

Extractive Industries Transparency Initiative (EITI)

Validation of Mongolia

Draft assessment by the EITI International Secretariat

9 February 2018

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1. Summary

Mongolia's second Validation commenced on 11 January 2018. The EITI International Secretariat has assessed the progress made in addressing the eight corrective actions established by the EITI Board following Mongolia's first Validation in 2016¹. The eight corrective actions relate to:

1. Oversight by the multi-stakeholder group (Requirement 1.4.b.vi & 1.4.b.iii);
2. The disclosure of license allocation (requirement 2.2) and the register of licenses (requirement 2.3)
3. State participation (requirement 2.6) and quasi-fiscal expenditures (requirement 6.2);
4. Transactions related to state-owned enterprises (requirement 4.5);
5. Data quality and assurance (requirement 4.5);
6. Subnational transfers (requirement 5.2);
7. Social expenditures by extractive companies (requirement 6.1); and
8. The review the outcomes and impact of EITI implementation (requirement 7.4).

The Secretariat's assessment is that Mongolia has addressed all of the corrective actions and has made "satisfactory progress" on the corresponding requirements. The draft assessment was sent to the Multi-Stakeholder Working Group (MSWG) on 22 January 2018. Following comments from the MSWG received on 9 February that concurred with the draft assessment, the assessment was thus finalised for consideration by the EITI Board.

2. Background

Mongolia was accepted as an EITI Candidate in September 2007 and was designated as compliant with the EITI Rules in October 2010. The first Validation of Mongolia against the EITI Standard commenced on 1 July 2016. On 11 January 2017, the EITI Board found that Mongolia had made meaningful progress in implementing the 2016 EITI Standard. Eight corrective actions were identified by the Board, pertaining to the following requirements: MSG governance (#1.4), license allocations (#2.2), license registers (#2.3),

¹ <https://eiti.org/validation/mongolia/2016>

state participation (#2.6), including SOE transactions (#4.5) and quasi-fiscal expenditures (#6.2), data quality (#4.9), subnational transfers (#5.2), social expenditures (#6.1) and documentation of impact (#7.4). The Board asked Mongolia to address these corrective actions to be assessed in a second Validation commencing on 11 January 2018.

Mongolia has undertaken a number of activities to address the corrective actions:

- At its 23 February 2017 meeting, the MSWG agreed a plan of action for addressing corrective actions from Mongolia's 2016 Validation.
- On 16 June 2017, the MSWG agreed the scope of the 2016 EITI Report with the Independent Administrator, KPMG (Mongolia and France).
- On 6 September 2017, the MSWG held a one-day workshop on assessing progress in addressing corrective actions from the 2016 Validation, updating the plan of action for addressing the outstanding correction actions.
- At its 15 November 2017 meeting, the MSWG agreed revised its revised Terms of Reference (ToR) in light of corrective actions related to Requirement 1.4.
- On 31 December 2017, Mongolia published its 2016 EITI Report, the 2017 annual progress report and an EITI work plan for 2018.
- On 3 January 2018, the PWYP and industry constituencies published their MSWG nominations procedures on the EITI Mongolia website.

The following section addresses progress on each of the corrective actions. The assessment is limited to the corrective actions established by the Board and the associated requirements in the EITI Standard. The assessment follows the guidance outlined in the Validation Guide². In the course of undertaking this assessment, the International Secretariat has also considered whether there is a need to review additional requirements, i.e. those assessed as "satisfactory progress" or "beyond" in the 2016 Validation. While these requirements have not been comprehensively assessed, in the Secretariat's view there is no evidence to suggest progress has fallen below the required standard and no additional issues that warrant consideration by the EITI Board.

3. Review of corrective actions

The Secretariat's assessment below discusses whether the corrective actions have been sufficiently addressed. The assessments are based on minutes of the MSWG meetings from January to December 2017, the 2015 and 2016 EITI Reports, the 2017 annual progress report and the 2018 work plan, various documents submitted by the MSG to the secretariat, e-mail correspondences, and stakeholder consultations (in-person and via skype).

3.1 Corrective action 1

In accordance with requirement 1.4.b.vi, the MSWG should ensure that there is an inclusive decision-making process throughout implementation, with each constituency being treated as a partner. The MSWG should agree and publish its procedures for nominating and changing multi-stakeholder group representatives. In accordance with requirement 1.4.b.iii, members of the MSWG should ensure that they liaise with their constituency groups.

² https://eiti.org/sites/default/files/documents/validation-guide_0.pdf

Findings from the first Validation

The first Validation concluded that Mongolia had made meaningful progress in meeting this requirement. The MSWG had been formed and included self-appointed representatives from each stakeholder group with no suggestion of interference or coercion. However, Validation assessed that, while the ToR for the MSWG addressed the requirements of the EITI Standard, stakeholders had highlighted certain deviations in practice, particularly related to voting. Certain MSWG decisions appeared to be passed despite objections of one of the stakeholder groups, for instance in relation to data quality assurance procedures. Attendance of MSWG members was also inconsistent, with delegation of attendance to different representatives being common. Validation found that the lack of publicly-codified MSWG nominations procedures and evidence of constituency coordination weakened the representativeness of MSWG discussions. The Validation considered that these weaknesses had affected EITI implementation and contributed to inconsistent multi-stakeholder oversight of the technical aspects of EITI reporting, in particular with respect to data quality.

