Extractive Industries Transparency Initiative

VALIDATION COMMITTEE

Secretariat Review: Zambia

EITI International Secretariat Oslo, 21 August 2012

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SECRETARIAT REVIEW: ZAMBIA

Recommendation

The Secretariat recommends that the Validation Committee makes the following recommendation to the Board:

The EITI Board designates Zambia as EITI Compliant as of *19 September 2012*. In accordance with the EITI Rules:

- Zambia must be revalidated within 5 years (i.e., by *19 September 2012*);
- Stakeholders in the process may call for a new validation at any time within that period if they think the process needs reviewing;
- Where valid concerns exist that a country has become EITI Compliant, but its implementation of the EITI has subsequently fallen below the standard required for Compliance, then the Board reserves the right to require the country to undergo a new validation or face delisting from the EITI; and
- In accordance with the 2011 edition of the EITI Rules, Zambia is required to produce EITI reports annually. EITI Reports should cover data no older than the second to last complete accounting period (e.g. an EITI Report published in calendar/financial year 2013 should be based on data no later than calendar/financial year 2011);

○ In accordance with requirement 21(c), Zambia is required to publish a public report annually on the previous year's activities, detailing progress in implementing the EITI and any recommendations from the validator.

The Board congratulates the government of Zambia for its sustained commitment and leadership of the EITI process. The Board also congratulates the Zambia EITI Council for its efforts and effective leadership in EITI implementation. The Board calls on the government and multi-stakeholder working group to ensure that the Board's recommendations are implemented in full, and tasks the EITI International Secretariat with providing regular progress reports to the EITI Board.

SECRETARIAT REVIEW: ZAMBIA

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1 Executive Summary

In August 2011, the EITI Board established five corrective actions required for Zambia to achieve Compliance. The Board subsequently granted Zambia a waiver from undertaking a second validation, and tasked the International Secretariat with assessing whether the remaining EITI requirements have been met. The Secretariat's assessment is attached. The Zambian MSG approved the draft Secretariat review on 19 July. The International Secretariat's conclusion is that all the requirements are met.

2 Introduction

Zambia was admitted as an EITI Candidate Country on 15 May 2009. Zambia's first EITI report was published in February 2011, disclosing payments made by the major mining companies to the government in 2008. On 30 March 2012, Zambia published the 2009 EITI Report. The multi-stakeholder group, the Zambia EITI Council (ZEC), has agreed terms of reference for the 2010 report (including a scoping report), and has begun the tender process with a view to completing the report by the end of 2012.

The Zambian validation report[1] was received in May 2011. On 16 August, the international EITI Board declared that Zambia had made "meaningful progress" in its implementation of the EITI[2]. The Board agreed that indicators 9, 11, 13, 14, and 15 were unmet, and agreed the following corrective actions were needed in order for Zambia to achieve compliance:

1. The MSG should undertake an improved scoping and clarification of the receipts/payments to be included in future EITI reconciliations including a clear definition of "material payments and revenues" and incorporate this definition into the reporting templates for the second EITI Report (indicator 9). This should specifically address the question of the reporting of oil and gas signature bonuses, and the reporting procedures for ZCCM-IH.

2. The second EITI Report should clearly demonstrate that all entities that make or receive material payments are participating in the reporting process (requirement 11).

3. As per the Indicator Assessment Tool for Indicator 13, the government and MSG should take steps to ensure that government disclosures to the reconciler are based on audited accounts to international standards and agree a strategy for addressing these issues in accordance with the requirements as specified in Validation IAT 13.

4. In accordance with the agreed definition of materiality (see point 1, above), the MSG should ensure that all material oil, gas and mining payments by companies to government are disclosed to the reconciler and incorporated into the second EITI Report (indicator 14).

5. In accordance with the agreed definition of materiality (see point 1, above), the MSG should ensure that all material oil, gas and mining revenues received by the government are disclosed to the reconciler and incorporated into the second EITI Report (indicator 15).

2 Zambia's response to the Board decision

The ZEC undertook a number of activities to address the four corrective measures agreed by the Board and comply with the unmet requirements (9, 11, 13, 14, and 15).

