GmbH & Co. KG
			ExxonMobil Central Europe Holding GmbH
3.	Meppen (town)	3.133	ExxonMobil Central Europe Holding GmbH
			BEB Erdgas und Erdöl GmbH & Co. KG
4.	Town of Frechen	2.740	Quarzwerte GmbH
5.	City of Heilbronn	2.604	Südwestdeutsche Salzwerke AG
6.	Dötlingen (municipality)	1.956	ExxonMobil Central Europe Holding GmbH

			BEB Erdgas und Erdöl GmbH & Co. KG
7.	City of Hamburg	1.449	ExxonMobil Central Europe Holding GmbH
8.	Rheinberg (town)	1.030	Hülskens Holding GmbH & Co. KG
9.	Schöningen (town)	976	JTSD-Braunkohlebergbau GmbH
10.	City of Wiesbaden	954	Dyckerhoff-Gruppe
11.	Helmstedt (town)	851	JTSD-Braunkohlebergbau GmbH
12.	City of Cologne	847	ExxonMobil Central Europe Holding GmbH
13.	Elsteraue (town)	792	JTSD-Braunkohlebergbau GmbH
14.	Brockel / joint municipality of Bothel	718	BEB Erdgas und Erdöl GmbH & Co. KG
			ExxonMobil Central Europe Holding GmbH
15.	Haltern am See (town)	662	Quarzwerke GmbH
16.	Vechta (town)	596	ExxonMobil Central Europe Holding GmbH
			BEB Erdgas und Erdöl GmbH & Co. KG
17.	Lengerich (town)	583	Dyckerhoff-Gruppe
18.	Emstek (municipality)	519	BEB Erdgas und Erdöl GmbH & Co. KG
			ExxonMobil Central Europe Holding GmbH
19.	Bad Reichenhall	476	Südwestdeutsche Salzwerke AG
20.	Osterwald / joint municipality of Neuenhaus	462	ExxonMobil Central Europe Holding GmbH
			BEB Erdgas und Erdöl GmbH & Co. KG

For the fifth D-EITI report, the trade tax collection process was analysed in more detail using a questionnaire developed by us. This questionnaire was sent to the 20 municipalities mentioned above. The responses resulting from the

questionnaires provide insight into the processes and controls put in place by municipalities of various sizes to ensure the regularity of the collection of trade tax. The response rate of the municipalities surveyed was 65% at the time of drafting this D-EITI report. For more details on how the survey was conducted and for statistical information regarding the responses, please refer to Annex 8 to this report. The questions sent to the municipalities are presented in Annex 7.

The feedback from the municipalities indicates that the trade tax assessment notices are generally issued by the office or department responsible for finances in the municipality, while the cash office collects the payments. The recording of payments and the reconciliation with the respective receivables due from the companies is mainly automated, although in the case of discrepancies between payments and receivables or incomplete or incorrect information, manual corrections have to be made. The number of employees in the respective municipalities who are responsible for issuing the trade tax assessment notices and collecting the payments varies significantly with the size of the respective municipality. The number of employees in the area of the cash office is always higher than the number of employees responsible for issuing trade tax notices, regardless of the size of the respective municipality. The fact that the assessment processes are closely linked (as described above) has a direct effect on the design of the processes in the municipalities and the issuing of basic notices by the tax offices.

In all cases, the two administrative steps of assessment and collection are strictly separated in terms of personnel so that the basic principle of separation of functions is always guaranteed, regardless of the size of the municipality. Unclear payments are always handled by the cash office. In individual cases, coordination with the office responsible for issuing the trade tax assessment notice is necessary.

With one exception, all municipalities have written regulations to ensure the timely enforcement of trade tax claims by the municipality. In exceptional cases, without written regulations, this is the responsibility of the municipality's cash office. In principle, the cash office is responsible for the implementation of these regulations.

In the context of taxation, so-called equity measures may exceptionally occur. This is understood to mean both the temporary deferral of payments and the final remission of trade tax claims in compliance with the respective regulations on these equity measures. In principle, decisions on this are made within the administration of the municipality. Only in individual cases does the municipality follow the corresponding decisions of the tax administration for corporate income tax. The respective decisions are not made by the cash office and depending on the importance of the equity measure for the municipal budget, require the involvement of higher-level decision-makers up to the mayor or main or administrative committee (a permanent, representative committee of the municipal parliament or municipal council).