Progress since Validation

The MSWG and National Council have taken several steps to address deficiencies related to effective multi-stakeholder oversight of EITI implementation identified during Mongolia's first Validation. At its meeting on 15 November 2017, the MSWG adopted revisions to its ToR that clarified roles and responsibilities as well as internal governance rules.³ Each of the three constituencies on the MSWG codified the nominations procedures for appointing their representatives to the MSWG and National Council. The MSWG's revised ToR (in November 2017) codified the government's nominations procedures, confirming the Prime Minister's responsibility for appointing and replacing government MSWG members (Article 8.1). The two other sets of constituency MSWG member nominations procedures (from industry and civil society) were published on the EITI Mongolia website on 3 January 2018.⁴ None of the constituencies represented on the MSWG have expressed concerns over their level of EITI representation since the Board's decision on Mongolia's first Validation in January 2018.

The November 2017 revisions to the MSWG's ToR provide more detailed descriptions of MSWG members' roles and responsibilities, including the requirement to attend meetings and engage in MSWG discussions and decisions (Article 15). The revised ToR also changed the rules for quorum at MSWG meetings. In practice, attendance at MSWG meetings appears to have improved across the three meetings in 2017, with quorum under the November 2012 rules reached at the first two meetings of 2017 and under the revised November 2017 rules at the November 2017 meeting (see MSWG meeting attendance on the EITI Mongolia website⁵).

The November 2017 revisions to the MSWG's ToR refined the rules governing the MSWG's decision-making process. The revised ToR explicitly recognises each constituency as equal and describes the principle of consensus for MSWG decisions. The ToR describes procedures in case of "misunderstandings" in the decision-making process, involving consultations led by an ad hoc working group (Article 41), leading to a vote by two-thirds majority (Article 42). The revised ToR also explicitly require members to implement the MSWG's decisions (Article 45).

³ See EITI Mongolia (November 2017), 'Terms of Reference of the MSWG committed to implement EITI', accessed [here](#) in January 2018.

⁴ See EITI Mongolia (January 2018), 'Constituency nominations procedures for MSWG members', accessed [here](#) in January 2018.

⁵ EITI Mongolia (December 2017), 'Attendance at MSWG meetings, 2014-2017', accessed [here](#) in January 2018.

In practice, the MSWG's gradually strengthening oversight of the technical aspects of EITI reporting is evident in improvements in the 2016 EITI Report and the conclusion of an agreement with the Auditor General (MNAO) for certification of government EITI reporting reflect the MSWG's increasingly robust oversight of EITI reporting. There has also been evidence of greater coordination within each of the three constituencies on key decisions related to the scope of the 2016 EITI Report, including on the selection of license allocations and transfers to be investigated as well as on quality assurance procedures.

Secretariat's Assessment

The Secretariat is satisfied that the corrective action on multi-stakeholder oversight has been addressed, and considers that Mongolia has achieved satisfactory progress on requirement 1.4. Each constituency publicly codified its MSWG membership nominations procedures in January 2018. The lack of safeguards in the MSWG's decision-making has been resolved through revisions to the MSWG's ToR in November 2017. Attendance at MSWG meetings has improved over 2017 and the MSWG ensured strong quorum rules in its revised ToR. There is also evidence of growing constituency coordination on key issues related to the scope of the 2016 EITI Report, ahead of MSWG meetings.

3.2 Corrective action 2

In accordance with requirement 2.2.a, the government should ensure annual disclosure of which mining, oil, and gas licenses were awarded and transferred during the year, highlighting any non-trivial deviations from the applicable legal and regulatory framework governing license awards and transfers.

In accordance with requirement 2.3, the government should also ensure that the dates of application for all oil, gas and mining licenses are publicly available and that the coordinates for oil and gas PSAs are published.

Findings from the first Validation

The first Validation concluded that Mongolia had made meaningful progress in meeting requirement 2.2. It was noted that, while the 2014 EITI Report provided some useful information on license awards and transfers, the exact numbers of licenses that were allocated or transferred in the year under review remained unclear. The Validation also found that the report had failed to disclose whether there were any deviations from the license allocation procedures.

It was also concluded that Mongolia had made meaningful progress in meeting requirement 2.3. It was noted that, while most aspects of requirement 2.3 were addressed in the 2014 EITI Report and were publicly available through the MRAM cadastre and the eReporting system, information on dates of application were not available for mining licenses. In the oil and gas sector, there was no information on dates of application, commodities produced and license coordinates.

Progress since Validation

With regards to the corrective action related to requirement 2.2, the 2016 EITI Report provides detailed information on license awards and transfers in 2016 and assesses the existence of non-trivial deviations from statutory procedures.

For **mining**, the 2016 EITI Report confirms the number of licenses awarded and transferred in 2016. It states that 716 licenses (623 exploration and 93 production) were awarded and that 148 licenses (52

exploration and 96 production) were transferred in the year under review (pp.87,89⁶). Details of mining license awards and transfers, including recipients' names, are provided in Appendices 17.a-18.b (a/pp.74-83⁷) and Appendix 19 (a/pp.87-89) respectively.

In terms of non-trivial deviations in the award and transfer of mining licenses in 2016, the IA agreed a risk-based approach with the MSG. The IA checked the supporting documents in license awards and transfers in a total of 52 cases (out of 864 awards and transfers, i.e. 6% of the total). The MSG had requested the inclusion of six license awards⁸ and two transfers⁹ considered "risky", while the IA randomly selected an additional 44 licenses (17 awards, 17 transfers and 10 awards through bidding) (p.86). The detailed findings of the assessment of non-trivial deviations are provided in Appendix 15 (a/pp.39-45), detailing discrepancies in 11 license awards and six transfers (p.86). The EITI Report includes reference to Transparency International's "Mining for Sustainable Development" study¹⁰ to assess the corruption risk in the mining licence awarding process (p.86).

