This note has been issued by the EITI International Secretariat to provide guidance to implementing countries on meeting the requirements in the EITI Standard. Readers are advised to refer to the EITI Standard directly, and to contact the International Secretariat to seek further clarification. Contact details can be found at www.eiti.org.

Defining materiality, reporting thresholds and reporting entities

Guidance note 13 - Requirement 4.1

1. Summary

A fundamental element of the EITI is the disclosure of payments and revenues from oil, gas and mining. All implementing countries are required to disclose information about how much extractive companies pay in taxes, royalties and other payments and how much the government agencies have received. This data has to be comprehensive, i.e. give the reader a complete picture of the total revenues received from natural resources. Experience with EITI implementation shows that many implementing countries have struggled to develop a systematic approach to defining "all material payments and revenues". In some cases, important revenue streams have been left out. In other cases, it has been difficult to determine whether all companies that make material payments disclosed their payments. This is a particular challenge in countries where a number of small companies make payments that are individually insignificant, but collectively significant.

The EITI Standard seeks to address this through requirement 4.1 on comprehensive reporting. This note provides guidance to multi-stakeholder groups (MSGs) on defining materiality based on four steps (1) develop a clear understanding of the revenue streams in the relevant extractive sectors; (2) establish which revenue streams are material, and whether payment thresholds are needed; (3) identify reporting entities; and (4) document the MSG's deliberations.

EITI Requirement 4.1 relates to the comprehensive disclosure of taxes and revenues and the need to agree which payments and revenues are material and therefore must be disclosed.

Requirement 4.1.a further specifies that "in advance of the reporting process, the multi-stakeholder group is required to agree which payments and revenues are material and therefore must be disclosed, including appropriate materiality definitions and thresholds. Payments and revenues are considered material if their omission or misstatement could significantly affect the comprehensiveness of the EITI Report. A description of each revenue stream, related materiality definitions and thresholds should be disclosed. In establishing materiality definitions and thresholds, the multi-stakeholder group should consider the size of the revenue streams relative to total revenues. The multi-stakeholder group should document the options considered and the rationale for establishing the definitions and thresholds.

Requirement 4.1.b lists the revenue streams that are typically found in the extractive sector and should be disclosed as part of the EITI process.

Requirement 4.1.c outlines the requirements related to identifying reporting entities: "Implementing countries must provide a comprehensive reconciliation of government revenues and company payments, including payments to and from state owned enterprises, in accordance with the agreed scope. All companies making material payments to the government are required to comprehensively disclose these payments in accordance with the agreed scope. An entity should only be exempted from reporting if it can be demonstrated that its payments and revenues are not material. All government entities receiving material revenues are required to comprehensively disclose these revenues in accordance with the agreed scope".

Requirement 4.1.d provides details on the need for full government disclosure: "Unless there are significant practical barriers, the government is additionally required to provide aggregate information about the amount of total revenues received from each of the benefit streams agreed in the scope of the EITI Report, including revenues that fall below agreed materiality thresholds. Where this data is not available, the Independent Administrator should draw on any relevant data and estimates from other sources in order to provide a comprehensive account of the total government revenues".

Source: EITI Standard, p. 23-24.

2. Guidance

The EITI International Secretariat recommends a series of steps for MSGs to address materiality:

Step 1 - Develop a clear understanding of the revenue streams in the extractive sector

The MSG is advised to review and gain an understanding of what taxes, fees and other payments extractive companies are required to make to the government. Typical revenue streams include royalties, corporate income tax, production share, dividends, bonuses and fees. These payments may be constitutionally mandated, required by national or local legislation or regulation, or set out in a license or contract. While the largest payments are commonly made by companies that are in the production phase, the MSG will need to consider payments made at all stages of the production cycle. The MSG should pay particular attention to the revenue streams listed in requirement 4.1.b. The MSG may wish to consider relevant laws, regulations and model contracts and consult relevant ministries, tax collecting entities, and extractive companies in order to gather a complete picture of all existing revenue flows. In some cases, it may be helpful to map out these revenue streams in a flow chart illustrating which government entities collect the various revenue streams:

Figure 1 – Revenue flows from the oil sector in Albania

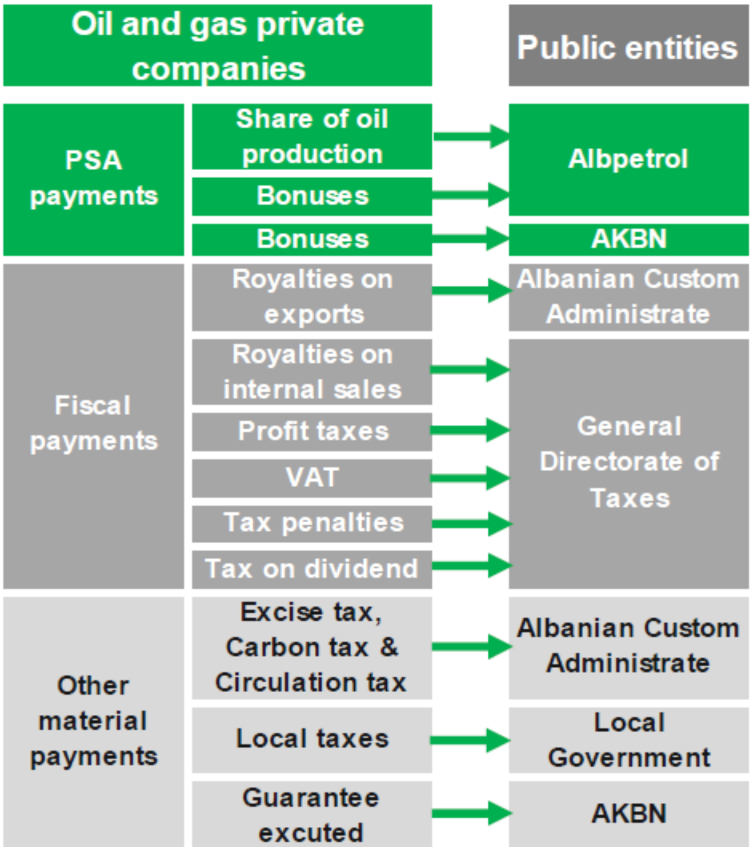
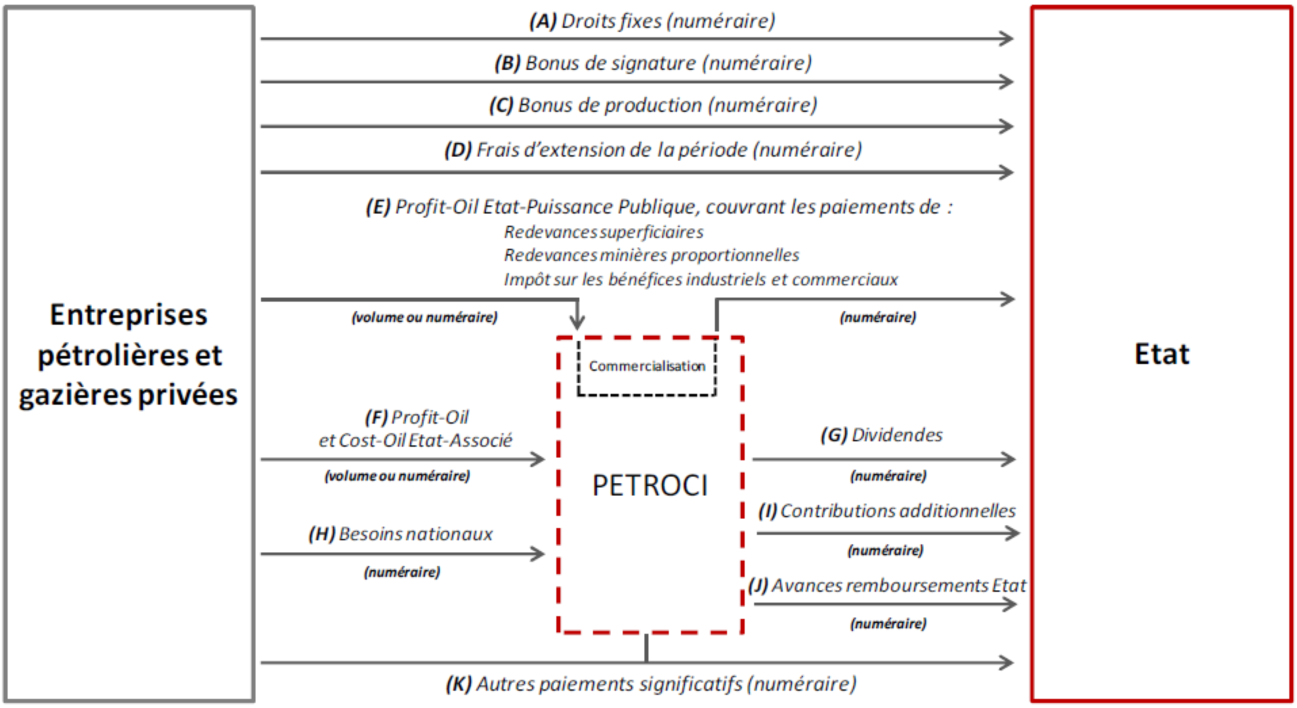