According to information from the Federal Ministry of Finance, the proportion of trade tax made up around 38.2% (previous period: 40.8%) of municipalities' tax receipts during the reporting period (2020). If one ignores the municipalities' share of income tax and VAT not administered by the municipalities themselves, the share even increases to around 72% (previous period: 75%). It should be noted that the

economic effects of the COVID-19 pandemic had a significant impact in the reporting period and the decline in trade tax appears plausible in this respect due to the decline in trade income.

Because of the great importance of trade tax for the municipalities' finances and the clear assignment of responsibility to the municipalities for collection, the results of the survey of the 20 municipalities listed above suggest that every single municipality has established 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 the responsible supra-local audit office (audit agency/State audit office) for each of the 20 government agencies listed in Section 3.2.5.1. (those with the highest trade tax payments in the aggregate):

Responsible supra-local audit office	Receiving municipality	
President, State Audit Office for Lower Saxony	City of Hanover	
	Großkneten (municipality)	
	Dötlingen (municipality)	
	Schöningen (town)	
	Helmstedt (town)	
	Brockel/ joint municipality of Bothel	
	Vechta (town)	
	Emstek (municipality)	
	Osterwald/ joint municipality of Neuenhaus	
	Meppen (town)	
	NRW municipal audit office	Town of Frechen
		Rheinberg (town)
		City of Cologne
		Haltern am See (town)

	Lengerich (town)
Baden-Württemberg municipal audit office	City of Heilbronn
Audit Office of the Free Hanseatic City of Hamburg	City of Hamburg
President of the Hessian audit office	City of Wiesbaden
State Audit Office of Saxony-Anhalt	Elsteraue (town)
Audit Office at the Berchtesgadener Land District Office	Bad Reichenhall

In all surveyed municipalities, local or supra-local audits of cash management or payment processing are carried out by the government offices for auditing accounts or municipal audit offices or Federal State Audit Offices. The majority of the municipalities reported that the last audits took place in 2022 or 2021. Written reports are submitted by the auditing bodies in each case. However, these audit reports are not always available on the Internet for the general public. Rather, the audit reports are only available within the respective administration or are brought to the attention of a committee of the municipal parliament or municipal council. In North-Rhine Westphalia, the results of the supra-local audit of accounts are published in annual municipal reports or by the responsible audit agencies (e.g. NRW's municipal audit office).

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

We have presented the main elements of the control environment for trade tax and surveyed the 20 municipalities with the highest reported trade tax payments (in the aggregate) with regard to their established processes and controls and evaluated the results. Furthermore, we have presented the local and supra-local audit control mechanisms and asked the 20 municipalities whether these controls have been implemented. For the existing process-independent controls, we have reviewed the reports of the State Audit Offices in Lower Saxony and Hesse as well as the reports of individual supra-local audit offices. During this review we did not become aware of any findings of control weaknesses with regard 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.

For further details, we refer to our (unchanged) explanations contained in the same sections of our working report of 16 February 2022, which was prepared in the course of the fourth German EITI Report.

#### **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.

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.

For further details, we refer to our (unchanged) explanations contained in the same sections of our working report of 16 February 2022, which was prepared in the course of the fourth German EITI Report.

### **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 mine site and extraction royalties. 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. Mine site 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 mine site 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 (2020) 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 2020) 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 (2020) 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 2020) 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 mine site 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 mine site 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 (2020), 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**

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 extensive reconciliation of payments made with 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, in the event of a comprehensive risk assessed by the MSG with regard to breaches of the regularity of payment processes, requirement 4.9 of the EITI Standard on quality assurance can be met through an immediate, meaningful reconciliation of payments made with payments received on the part of the government agencies.

### **3.4.2. Partial payment reconciliation for any remaining implausible items**

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 allow for 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. Obtaining information from the transparency register

As part of the assignment given to us in connection with the fifth German EITI report, we were also requested to determine for the companies invited to report whether they have an entry in the transparency register and whether this entry is to be regarded as plausible on the basis of the information available to us and to be obtained.

According to a judgement of the European Court of Justice of 22 November 2022 in the joined cases C-37/20 and C-601/20, the rule of the EU Money Laundering Directive, which requires in the whole EU that information on the beneficial owners of companies or other legal persons entered in the transparency register be accessible to all members of the public in all cases, is invalid. Against this background, the transparency register informed us in response to our enquiry on 3 February 2023 that, in view of the aforementioned decision of the ECJ, the right of inspection under Section 23(1) sentence 1 no. 3 of the German Money Laundering Act (GwG) was limited in accordance with EU law so as not to infringe the rights of third parties and that we had to demonstrate a legitimate interest in obtaining this information from the transparency register. The duties we have as IA do not provide a legitimate interest according to the cases mentioned by the transparency register. As a result, we have so far been denied access to the transparency register.