For **oil and gas**, the report clarifies that two oil and gas PSAs were awarded through competitive bidding and one PSA was transferred in 2016 (p.95). A description of non-trivial deviations in statutory procedures is provided for both PSAs awarded and the PSA transferred in 2016 (pp.95-96). The list of unsuccessful bidders for the two PSAs awarded through bidding is provided (p.95). Appendices 21.c-d provide more information on the two awards and one transfer (a/pp.103-104).

In terms of the corrective action related to requirement 2.3, the 2016 EITI Report provides guidance on how to access all information on all active licenses mandated under requirement 2.3.b. Based on the review of the EITI Report and the online MRPAM cadastre, dates of application have been disclosed for 251 of the 661 mining licenses and eight of the 11 PSAs held by material companies (Appendices 20 (a/pp.90-93) and 21.a (a/p.94) respectively). The report is transparent about challenges in securing dates of application for all licenses and PSAs. It notes that electronic records of application dates were not maintained under the first-come-first-served system prior to 2010, and that MRPAM and the IA has carried out extra work to try to secure this data. The report estimates that the 259 mining, oil and gas licenses for which dates of application were secured (and published) accounted for 98.8% of extractives revenues in 2016 (p.91). The 2018 EITI work plan includes activities related to securing dates of application for all active mining, oil and gas licenses "in a timely manner" (Activities 1.1 and 1.2).¹¹

With regards to coordinates for oil and gas PSAs, the EITI Mongolia Data Portal discloses coordinates¹², and these are also included in appendix 21 of the 2016 EITI Report (a/pp.95-102).

Secretariat's Assessment

The Secretariat is satisfied that the corrective action on transparency in license allocation and transfer practices has been addressed, and considers that Mongolia has achieved satisfactory progress on

⁶ References to page numbers in the full text relate to EITI Mongolia (31 December 2017), 'Mongolia 2016 EITI Report', accessed [here](#) in January 2018.

⁷ References to appendix page numbers (a/pp.) in the full text relate to EITI Mongolia (31 December 2017), 'Appendixes to the Mongolia 2016 EITI Report', accessed [here](#) in January 2018.

⁸ XV-016319, XV-020580, XV-19691, XV-20704, MV-020875, MV-020877.

⁹ MV-009515, MV-020419.

¹⁰ Transparency International (June 2017), 'Mining for Sustainable Development: Corruption Risk Assessment in the mining license award system in Mongolia', accessed [here](#) in January 2018.

¹¹ See EITI Mongolia (January 2018), 'EITI Mongolia 2018 work plan', accessed [here](#) in January 2018.

¹² <http://www.eitimongolia.mn/mn/node/4922>

requirement 2.2. The 2016 EITI Report discloses which mining, oil, and gas licenses were awarded and transferred during the year, highlighting any non-trivial deviations from the applicable legal and regulatory framework governing license awards and transfers. The Secretariat considers that the extensive work on assessing deviations in practice constitutes a good example of increasing awareness of how criteria are assessed during the allocation process. The MSWG's input to the selection of license awards and transfers to investigate is particularly welcome, although the lack of recommendations on the basis of non-trivial deviations identified in practice is a concern.

The Secretariat is also satisfied that the corrective action on transparency in the license register(s) has been addressed, and considers that Mongolia has achieved satisfactory progress on requirement 2.3. The 2016 EITI Report provides guidance on accessing license coordinates in the oil and gas sector. While the MSWG has only been able to secure dates of application for 251 of the 661 mining licenses and eight of the 11 PSAs held by material companies in the 2016 EITI Report, it has made efforts to secure missing dates of application and has been transparent about the obstacles hindering the comprehensive disclosure of dates of application for licenses awarded under the previous system. The MSWG has also included activities in its 2018 work plan to secure dates of application for all active mining, oil and gas licenses. Requirement 2.3 states *"It is expected that the license register or cadastre includes information about licenses held by all entities, including companies and individuals or groups that are not included in the EITI Report, i.e. where their payments fall below the agreed materiality threshold. Any significant legal or practical barriers preventing such comprehensive disclosure should be documented and explained in the EITI Report, including an account of government plans for seeking to overcome such barriers and the anticipated timescale for achieving them"*. The MSWG's relatively low materiality threshold for selecting companies provides context for the large number of active licenses held by material companies.

3.3 Corrective action 3

In accordance with requirement 2.6, the MSWG should provide an explanation of the prevailing rules and practices related to SOEs' retained earnings and reinvestment. The government should also ensure annual disclosure of any changes in government ownership in SOEs or their subsidiaries, and provide a comprehensive account of any loans or loan guarantees extended by the state or SOEs to mining, oil, and gas companies.

In accordance with requirement 6.2, the MSWG should consider the existence and materiality of any quasi-fiscal expenditures undertaken by SOEs and subsidiaries in the extractive industries, including subsidies, and ensure that any material quasi-fiscal expenditures are disclosed.

Findings from the first Validation

The first Validation concluded that Mongolia had made inadequate progress in meeting requirement 2.6. It was noted that the 2014 EITI Report listed 21 extractives companies in which the state holds majority equity, but provided limited detail on the rules and practices governing financial transfers between government and SOEs, including loans and loan guarantees. The rules and practices related to SOEs' retained earnings and reinvestment were not described and the report did not clarify any changes in ownership of extractives SOEs or their subsidiaries in 2014.