Figure 2 – Revenue flows from the extractive sector in Côte d'Ivoire



In addition, the MSG will need to consider whether benefit streams such as revenues from sale of the state's share of production or other revenues collected in-kind (4.2), infrastructure provisions and barter arrangements (4.3), social expenditures (6.1), and transportation revenues (4.4) exist and whether they are material. In defining materiality, the MSG is advised to consider the guidance notes produced by the International Secretariat for each of these issues.

Step 2 – Establish which revenue streams are material and whether materiality thresholds are needed

In accordance with requirement 4.1.a, *"payments and revenues are considered material if their omission or misstatement could significantly affect the comprehensiveness of the EITI Report…. In establishing materiality definitions and thresholds, the MSG should consider the size of the revenue streams relative to total revenues".* Once the MSG has identified all the existing revenue streams in the sector, a useful starting point for determining materiality is to calculate the share of total revenues from extractive industries that each revenue stream represents. In order to do so, the MSG may wish to review revenue data from relevant ministries and tax collecting entities, previous EITI reports, and other available information with a view to identify the most material revenue streams (see example of Indonesia in figure 3 below). A revenue stream should only be excluded if the MSG can justify that it is not material. In accordance with requirement 4.1.a, a description of the material revenue streams should be included in the EITI report.

Figure 3 – Establishing the materiality of extractive industry revenue streams in Indonesia

Table 3.1-1 Revenues from Oil and Gas[79]

REVENUE STREAMS	2012 (IDR)	% of total Oil and Gas sector	2013 (IDR)	% of total Oil and Gas sector	Y/N Reconciled in EITI 2012/2013 report
NON - TAX REVENUE					
Revenue from Oil production	144,717,087,022,468	45.00	135,329,234,847,290	41.46	Yes
Revenue from Gas production	61,106,427,615,761	19.00	68,300,185,200,293	20.92	Yes
Revenue from DMO	12,339,481,343,731	3.84	12,941,088,975,472	3.96	Yes
Signature bonus	162,411,318,000	0.05	176,740,500,000	0.05	Yes
Production bonus	3,750,000	0.00	17,500,000	0.00	Yes
TAX REVENUE					
Oil Income Tax	32,976,020,386,273	10.25	32,363,301,224,444	9.91	Yes
Gas Income Tax	50,484,720,419,499	15.70	56,384,134,954,761	17.27	Yes
Land and Building Tax	19,793,314,708,579	6.16	20,940,660,552,311	6.41	Unilaterally reported by DG of Budget
Value Added Tax	-	< 1%	-	< 1%	Unilaterally reported by DG of Budget
Other local taxes and levies	-	< 1%	-	< 1%	Unilaterally reported by DG of Budget
Total OIL and GAS	321,579,466,564,311		326,435,363,754,571		

Having established what the material revenue streams are, the MSGs should consider whether **thresholds for company disclosures** are necessary (requirement 4.1.c). Where the sector is relatively small, **full company disclosure** may be feasible. Full company disclosure means that all payments within the scope of the agreed material revenue streams would be disclosed regardless of the size of the payment. In other words, all companies that contribute towards the revenue streams identified as material will be required to participate in the reporting process.

In some cases, for example in countries where there is a large number of small companies it may not be feasible with full company disclosure (see case study on Tanzania). In such cases, the MSG should consider establishing a threshold determining which companies should be required to report .The MSG may wish to consider a cost / benefit analysis in determining whether full company disclosure is feasible or whether thresholds are needed. There are several options for establishing thresholds for company disclosures:

a) <u>Set an aggregate payment threshold</u> based on the total payments made by a company. For example: "Any company making total payments (within the scope of the agreed material revenue streams) in excess of $50 000 is considered material and should report all payments regardless of the size of the individual payments". Figure 4 gives an example of options for aggregate payment thresholds showing the percentage of revenues that would be covered using different payment threshold scenarios, and the number of corresponding reporting companies.