As part of the implementation of the requirement in para. 2.5 lit. c) of the EITI Standard, the Federal Ministry for Economic Affairs and Climate Action is currently working on clarifying in which cases information may be obtained from the transparency register.

## 5. 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, for the payment flows of corporation tax, trade tax and mine site 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.

The continued system-based approach did not result in any findings for the reporting year 2020 that differed 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.

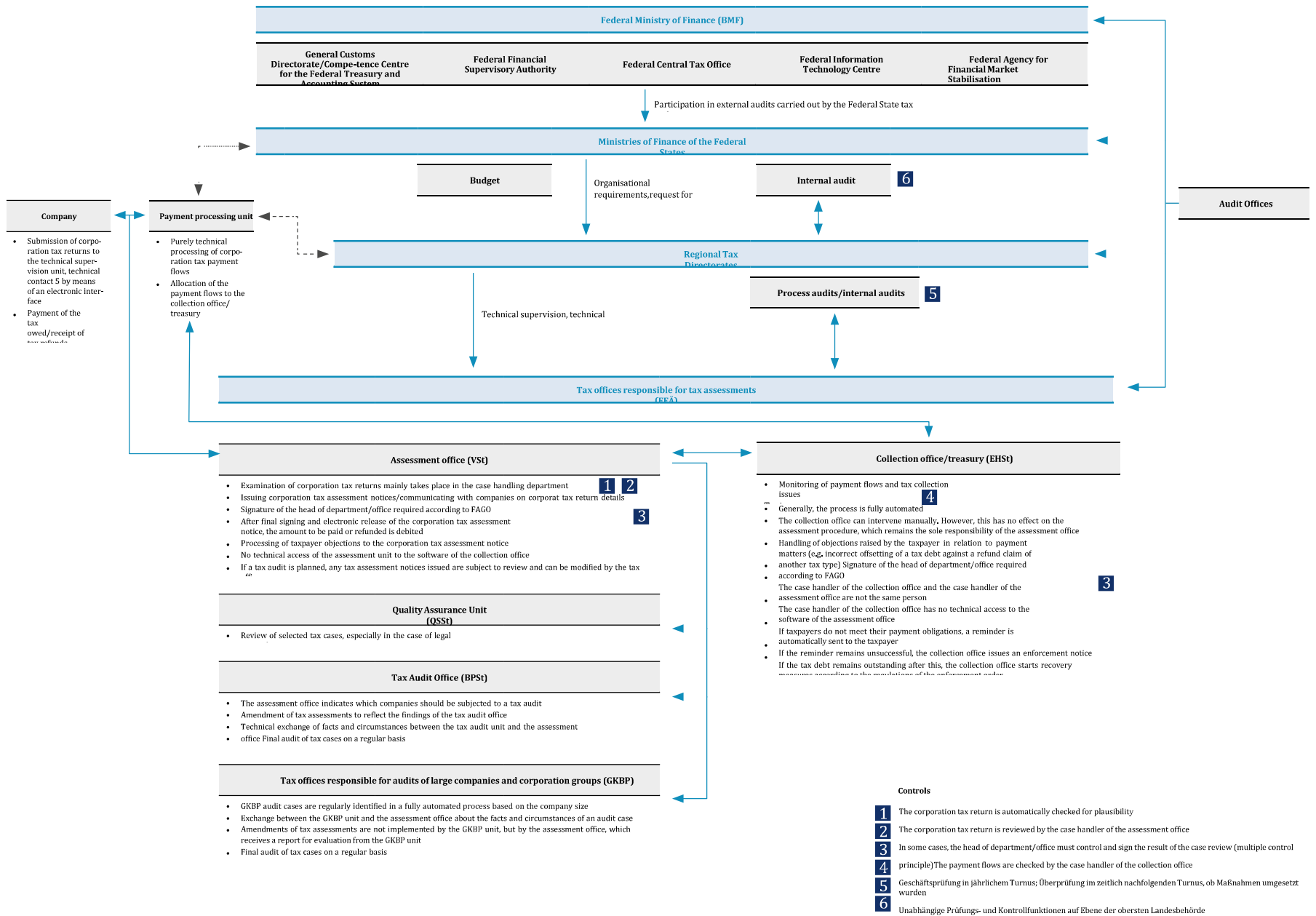
Düsseldorf, 28 March 2023

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft

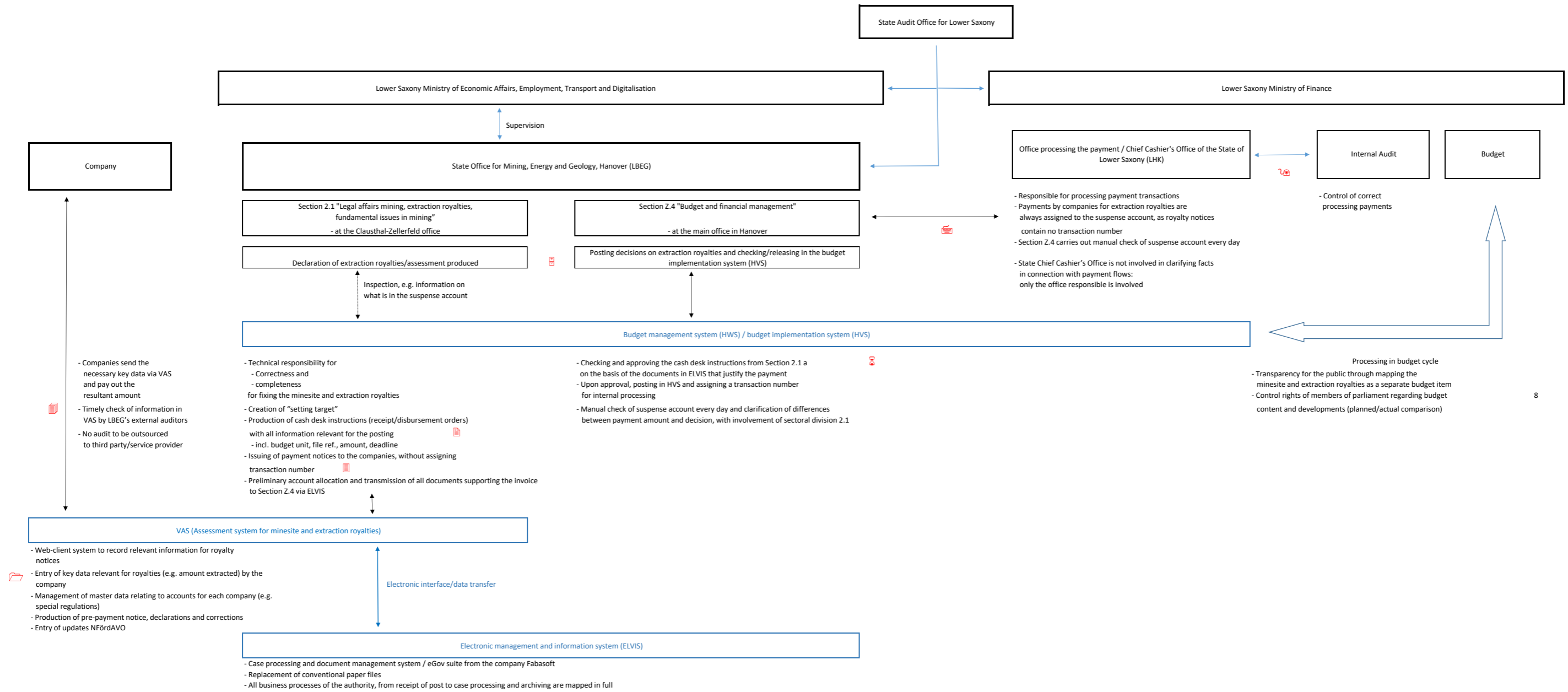
Ralf Clemens  
Wirtschaftsprüfer  
[German Public Auditor]

Christoph Heinrich  
Wirtschaftsprüfer  
[German Public Auditor]