The first Validation also concluded that Mongolia had made inadequate progress in meeting requirement 6.2. It was noted that the 2014 EITI Report only disclosed the quasi-fiscal expenditures of one SOE, and that the comprehensiveness of assessments of quasi-fiscal expenditures was unclear. The Validation also highlighted confusion about the classification of "payments to subnational governments" by SOEs and

that the MSWG did not appear to have considered whether quasi-fiscal expenditures existed, despite widespread knowledge of subsidized state-owned coal sales to power plants.

Progress since Validation

With regards to requirement 2.6, the 2016 EITI Report describes the MSWG's more systematic approach to defining the scope of nine state-owned enterprises (SOEs) making material payments to government in 2016, and detailing their statutory financial relations with the state, as well as non-trivial deviations therefrom.

Materiality: The report lists the 19 companies that meet the MSWG's definition of SOE¹³ and justifies its selection of the nine SOEs making material payments to government in 2016 (p.113). Four companies¹⁴ categorised as "SOEs" in previous EITI Reports were excluded given that the government only holds a minority interest in them.

Financial relations: The report describes the statutory financial relations between SOEs and government¹⁵, explaining that the Board of Directors of each SOE has the discretion of deciding dividends policy but are able to secure loans or issue stock only upon written permission from the MoF (p.116). The report also describes SOEs' financial relations in practice in 2016, including the nine material SOEs' retained earnings, net profit/loss and dividends (pp.118-119), transactions specific to SOEs and quasi-fiscal expenditures (pp.122-125). The report also describes a March 2016 coal-purchase concession agreement between Baganuur JSC and Baganuur Power LLC (operating the power plant) as a third-party financing deal under the government's "Baganuur Power Plan" (p.119).

Ownership: The report provides brief histories of 15 SOEs¹⁶, including the level of state ownership (pp.113-116), and notes the existence of a further 7 SOEs¹⁷ that did not make payments to government in 2016 (p.116). The creation of three new subsidiaries¹⁸ by Erdenes Mongol LLC in 2016 is highlighted (pp.114,120). It also notes that, while the Government of Mongolia's 51% interest in Erdenet Mining Corporation did not change in 2016, the Russian state-owned Rostekhnologii Corporation sold its 49% stake to Mongolian Copper Corporation LLC in June 2016 (p.120).

Loans and guarantees: The report discloses the government (through Development Bank of Mongolia) and four SOEs' loans and loan guarantees to extractives companies (pp.120-121). Details include type of agreement, start date and loan period, amount, involved parties, description and comments where applicable.

With regards to requirement 6.2, there is evidence in the 2016 EITI Report of the MSWG's work on defining quasi-fiscal expenditures for the purposes of EITI reporting, clearly distinguishing them from other transactions involving SOEs (p.122). The MSWG agreed a MNT 100m threshold for disclosing quasi-

¹³ Majority-owned and engaged in the extractive industries, in accordance with Requirement 2.6.a.

¹⁴ Oyu Tolgoi, Gurvansaikhan, Ulaanbaatar Tumor Zavod and Andiin Elch.

¹⁵ Regulated under the Law on State and Local Property of Mongolia (LSLP) and various implementing regulations (e.g. State Ownership Implementing Procedure).

¹⁶ Erdenes Mongol LLC, Erdenes Tavan Tolgoi, Erdenes Oyu Tolgoi, Shivee Ovoo, Baganuur JSC, Tavan Tolgoi JSC, Mon Atom LLC, Gashuun Sukhait LLC, Erdenes Methane LLC, Erdenes Shivee Energy LLC, Erdenet Mining Corp., Mongolrostsvetmet LLC, Mogoin Gol JSC, Bayanteeg JSC, Darkhan metallurgical plant JSC.

¹⁷ Khorikh 443-r angi, SHTN, Avdrant Khairkhan, Bulgan aimag's Khorikh 439-r angi, Uul uurkhain avrakh angi, Khentii aimagiin shuuhiiin shiidver biyluuleh alba, and Shuuhiiin shiidver guitsetgeh alba.

¹⁸ 100% stakes in Erdenes Asset Management LLC and Erdenes Methane LLC, and 50% in Erdenes Shivee Energy LLC.

fiscal expenditures given past experience (in 2013-15) in company reporting of donations that could be categorized as quasi-fiscal (p.123). Three SOEs¹⁹ reported quasi-fiscal activities, including Baganuur's sales of thermal coal to power plants at prices subsidized by its own budget, while six responded that they did not undertake such activities (pp.123-125). The information on quasi-fiscal expenditures in the 2016 EITI Report is sourced from SOE's own EITI reporting and available audited financial statements.

Secretariat's Assessment

The Secretariat is satisfied that the corrective action on transparency in extractives state-owned enterprises has been addressed, and considers that Mongolia has made satisfactory progress against requirement 2.6. The 2016 EITI Report clearly defines a set of nine SOEs making material payments to government and describes their statutory financial relations with the state, including loans and guarantees, as well as non-trivial deviations in the year under review. The MSWG is encouraged to explore closer cooperation with Erdenes Mongol and technical assistance providers like the International Monetary Fund (IMF), International Finance Corporation (IFC) and Asian Development Bank (ADB) with a view to systematically disclosing information under Requirement 2.6 (such as SOEs' audited financial statements) through routine government systems.