The ZEC has submitted evidence[3] that these corrective actions had been undertaken as part of the second reporting process, including:

- The Zambia EITI Council (ZEC) conducted a scoping study to establish which revenue streams were material and consequently which companies and government entities should be covered in the EITI report. Based on the findings of the scoping study, ZEC agreed a clear definition of materiality and established a materiality threshold.
- The government confirmed that there were no oil and gas signature bonuses paid in 2009.
- ZEC agreed that ZCCM-IH be considered as an extractive company in the reconciliation exercise.
- A schedule for the publication of the 2009 EITI report and an agreed timeline for the publication of the 2010 and 2011 EITI reports.

[1] http://eiti.org/files/Zambia_FINAL_Validation_report_18-05-11.pdf

[2] Annex A – Board decision on Zambia, Board Circular 107, 24 July 2011.

[3] Annex B – Letter from the Chair of the Zambia EITI Council requesting Secretariat Review, 13 April 2012, available from http://eiti.org/internal.

- ZEC ensured that that all 28 companies and the 20 government entities that met the threshold reported.
- The government ensured that government reports were based on accounts audited to international standards by requesting the Office of the Auditor General (OAG), which audited the 2009 accounts for the Ministry of Miners and Natural Resources, the Ministry of Finance and the Ministry of Lands, to confirm that these accounts were audited to international standards.
- For Local Councils, ZEC decided that auditing by the Local Government Auditor would be adequate.
- According to the EITI report, the discrepancy resulting from tax payments not reported by extractive companies amount to K12 millions [US$ 2400]. ZEC is satisfied that all companies have comprehensively disclosed all material payments.
- According to the EITI report, the discrepancy resulting from tax receipts not reported by government entities amount to K2504 millions [US$ 500 000]. Weak accounting and reporting systems were stated as the main reason for these omissions. ZEC was satisfied that all government entities have comprehensively disclosed all material payments.

Based on the above, on 13 April 2012 Mr Fredson Yamba, Secretary to the Treasury and ZEC Chairperson, wrote to the EITI Board to request a Secretariat Review on behalf of the whole Council. On 11 May 2012, the EITI Board granted Zambia's request for a secretariat review[4]. The Terms of reference for the review are presented in annex C. The EITI International Secretariat conducted a desk review in May 2012. During the review, Zambian EITI stakeholders were consulted and given an opportunity to share their views.

3 Secretariat review of remedial actions and assessment of indicators

The EITI Board agreed five remedial actions and tasked the Secretariat with reassessing compliance with Requirements 9, 11, 13, 14, and 15.

3. 1 Remedial action 1

The MSG should undertake an improved scoping and clarification of the receipts/payments to be included in future EITI reconciliations including a clear definition of "material payments and revenues" and incorporate this definition into the reporting templates for the second EITI Report (requirement 9). This should specifically address the question of the reporting of oil and gas signature bonuses, and the reporting procedures for ZCCM-IH.

Validator's findings

The validator noted that there was evidence of much discussion by the ZEC and by stakeholders of the payments to be included, or not included. There was, however, no definition or discussion of materiality recorded in terms of, for example, the value of a payment stream as a proportion of government revenues. The Board required that the ZEC should agree a clear definition of "material payments and revenues", including addressing the question of oil and gas signature bonuses and the reporting procedures for ZCCM-IH.

The validator reported that 'The status of ZCCM-IH was not properly defined for the reconciliation…it was initially included by ZEC as government entity' (Validation report, p.48). ZEC later decided that ZCMM-IH be treated as a private company. According to the Validator, 'ZCMM-IH receives dividends and fees from private companies in the mining sector, which could be viewed as payments to government in view of the majority

[4] Annex C – Board decision on Zambia's Validation waiver request, Board Circular 123, 6 May 2012, including Terms of reference for the Secretariat Review, available from http://eiti.org/internal.

stakeholding of the government. Following the decision to treat ZCMM-IH as a private company these payments by companies (and their receipts by ZCCM-IH) were excluded from the reconciliation' (Validation report, p.48).

Progress since Validation

The Zambia EITI Council (ZEC) conducted a scoping study[5] to establish which revenue streams were material, and consequently which companies and government entities should be covered in the EITI report. Based on the findings of the scoping study, ZEC agreed a clear definition of materiality that covered 26 revenue streams, drawn from the mining cadastre and verified by the various Government agencies (Zambia Revenue Authority, Ministry of Local Government, Ministry of Mines, and Ministry of Lands). Pay As You Earn (PAYE), the tax on workers, was included for the first time. There were no agreements between the Zambian Government and mining companies for in-kind payments in 2009. The companies were requested to report social payments and transfers made during 2009. 27 extractive companies out of 28 have reported their expenditure on corporate social responsibility. These figures are reported as unilateral company disclosures. They have not been verified or reconciled. The report confirmed that there were no material oil and gas signature bonuses paid in 2009 (confirmed by government).