# **Annex 1**



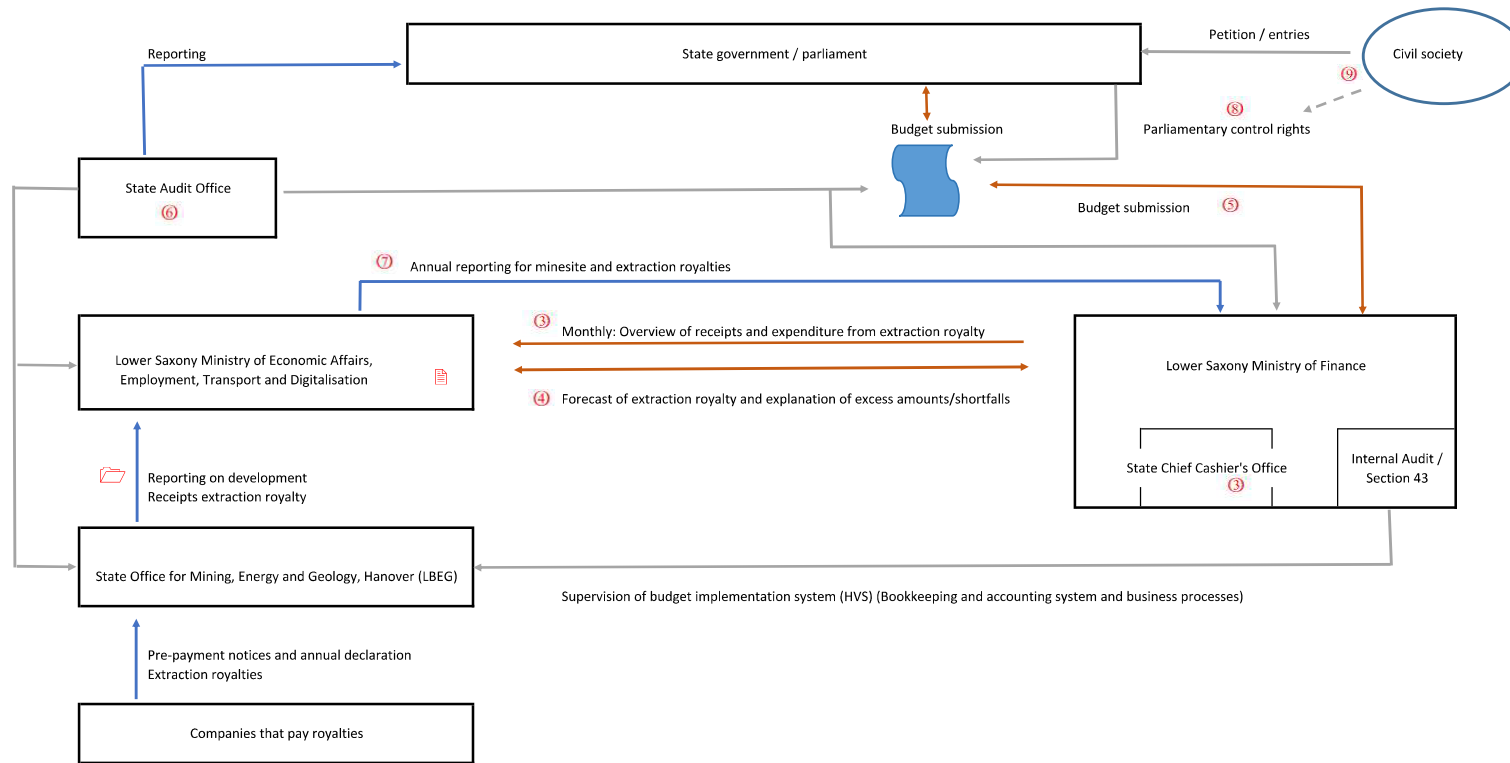
## **Annex 2**



- 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

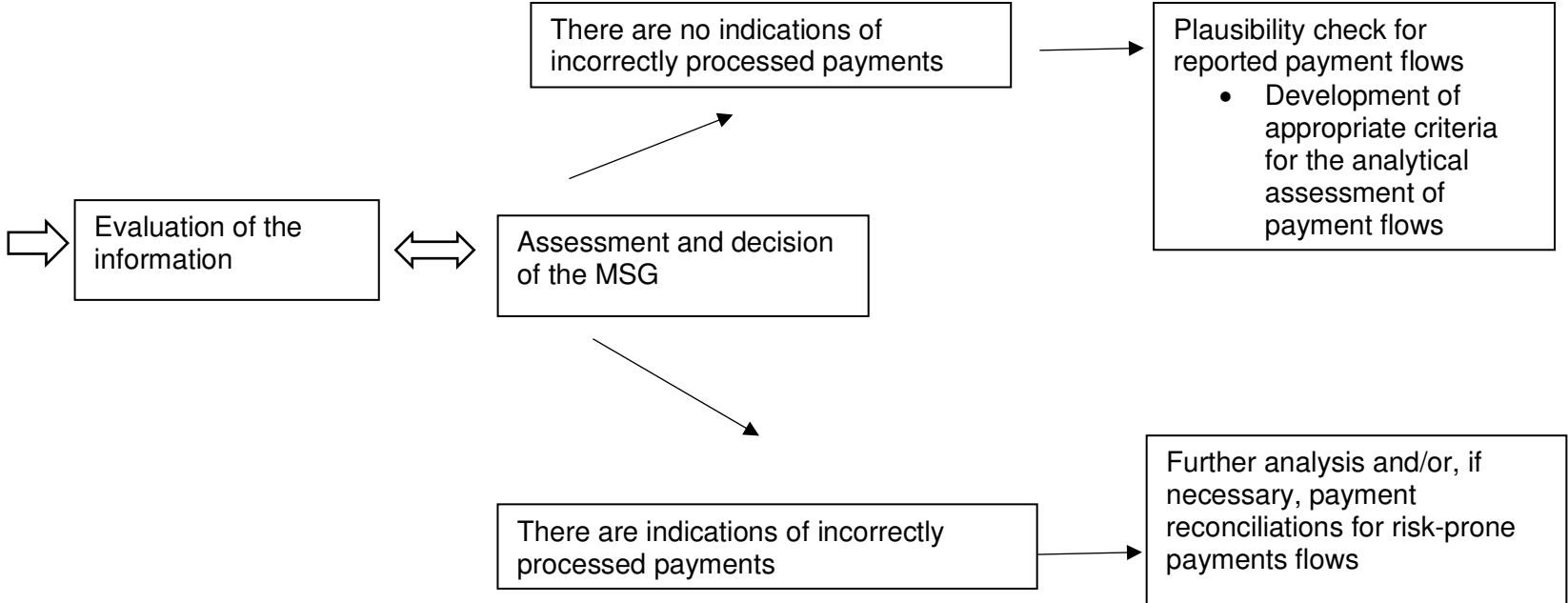
- Development of appropriate criteria for the analytical assessment of payment flows