The Secretariat is also satisfied that the corrective action on transparency in quasi-fiscal expenditures has been addressed, and considers that Mongolia has made satisfactory progress on requirement 6.2. The 2016 EITI Report describes the MSWG's definition of quasi-fiscal expenditures (consistent with the EITI Standard's), its assessment of their materiality and reporting of SOEs' unilateral disclosures of material quasi-fiscal expenditures in 2016. To strengthen implementation, the MSWG may wish to undertake a more extensive scoping of quasi-fiscal expenditures, with a view to embedding their regular disclosure through government systems such as the MoF website or EITI Mongolia Data Portal.

3.4 Corrective action 4

In accordance with requirement 4.5, the MSWG must ensure that the reporting process assesses the materiality and comprehensively discloses material payments to subnational government entities.

Findings from the first Validation

The first Validation concluded that Mongolia had made meaningful progress in meeting this requirement. It was noted that the MSWG had considered the transactions between SOEs and government and disclosed dividends from the 21 SOEs operating in the extractive industries. However, Validation found that, while the 2014 EITI Report included payments by SOE's to subnational governments, there was confusion between "subnational direct payments" and "subnational transfers".

Progress since Validation

In terms of *extractives company payments to SOEs*, the 2016 EITI Report presents private companies' payments to four SOEs for their purchase of coal and electricity (p.122), although these represent commercial payments for goods rather than payments for taxes or fees specific to SOEs.

In terms of *SOE payments to government*, the report clearly distinguishes between transactions specific to SOEs (dividends), statutory payments common to all companies, fiscal payments recorded in the national budget, quasi-fiscal expenditures and direct subnational payments (pp.122-124). Six of the nine material

¹⁹ Baganuur, Shivee-Ovoo and Erdenes Mongol.

SOEs reported some type of ad hoc intra-SOE or government transaction, including loan repayments, management costs and penalties (p.122). The report provides the value of dividends reported paid by four of the nine material SOEs (pp.118-119), but notes that that SOE dividends were below the materiality threshold for selecting revenue streams and thus not reconciled (p.119). The report presents details of direct subnational payments by SOEs (p.126) and quasi-fiscal expenditures (pp.123-125).

In terms of *transactions from government to SOEs*, the 2016 EITI Report provides the value of loans from the national government to three SOEs in 2016 (pp.120-121) and states that all transfers from government to SOEs are recorded in the national budget execution report (p.122). While the 2016 EITI Report does not provide a link to the 2016 budget execution report, this information is publicly-accessible on the Glass Accounts website.²⁰

Secretariat's Assessment

The Secretariat is satisfied that the corrective action on transparency in transactions related to state-owned enterprises has been addressed, and considers that Mongolia has made satisfactory progress on requirement 4.5. The 2016 EITI Report clearly distinguishes SOE-specific transactions from other types of payments from SOEs (e.g. common taxes). Dividends from SOEs were below the MSWG's materiality threshold for selecting revenue streams and were thus unilaterally disclosed. To further strengthen implementation, the MSWG is encouraged to explore means of embedding systematic disclosure of SOE-specific transactions through routine government systems or the EITI Mongolia Data Portal.

3.5 Corrective action 5

In accordance with requirement 4.9.b.iii and the standard Terms of Reference for the Independent Administrator agreed by the EITI Board, the MSWG and Independent Administrator should:

- a. examine the audit and assurance procedures in companies and government entities participating in the EITI reporting process, and based on this examination, agree what information participating companies and government entities are required to provide to the Independent Administrator in order to assure the credibility of the data in accordance with Requirement 4.9. The Independent Administrator should exercise judgement and apply appropriate international professional standards in developing a procedure that provide a sufficient basis for a comprehensive and reliable EITI Report. The Independent Administrator should employ his /her professional judgement to determine the extent to which reliance can be placed on the existing controls and audit frameworks of the companies and governments. The Independent Administrator's inception report should document the options considered and the rationale for the assurances to be provided.
- b. ensure that the Independent Administrator provides an assessment of comprehensiveness and reliability of the (financial) data presented, including an informative summary of the work performed by the Independent Administrator and the limitations of the assessment provided.
- c. ensure that the Independent Administrator provides an assessment of whether all companies and government entities within the agreed scope of the EITI reporting process provided the requested information. Any gaps or weaknesses in reporting to the Independent Administrator must be disclosed in the EITI Report, including naming any entities that failed to comply with the agreed procedures, and an assessment of whether this is likely to have had material impact on the comprehensiveness of the report.

Findings from the first Validation

²⁰ See Glass Accounts Website, 2016 national budget execution, accessed [here](#) in January 2018.

The first Validation concluded that Mongolia had made meaningful progress in meeting this requirement. It was noted that the MSG had never undertaken a review of auditing practices prior to agreeing quality assurance procedures. Validation found that issues of data quality assurance (for both companies and government) were significant in 2014 EITI Report. While the eReporting system used for the 2014 EITI Report had addressed concerns over the confidentiality of EITI financial information pre-reconciliation, it did not appear to have resolved data quality assurance challenges. It was noted that the 2014 EITI Report provided overview of quality assurances, although the materiality of omissions by reporting companies and government entities was not assessed.

Progress since Validation

The 2016 EITI Report marks a more measured approach agreed by the MSG for providing quality assurance for the reconciled data. According to EITI Mongolia documents including meeting minutes, the MSG endorsed the selection of the IA based on ToR in line with the Board-approved template.