ZEC established a materiality threshold of 500,000 ZMK (around $100,000) which covered 99.83% of total revenue collected by Zambia Revenue Authority (ZRA) (Scoping report, p.14). The threshold was established on the basis of taxes collected by ZRA only, not revenue from other tax collecting entities. According to the scoping report, 'the information provided during the scoping study and related to 2009 tax collection was not complete from most government agencies' (Scoping report, p.13). The 2009 EITI report confirms that ZRA collected 98.2% of total revenues reported. ZEC has subsequently confirmed no material payments were received by government other than through ZRA and the listed agencies in the report[6].Any government agency, including local councils, that received payments from the material companies were required to report regardless of the size of the individual payments.

With regards to ZCCM-IH, ZEC agreed that it be considered as an extractive company only in the reconciliation exercise and not as a government entity. The 2009 report confirmed that ZCCM-IH pays the same taxes as other extractive companies (EITI report, p.21). The only revenue stream that is collected by ZCCM-IH is dividends from mining companies in which ZCCM-IH holds shares. The report notes that there was no need for the ZCCM to record its dividends from mining companies in which it holds shares, since the government already declares these as revenues in the EITI Report. The payments received by ZCCM-IH in terms of dividends are unilaterally disclosed in the EITI report in order to increase transparency around these receipts. The government has also confirmed that no dividends were paid by ZCCM-IH 2009.

Secretariat's Assessment

The Secretariat has reviewed the scoping study and the 2009 EITI report**.** Although there is a significant difference between the figures on which the threshold was based and the figures in the EITI report, the threshold seems reasonable. It is clear that ZRA collected more than 98 % of total revenue, and the ZEC and the government has confirmed that no material tax payers were excluded. The role of ZCCM and the questions of

[5] Zambia Scoping study, available from http://eiti.org/files/2009%20ZEITI%20Reconciliation%20-%20Scoping%20Report%20Draft%20(01-10-2011).doc

[6] Letter from Head of Zambian EITI to Eddie Rich confirming some issues raised, 19 April 2012.

oil and gas signature bonuses is clearly set out in the letter from ZEC and explained in the EITI report.

The EITI International Secretariat is satisfied that the remedial action requested by the Board has been completed.

3.2 Remedial Action 2

The second EITI Report should clearly demonstrate that all entities that make or receive material payments are participating in the reporting process (requirement 11).

Validator's findings

The validator found that all extractive companies in production participated in the 2008 report. However, the EITI Board noted that two companies failed to report, albeit for sound reasons, and that the reporting procedures for ZCCM-IH had to be clarified. It therefore disagreed with the validator's assessment and established comprehensive company reporting as an action necessary to achieve compliance.

Progress since Validation

According to the 2009 report, 32 companies met the materiality threshold and were asked to report. ZEC subsequently decided to exclude four non-extractive companies that were not involved in upstream activity. All 27 companies, plus ZCCM-IH, and the 20 government entities, including 16 Local Councils, that met the threshold reported.

Secretariat's Assessment The Secretariat has reviewed the report and the data from the ZRA. The collection of this information took seven weeks to confirm because the Zambian Revenue Authority had difficulty compiling all the data from the different departments that administer the importation of goods ie. customs and excise, and import duties. In addition, the ZEITI secretariat was conducting a number of dissemination activities outside Lusaka which meant that e-mails were not immediately seen.

The final and complete figures came in on 15 August. Detailed documentation is available on companies not included in the report. They fall into three groups:

- 100s of companies that made payments below the materiality threshold agreed by the MSG;
- 19 companies that made payments in excess of the threshold agreed by the MSG, but without license. These companies are typically mining service companies;
- Two companies that made payments above the threshold agreed by the MSG, with a license, but not operating.

In the last category the companies paid PAYE only. They did not pay any other type of tax during the year:

- Albidon Zambia Ltd - who paid ZMK 705m in PAYE (nb. ZMK 500m threshold) – was listed as in 'care and maintenance'. This means that that their mines has closed, but they are employing people to clean it and possibly to sell;
- JV Civils Ltd - ZMK 1,555m – they were still establishing themselves to start mining.