There are indications of incorrectly processed payments

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

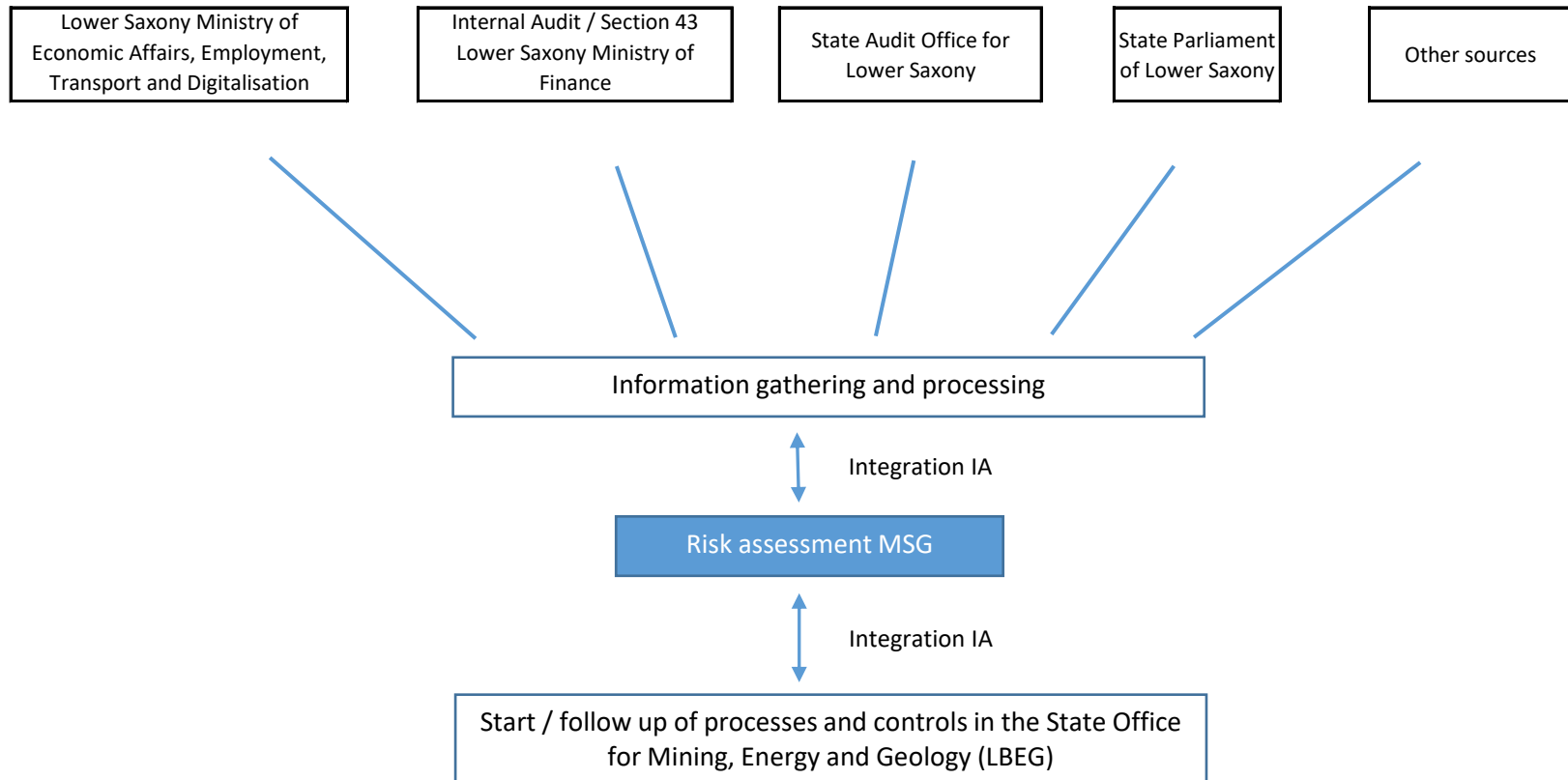
Engagement of the Independent Administrator