Audit practices: The report describes the statutory rules for audit and assurance in the public and private sectors, and highlights deviations from international standards. It describes 2015 revisions to the 1997 Audit Law of Mongolia, which removed audit requirements for some companies (pp.62-63), and describes the Auditor General (MNAO)'s budget planning and performance (not revenue audits) reports in detail, with links to 2016 reports provided (pp.107,111). The report also notes that SOEs tend to have two sets of audited financial statements – one more detailed by independent external auditors and another more general by MNAO. Six of the nine material SOEs provided copies of their MNAO reports for 2016 (pp.118,121). The report notes that 146 of the 213 material companies in 2016 provided copies of their 2016 audited financial statements and 97% of reporting companies sent unqualified audit opinions (pp.45-46). Appendix 12 lists the audit opinions on the 213 material companies (a/pp.28-31).

Assurance methodology: The report notes that the IA focused on stronger quality assurances from companies than for government entities as a means of improving the reliability of reconciled data (p.33). The quality assurances required from companies and government entities included the disaggregation of reported payments/revenues by transaction, an attestation letter from senior company management or senior government entity representative (or Minister) and, where available, copies of companies' audited financial statements and audit reports (pp.16-17,27,30,41,45,46). The 2016 inception report clearly describes the different options considered and the rationale for the quality assurances agreed for reporting.²¹ The 2016 EITI Report clearly describes the process for ensuring the reliability of the data, assesses the materiality of non-complying companies' payments and their impact on the overall reliability of the reconciliation (pp.21-22,27-32). In total, some 24 of the 213 companies did not provide any assurances for their reporting (p.17). These 24 companies accounted for a combined 0.5% of government-reported extractives revenues according to the report (p.31). The report describes the general reasons for companies' failure to provide the required quality assurances, including liquidation of certain companies and a lack of understanding of requirements from others (pp.44-45). The IA's extensive follow-up with non-complying companies (through calls and emails) is briefly described (pp.44-45). Appendices 4-5 provides the results of material companies and government entities' reporting (a/pp.5-8), which show that 166 companies provided unmodified representation letters (pp.45-46). Overall, the report notes significant improvements in the reliability of data reported across the 2014, 2015 and 2016 EITI Reports, with 57% of revenues having medium/low assurance and 42% high assurance in the 2016 EITI Report (pp.31-32).

As in previous EITI Reports, the MSG approved procurement of the IA, who undertook its assignment in line with ISRS 4400 and its MSG-approved ToR (p.8). The MSG's agreement to assurance procedures is

²¹ See EITI Mongolia (June 2017), '2016 EITI inception report', unpublished, provided by the EITI Mongolia Secretariat, pp.22-30.

explicitly noted (p.27). The report also notes the MSWG's efforts to pilot certification of government EITI reporting by MNAO in 2018 (p.148), although it does not offer the IA's professional opinion of the proposed MNAO procedures.

Reliability assessment: The report provides assurances on the reconciled data based on company assurances primarily, with only 0.94% of reconciled data having "low" assurances, and considers the comprehensiveness and reliability of reconciled data to be "satisfactory" (pp.10, 33).

Secretariat's Assessment

The Secretariat is satisfied that the corrective action on reliability of the reconciled data in EITI reporting has been addressed, and considers that Mongolia has achieved satisfactory progress on requirement 4.9. The 2016 EITI Report provides a detailed description of the approach to ensuring the reliability of reconciled data, including review of audit and assurance procedures and practices, a description of the assurance procedures and an assessment of the materiality of non-complying entities. The report includes a clear statement by the IA of the comprehensiveness and reliability of the reconciled data.

3.6 Corrective action 6

In accordance with requirement 5.2.a, the MSWG should clarify the distinction between SOEs' direct subnational payments and subnational transfers prior to data collection. The MSWG should ensure that the EITI Report includes the revenue sharing formula used to calculate transfers to individual aimags and soums, and that it discloses any discrepancies between budgeted and executed subnational transfers.

Findings from the first Validation

The first Validation concluded that Mongolia had made meaningful progress in meeting this requirement. It was noted that the general formula for calculating subnational transfers was disclosed in the 2014 EITI Report, although the formula for calculating transfers to individual aimags and soums was not provided. Validation found that discrepancies between actual and calculated transfers were not disclosed.

Progress since Validation

The 2016 EITI Report describes two types of subnational transfers of mining/petroleum royalties and license revenues: the General Local Development Fund (GLDF) and the Local Development Funds (LDF) (pp.100-105). The first type of transfers consists of allocations to the GLDF, which are then transferred to respective LDFs, while the second type of transfers consists of direct transfers from the national budget (Ministry of Finance) to LDFs (p.100). The GLDF receives 10% of total VAT on goods and services (excluding imports), 5% of mining royalties and 30% of petroleum royalties (p.100). In addition, 30% of "mega project revenues" and 50% of mineral resource exploration and production license fees (p.100). The report clearly states that GLDF and LDF transfers are made from the national government to aimags, who then in turn remit each of their constituent soums' shares (p.100). There is evidence that the MSWG has drawn a clear distinction between direct subnational payments, subnational transfers, social expenditures and quasi-fiscal expenditures paid by SOEs (pp.122-126).

The GLDF is a major source of funding for the 21 provinces (aimags), which maintain their own LDFs as corresponding local development funds. The report explains that all GLDF transfers and direct transfers to LDFs are first made to aimag-level LDFs, which then remit each soum's share (p.100). The general formula

for calculating the GLDF's funding²² and the general formula for LDFs' funding²³ are provided (p.100). The value of planned GLDF and LDF income according to the formula and the value of actual GLDF and LDF transfers is included, in aggregate for GLDF and LDF income (p.100). Discrepancies are identified, insofar as the value of actual collected revenues was higher than planned according to the formula in 2016 (p.100).