In addition, Sable Zinc Kabwe Ltd does not have a mining license, but is related to Sable Transport Limited which does. It paid ZMK 2,053m in PAYE. Collectively the companies in 2009 only drew from abandoned deposits and move products, rather than operating.

In total, the total payments from these final three companies amounted to 0.16% of total revenue.

The Secretariat therefore concludes that there was no exclusion of material operating mining companies.

The EITI International Secretariat is satisfied that the remedial action requested by the Board has been completed.

3.3 Remedial Action 3

As per the Indicator Assessment Tool for Indicator 13, the government and MSG should take steps to ensure that government disclosures to the reconciler are based on audited accounts to international standards and agree a strategy for addressing these issues in accordance with the requirements as specified in Validation IAT 13.

Validator's findings

The validator reported that the Office of the Auditor General (OAG) confirmed that her Office applies both IFAC's ISA and INTOSAI Financial Audit guidelines. However, the validator noted the lack of a substantive discussion about the approach to this indicator. The lack of how to deal with local government accounts is a case in point. It was noted that the Ministry of Local Government needs to ensure that their accounts accord with international auditing standards or the ZEC need a method of addressing this. The validator concluded that the indicator was met. However, the Board disagreed with the validator's assessment and called on the government and the ZEC to agree a strategy for addressing this requirement as a necessary action for achieving compliance.

Progress since Validation

The Office of the Auditor General (OAG) wrote covering letters for each of the following Governmental Bodies: the ZRA, the Ministry of Mines and Minerals Development, the Ministry of Lands and the Ministry of Finance and National Planning. The letters stated that these institutions are audited to international standards for the period covered by the report. The letters state: "In accordance with Regulation 13 of the EITI requirements, I wish to confirm that the accounts for 2009 for [the government agency] were audited in accordance with the International Accounting Standards" and are all signed by the Auditor General. The OAG also confirmed through the national Secretariat that the figures are in line with accounts that were audited to international standards.

The Local Councils were audited by the Local Government Auditor and not by the OAG. According to ZEC, the 16 Local Councils received a total of 1.3% of total revenue reported. It was also noted that the councils lack capacity to engage international auditing firms. ZEC was therefore satisfied that auditing by local government auditor was sufficient.

Secretariat's Assessment

The Secretariat's assessment is that the MSG has agreed a reasonable approach for ensuring that government disclosures to the reconciler are based on accounts audited to international standards.

The EITI International Secretariat is satisfied that the remedial action requested by the Board has been completed.

3.4 Remedial Action 4

In accordance with the agreed definition of materiality (see remedial action 1, above), the MSG should ensure that all material oil, gas and mining payments by companies to government are disclosed to the reconciler and incorporated into the second EITI Report (indicator 14).

Validator's findings

The validator concluded that the indicator is not met, because he could not confirm the whether all material payments, including those from signature bonuses for oil and gas in 2008, were included. The Board agreed that indicator 14 had not been met, and established the inclusion of oil and gas signature bonuses and all material company payments as a necessary action for achieving compliance.

Progress since Validation

All material companies submitted their reporting templates. The report notes that there were no material oil and gas signature bonuses in 2009. According to the EITI report, the discrepancy resulting from tax payments not reported by extractive companies amounted to 12 million ZMK [US$ 2400]. ZEC was satisfied that these omissions were immaterial and that all companies have comprehensively disclosed all material payments.

Secretariat's Assessment

The EITI International Secretariat is satisfied that the remedial action requested by the Board has been completed.

3.5 Remedial Action 5

In accordance with the agreed definition of materiality (see remedial action 1, above), the MSG should ensure that all material oil, gas and mining revenues received by the government are disclosed to the reconciler and incorporated into the second EITI Report (indicator 15).

Validator's findings

The validator listed the recipient entities including the local authorities. The validator noted the difficulty of receiving reliable documentation to back-up whether all revenues were disclosed and therefore assessed that the indicator was not met. The Board agreed with that assessment.

Progress since Validation

All material Governmental agencies (including local councils) lodged their reporting templates. The government has confirmed that the ZC CM-IH did not pay any dividends in 2009.