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.



## **Annex 7**



## Structure of the "Trade tax payments" Questionnaire

### **Aspects related to administrative law**

1. Which legal norms do you have to observe with regard to the collection of trade tax receivables (e.g. Municipal Treasury Ordinance of Hesse or Municipal Budget Ordinance of North Rhine-Westphalia)?
2. Which office/department of your administration is responsible for issuing trade tax assessments on the basis of the trade tax assessment figures determined by the tax authorities?

### **Organisational aspects**

3. Which office/department collects the taxpayers' payments to one of your bank accounts? What specific measures are taken to make sure that the administrative functions and employees responsible for tax assessment are separated from those responsible for tax collection?
4. How many employees in total were employed in the cash office/municipal treasury as of 31 December 2020? How many employees were employed in the office/department responsible for issuing administrative decisions on trade tax as of 31 December 2020?

### **Organisation of payment processing**

5. When payments are made, is there an automated clearing against existing trade tax claims or is this done manually by employees of the cash office/municipal treasury?
6. Were there any unclear incoming payments in the past in connection with payments on trade tax receivables?
7. If the answer to question 6 is in the affirmative: Which office/department is responsible for clarifying these unclear incoming payments in connection with trade tax claims?
8. Does your municipality have written regulations for granting equity measures (e.g. deferral, remission, waiver of interest) in connection with (trade tax) claims?
9. Who is responsible within the administration for decisions on equity measures and how is the approval process regulated? Does this require the consent of more than one person?
10. Does your municipality have written regulations to ensure the timely enforcement of (trade tax) claims (dunning process / enforcement)? Which office/department is responsible for these processes?

### **Quality assurance**

11. Who is responsible for the local or supra-local audit of your cash management or payment processing? How are the tasks of the local audit implemented in your organisation?



2 | 2

12. In which (calendar) year was the last local or supra-local audit of the cash management or payment processing of your municipality? Are the audit reports or results of the local or supra-local audit publicly available?

**"Trade tax dynamics" indicator**

13. For which (calendar) year did the municipal council last decide to change the trade tax factor?

**End of the questionnaire**

## **Annex 8**



## Detailed information on the survey of the 20 municipalities with the highest reported trade tax payments as part of the fifth D-EITI report

### **Background to the survey**

For the fifth German EITI report, the MSG decided to deepen the knowledge previously acquired on processes and controls of municipalities in relation to trade tax payments and thus enhance the systems-based approach developed in the pilot for trade tax purposes. To this end, the IA was commissioned to use a questionnaire to obtain relevant in-depth information from those 20 municipalities for which the participating companies reported the highest trade tax payments in the aggregate for the 2020 reporting year.