The report also provides the detailed formula for calculating transfers from the GLDF to individual aimags²⁴ and the government sources for each of the four formula variables (p.102).²⁵ It is clearly stated that the MoF used the same revenue sharing formula for calculating planned transfers to the GLDF and planned transfers directly to the LDFs (p.104). The report provides the value of GLDF transfers to LDFs as well as direct transfers to LDFs, both planned according to the detailed formula and actually executed in 2016 (pp.101,103-104). Appendix 23.a provides the value of each aimag's LDF transfers to individual soums in 2016, reported by each of the 21 aimags (a/pp.109-111), while Appendix 23.b provides the values of planned and actually executed LDF transfers to individual soums, sourced from the MoF's LDF platform²⁶ with discrepancies identified (a/pp.112-116). A link to the MNAO's compliance audit report on 2016 GLDF transfers²⁷ is provided, alongside a brief summary of concerns raised (p.105).

Secretariat's Assessment

The Secretariat is satisfied that the corrective action on transparency in subnational transfers has been addressed, and considers that Mongolia has achieved satisfactory progress on requirement 5.2. The 2016 EITI Report provides the detailed formulas for calculating GLDF transfers to LDFs of aimags as well as direct royalty transfers by the Ministry of Finance to LDFs of aimags. The values of planned subnational transfers according to the formula and actual 2016 transfers are provided for both aimags, the direct recipients of subnational transfers, and for soums, who receive transfers from aimags. While the discrepancies between planned and realised transfers are only explained in general, the disaggregation of data by aimag and soum allows for traceability of extractives revenues at the subnational level.

3.7 Corrective action 7

In accordance with requirement 6.1.a, the MSWG should agree a clear distinction between mandatory and voluntary social expenditures prior to data collection. Where mandatory social expenditures are provided in-kind, the MSWG should ensure that the nature and deemed value of such in-kind transactions are disclosed. Where beneficiaries of mandatory social expenditures is a third party, i.e. not a government agency, the MSWG should ensure that the name and function of the beneficiary be disclosed.

²² The GLDF is funded by 10% of total VAT of goods and services except that of imported goods and services; 5% of the received mineral resource royalties; 30% of the oil resource royalties; Grants and donations rendered by domestic non-governmental organisations and official foreign aid to support local development; and Transfers from lower-level funds to upper-level funds.

²³ The LDFs are funded by 30% of mega project revenue and 50% of mineral resource exploration and production licence revenue.

²⁴ Calculations of GLDF transfers to LDFs are based on four variables, weighted 25% each: Local development index; Population; Population density, remoteness and size of territory; and Local tax initiative.

²⁵ The formula for calculating transfers from the GLDF to LDFs and directly to LDFs is based on four variables for each aimag LDF: local development index score; population; population density, remoteness and territory size; and local tax initiative index score. Each of these four variables changes on an annual basis. Data on each of the four variables is accessible from the Ministry of Finance, National Statistics Office, Mongolian Tax Authority and each aimag's respective Citizen's Representative Council. This is confirmed in the 2016 EITI Report, which provides both the formula and the value of each of the four variables for each of the 21 aimags (pp.102-103).

²⁶ A link is provided to the MoF's LDF tracking platform, accessed [here](#) in January 2018.

²⁷ MNAO (2017), 'Compliance audit report on 2016 GLDF transfers', accessed [here](#) in January 2018.

Findings from the first Validation

The first Validation concluded that Mongolia had made meaningful progress in meeting this requirement. Although the MSWG had considered social expenditures in detail and disclosed these in the 2013 and 2014 EITI Reports, Validation found that the distinction between mandatory and voluntary social expenditures seemed to have been made by reporting entities themselves. The comprehensiveness of disclosures of mandatory social expenditures was thus unclear. The nature and basis for reporting in-kind expenditures was not described and no details on the identity of non-governmental recipients were provided.

Progress since Validation

The 2016 EITI Report provides a clear distinction between mandatory and voluntary social expenditures, adopted prior to data collection and reflected in the inception report (p.136). The MSWG decided to disclose and reconcile mandatory social expenditures, defined as social expenditures required by law or contractual obligation, with a materiality threshold of zero (p.136). The report consistently draws a distinction between SOEs' direct subnational payments, subnational transfers, social expenditures and quasi-fiscal expenditures (pp.122-126). While certain SOEs reported infrastructure projects as barter and infrastructure provisions, the report categorizes them as social expenditures given the lack of counterparty resources pledged by the government (pp.134,135).

The report presents the results of reconciliation of mandatory social expenditures, with 15 companies accounting for 96% of mandatory social expenditures reconciled and only minor discrepancies (pp.136-139, a/pp.133-135). The details of reconciled mandatory social expenditures distinguish cash from in-kind expenditures, provides the nature and value of in-kind expenditures, and identifies the beneficiary soum and aimag (pp.136-139, a/pp.133-135). The identities of four non-government beneficiaries of mandatory social expenditures are provided (pp.138-139).

The MSWG also decided to include unilateral reporting of voluntary social expenditures by material companies, with a materiality threshold of MNT 5m for private companies (the same threshold as defined in the Glass Account Law on transparent government finances) and MNT 1m for SOEs, given the MSWG's interest in SOEs (p.136). The results of reporting on voluntary social expenditures by 26 companies are provided, disaggregated between cash and in-kind, the nature of payments and the identity of the beneficiary soum (p.139, a/p.136).