According to the EITI report, the discrepancy resulting from tax receipts not reported by government entities amount to 2504 million ZMK [US$ 500 000], or 0.0009 % of total reported revenues. The report states that 'the omissions [are] largely due to the fact that the Government agencies accounting and reporting systems have weaknesses and the reporting exercise does not seem to have been taken diligently in a small number of cases, resulting in the templates having been prepared hastily' (EITI report, p.30). ZEC is satisfied that all government entities have comprehensively disclosed all material receipts.

Secretariat's Assessment

The EITI International Secretariat is satisfied that the remedial action requested by the Board has been completed.

4 Conclusion

The Board decision stipulated that five remedial actions should be completed in order for Zambia to achieve Compliance. Subject to any further information from Zambia's MSG, the International Secretariat is satisfied that the remedial actions have been satisfactorily completed and that the outstanding requirements are met.

Annex A - Board decision on Zambia, Board Circular 107, 24 July 2011

The Board concludes that Zambia has made meaningful progress in implementing the EITI. The Board agreed that Zambia would retain is status as a Candidate country, subject to a clearly defined and agreed work plan for achieving Compliant status, including a schedule for its next Validation.

The Board congratulates the government, companies and civil society organisations in Zambia for the progress made in implementing the EITI. It especially notes the production of the first Zambia EITI Report in March 2011, and the subsequent publication of an accessible summary report. The Board also wishes to congratulate the validator and all stakeholders involved in the validation process on a clear and validation comprehensive report.

The validator found that Zambia has not met a number of the validation indicators, particularly related to the scoping of the process.

In all decisions on Validation the Board places a priority on the need for comparable treatment between countries and the need to protect the integrity of the EITI brand. The Board reviewed the validator's report in detail. On several issues, the Board shares the validator's concerns. However, the Board also disagreed with some of the validator's assessments. The Board agreed that indicators 9, 11, 13, 14, and 15 are unmet, and agreed the following corrective actions needed in order for Zambia to achieve compliance:

1. *The MSG should undertake an improved scoping and clarification of the receipts/payments to be included in future EITI reconciliations including a clear definition of "material payments and revenues" and incorporate this definition into the reporting templates for the second EITI Report (indicator 9). This should specifically address the question of the reporting of oil and gas signature bonuses, and the reporting procedures for ZCCM-IH;*

2. *The second EITI Report should clearly demonstrate that all entities that make or receive material payments are participating in the reporting process (requirement 11).*

3. *As per the Indicator Assessment Tool for Indicator 13, the government and MSG should take steps to ensure that government disclosures to the reconciler are based on audited accounts to international standards and agree a strategy for addressing these issues in accordance with the requirements as specified in Validation IAT 13.*

4. *In accordance with the agreed definition of materiality (see point 1, above), the MSG should ensure that all material oil, gas and mining payments by companies to government are disclosed to the reconciler and incorporated into the second EITI Report (indictor 14);*

5. *In accordance with the agreed definition of materiality (see point 1, above), the MSG should ensure that all material oil, gas and mining revenues received by the government are disclosed to the reconciler and incorporated into the second EITI Report (indictor 15);*

The Board recommends that:

1. *the MSG should agree a comprehensive (time-bound and costed) work plan that: (1) covers the publication and dissemination of the second EITI report and steps toward regular and timely EITI reporting thereafter; (2).addresses on the recommendations from the first reconciliation report and from the validator; and (3) addresses the corrective actions highlighted above;.*

2. *a review of the governance arrangements of the ZEC to ensure its smooth on-going functioning is undertaken; and*

3. *the procurement procedures and ZEC oversight should be strengthened for future reporting cycles*

In accordance with the transition procedures, the Board agreed that Zambia will have its candidacy renewed for 18 months (i.e. until 15 February 2013) by the end of which it must have completed a Validation that demonstrates compliance with the 2011 edition of the EITI rules. If Zambia does not achieve compliant status by this deadline it will *be de-listed.*

The MSG may request a waiver from the requirement to undergo a second Validation on the grounds that the remedial actions necessary for achieving compliance are not complex and can be undertaken quickly. It will be within the discretion of the Board to determine whether to grant the waiver request. If the waiver request is made in 2011 and subsequently granted, the secretariat review will be conducted in accordance with the old rules regardless of the date of the Board decision.

Annex B – Letter from the Chair of the Zambia EITI Council requesting Secretariat Review, 13 April 2012

Available from http://eiti.org/internal

Annex C –Board decision on Zambia's Validation waiver request, Board Circular 123, 6 May 2012, including Terms of reference for the Secretariat Review

Available from http://eiti.org/internal