The questionnaire, which was developed by us as IA, was subsequently refined with the German EITI Secretariat. The draft questionnaire took into account that the multi-stakeholder group and the IA relied on the voluntary support of the municipalities, so there was no obligation to participate. Against the background of the different sizes of the municipalities and the expected different staffing levels, the focus of the survey was placed on processing payment flows and the municipal quality assurance measures. A more comprehensive questionnaire could have included more aspects. However, the aim was to maximise the number of responses due to a manageable workload for the surveyed municipalities and thus to obtain the highest possible response rate. In this context, the municipalities were promised that the IA's reporting on the responses of the municipalities, both in its working report and in the corresponding chapter in the fifth German EITI report, would be condensed in such a way that it would not be possible to draw any conclusions about the responses of individual municipalities. Therefore, the presentation of the results from the survey by the IA is exclusively condensed.

### **Implementation of the survey**

The questionnaire was sent out with the support of the German Association of Towns and Municipalities together with a cover letter from the Federal Ministry of Economics and Climate Action to those 20 municipalities that we had previously identified for the 2020 reporting year as those for which the participating companies reported the highest trade tax payments in the aggregate for the reporting period.

A total of €41,907,000 in trade tax payments were reported for the 2020 reporting year, of which 72% or €30,158,000 was attributable to those 20 municipalities. The distribution of trade tax payments shows big differences for the reporting period. While the municipality with the highest trade tax payments was able to collect €5,162,000, the trade tax amount collected by the last of the 20 municipalities included was € 462,000 or just under 9% of the amount of the highest trade tax payments. The media value, i.e. the value that statistically di-



vides the 20 municipalities into two equal groups, was €903,000 or approx. 17% of the maximum amount.

The questionnaires completed by the municipalities were sent exclusively to us as IA and in all cases by email.

### **Response rate and classification of the results**

The response rate of the municipalities surveyed was 65% at the time of writing this fifth D-EITI report. Due to the different sizes of the municipalities surveyed, we divided them into three categories - small municipalities, medium-sized municipalities and large municipalities. Weighting the response rate with the trade tax payments made by the participating companies to the municipalities and included for the fifth D-EITI report resulted in a response rate of 81% for the small municipalities, 48% for the medium-sized municipalities and 100% for the large municipalities. Thus, the returns cover about 56% of all reported business tax payments in the reporting period or 78% of the corresponding volume of the 20 municipalities surveyed.

From the perspective of the municipalities receiving the trade tax payments, the significance of the trade tax payments made by the companies participating in D-EITI varies significantly depending on the size of the municipality. In order to better assess the economic significance of the reported trade tax payments for the respective municipalities, the respective revenues were set in relation to the respective population figures of the municipalities and thus the key figure "trade tax revenues per inhabitant" was determined. The trade tax revenue per inhabitant for all 20 municipalities in the minimum (i.e. the lowest amount for a municipality) is only €0.70 per inhabitant, while the maximum is €304.70. The median of the reported trade tax payments per inhabitant of all receiving municipalities amounts to €33.60. The data from the responses of the surveyed municipalities show equal values for the minimum and the maximum and a median of €31.00/inhabitant. The structure of the population of all 20 surveyed municipalities as well as the structure of the participating municipalities that completed the questionnaire and sent it to the IA is thus largely comparable.

Against this background, we consider the answers adequate to derive generalised statements on the processes used by the municipalities for securing payment flows and have presented them in a condensed form in our work report.

### **Tax factors influencing the amount trade taxes paid**

In connection with trade tax, the respective tax factors are the only parameter that the municipalities can influence independently through council decisions. Therefore, it was also asked for which (calendar) year a change in the trade tax factor was last adopted to be able to assess whether there could be a connection between the level of the tax factor or the time of the last increase and the trade tax payments received by the respective municipality.



The current trade tax factors for the surveyed municipalities ranged between 320% and 510% with a median value of 420%. Every year, the German Chamber of Industry and Commerce (DIHK) collects the tax trade factors of all municipalities with a population of 20,000 or more - in the calendar year 2020, this will be 700 municipalities, according to the DIHK. The average trade tax assessment rate for 2020 was 435% and thus only slightly above the median value of the companies we surveyed.

Feedback on the question of how often tax factors are changed over time revealed that one municipality had not changed its trade tax factor since 1981, while the most recent adjustments were made for 2023. The median value resulting from the answers received was the year 2011. We could not see any connection between this "date of the last tax factor adjustment" and the key figure "trade tax per inhabitant" determined by us.