Secretariat's Assessment

The Secretariat is satisfied that the corrective action on transparency in social expenditures has been addressed, and considers that Mongolia has made "beyond" satisfactory progress with requirement 6.1. The 2016 EITI Report provides a clear differentiation between mandatory and voluntary social expenditures, distinguished from other types of payments such as quasi-fiscal expenditures by SOEs. The results of the MSWG's reconciliation of mandatory social expenditures are provided, disaggregated between cash and in-kind (with the nature and value of in-kind expenditures provided) and highlighting the identity of the few non-government beneficiaries. The MSWG has also included material voluntary social expenditures in the scope of unilateral reporting by companies, with the results provided in the 2016 EITI Report.

3.8 Corrective action 8

In accordance with requirements 7.4.a.iii and 7.4.a.iv and 7.4.b, the MSWG should, in preparing the next annual progress report, conduct an assessment of follow-up on EITI recommendations and impact of implementation based on consultations with a broad range of stakeholders.

Findings from the first Validation

The first Validation concluded that Mongolia had made meaningful progress in meeting this requirement. It was noted that the MSWG had produced annual progress reports documenting progress and outcomes of implementation, although not tracking its impact. It appeared that only one of the three stakeholder groups provided input to the 2015 annual activity report. Validation found that further work on assessing impact was needed and stakeholder engagement in developing the annual progress report should be strengthened.

Progress since Validation

The MSWG discussed a draft of the 2017 annual progress report at its 15 November 2017 meeting²⁸ and the National Council approved the final version for publication at its 21 December 2017 meeting.²⁹ The 2017 annual progress report and 2017 work plan implementation report were both published on the EITI Mongolia website³⁰ and the Mongolia country page of the EITI website³¹ on 2 January 2018. However, the EITI Mongolia Secretariat drafted the first version of the annual progress report and, while there is evidence that the secretariat conducted outreach to all three constituencies on the MSWG for input, there is only evidence of the government constituency providing input to drafting the annual progress report.³² During its workshop on Validation corrective actions on 6 September 2017, the MSWG agreed that each constituency would provide written input to drafting the 2017 annual progress report.³³ There is evidence that the EITI Mongolia Secretariat followed up with emails to the MSWG in October, soliciting input by 15 November 2017.³⁴ Based on consultations with the EITI Mongolia Secretariat, representatives of the two constituencies that did not provide input (industry and civil society) did not provide any explanation for their lack of input to drafting the annual progress report.

The 2017 annual progress report provides an overview of the MSWG's efforts to address recommendations from the 2016 Validation and the 2015 EITI Report (pp.14-15). The progress report includes an overview of the MSWG's assessment of weaknesses in Mongolia's EITI implementation and general proposals for strengthening implementation (p.16). The report provides a general overview of the types of impact of EITI implementation (pp.4-5), although the specific links to EITI implementation are at times vague. There is evidence that the MSWG has consistently discussed recommendations from the

²⁸ EITI Mongolia (November 2017), 'Minutes of the MSWG's 45th meeting, 15 November 2017', provided by the EITI Mongolia Secretariat in January 2018.

²⁹ EITI Mongolia (December 2017), 'Minutes of the National Council's 16th meeting, 21 December 2017', provided by the EITI Mongolia Secretariat in January 2018.

³⁰ See EITI Mongolia, Work plans and reports, accessed [here](#) in January 2018.

³¹ See EITI, EITI Mongolia 2017 annual progress report, accessed [here](#) in January 2018.

³² See for instance overview of government constituency's EITI-related activities, Attachment (p.21) of EITI Mongolia (January 2018), 'EITI Mongolia 2017 annual progress report', accessed [here](#) in January 2018.

³³ EITI Mongolia (September 2017), 'Agreed actions to follow up on Validation corrective actions', unpublished, provided by the EITI Mongolia Secretariat.

³⁴ EITI Mongolia (October 2017), 'Emails to the MSWG soliciting input to 2017 annual progress report', unpublished, provided by the EITI Mongolia Secretariat.

2015 EITI Report and the 2016 Validation at its three meetings in 2017.³⁵ As reflected in meeting minutes, the MSWG has also discussed the results and impact of some of its activities in 2017, most notably the subnational EITI pilots in five soums, with several civil society representatives voicing critical views about their perception of insufficient impact.³⁶

Secretariat's Assessment

The Secretariat is satisfied that the corrective action on the annual progress report has been completed, and considers that Mongolia has made satisfactory progress in meeting requirement 7.4. The 2017 annual progress report provides a summary of the MSWG's follow-up on past recommendations from Validation and EITI Reports, as well as a narrative account of efforts to strengthen implementation and general observations on the impact of EITI implementation. Although the lack of evidence of different MSWG constituencies' input to drafting the annual progress report is a concern, the Secretariat understands that stakeholders were given reasonable time and opportunities to contribute. Requirement 7.4.b states that "All stakeholders *should be able to* participate in the production of the annual progress report and reviewing the impact of EITI implementation" (emphasis added). The Secretariat understands that there was no attempt to restrict stakeholder's ability to contribute to reviewing the progress and impact of the EITI. Rather, stakeholders appear to have chosen not to contribute to the production of the report. The Secretariat recommends that the MSWG discusses how this process can be improved in the future.

4. Conclusion

Having reviewed the steps taken by Mongolia to address the eight corrective actions requested by the EITI Board, the Secretariat's assessment is that Mongolia has addressed all of the corrective actions and has made "satisfactory progress" on the corresponding requirements.

³⁵ EITI Mongolia (2017), Minutes from MSWG 43rd, 44th and 45th meetings on 23 February, 16 June and 15 November 2017, accessed [here](#) in January 2018.

³⁶ *Ibid.*