Figure 4 – Options for aggregate payment thresholds in Zambia

Threshold	Number of companies	Revenue collected by ZRA (Million ZMK)	Weight / total collected revenue	Cumulative weight
Amount > 100 billion ZMK	4	1,309,695	79.14%	79.14%
10 Billion ZMK < Amount < 100 billion ZMK	6	287,751	17.39%	96.53%
1 Billion ZMK < Amount < 10 billion ZMK	14	50,452	3.05%	99.58%
0.5 Billion ZMK < Amount < 1 billion ZMK	6	4,255	0.26%	99.83%
Amount < 0.5 billion ZMK	43	2,733	0.17%	100.00%
Total	**73**	**1,654,886**	**100%**	

b) Set disaggregated payment thresholds – this approach employs the same rationale as above, but sets different thresholds for each of the material revenue streams. For example: "Any company paying corporate taxes greater than $10 000 *or* royalties greater than $5 000 *or* dividends greater than $10 000, or license fees greater than $1000 is required to report" The MSG should establish whether the entities that meet this test should disclose all payments, or just the payments that are material[1].

The MSG should review and adjust the thresholds for each reporting cycle.

The EITI Standard requires that the **government fully discloses all revenues** from the extractive sector. In accordance with requirement 4.1.d "*unless there are significant practical barriers, the government is additionally required to provide aggregate information about the amount of total revenues received from each of the benefit streams agreed in the scope of the EITI Report, including revenues that fall below agreed materiality thresholds. Where this data is not available, the Independent Administrator should draw on any relevant data and estimates from other sources in order to provide a comprehensive account of the total government revenues".* This means that while the MSG may agree to establish payment thresholds for company disclosures, the government should on the other hand disclose the total revenues received, including the revenues from any company payments that fall below the materiality threshold. As additional revenues from companies below the threshold cannot be reconciled, the MSG may wish to include information about these additional revenues in an annex to the EITI report or simply specify in the EITI report how much the government collected from the companies that did not meet the materiality threshold. The case study from Tanzania illustrates how this works in practice:

[1] For example, If company XYZ paid $20 000 in royalties and $5000 in dividends and the threshold for both these streams is set at $10 000, the MSG should clearly agree whether the company should disclose all payments (the royalties and the dividends) or just those payments above the agreed threshold (in this example, just the royalties).

Identifying material revenue streams and reporting entities in Tanzania

The TEITI-MSG conducted a scoping study in November 2011 to establish which revenue streams were material, and consequently which companies and government entities should be covered in their 2009/2010 EITI Report. Having reviewed data provided by the Ministry of Energy and Minerals, Tanzania Petroleum Development Corporation, Tanzania Revenue Authority, and Tanzania Mineral Audit Agency as well as relevant laws and regulations, the MSG agreed that 19 revenue streams were material. According to the data provided by the government agencies, a total of 269 companies made payments to the government in financial year 2009/2010. The MSG considered several options for materiality thresholds:

Table 6(a) Threshold Scenarios:

Threshold	Number of companies	Revenue collected by TRA &MEM (TZS)	Weight / total collected revenue	Cumulative weight
Amount > 25 billion TZS	5	169,124,400,835	59.00%	59.30%
10 Billion TZS < Amount < 25 billion TZS	5	91,323,909,211	32.00%	91.30%
2 BillionTZS < Amount < 10 billion TZS	6	20,568,461,141	7.20%	98.50%
0.2 Billion TZS < Amount < 2 billion TZS	7	2,670,309,736	0.90%	99.40%
Amount < 0.2billionTZS	247	1,752,458,102	0.60%	100.00%
Total	**269**	**285,439,539,024**	**100%**	

Having considered these options, the MSG decided that a payment threshold of TzS 200 million would ensure that all material payments and revenues would be captured. As illustrated in the table above, the payment threshold ensured that 99.4% of the revenues from the extractive sector would be covered. A total of 23 companies made payments equal to or exceeding this threshold, and were thus asked to participate in the reporting exercise. The 247 companies below the threshold were not asked to participate, but the government disclosed the revenues received from these companies in an annex to the EITI Report, thus ensuring full government disclosure.

As illustrated in figures 5 and 6, the 2011 EITI Report from Cameroon also includes disclosures of revenues received by the government from mining companies that did not meet the threshold:

Figure 5 – List of mining companies below the materiality threshold

The remaining mining companies and artisanal operators identified in Cameroon which contribute lower than the materiality threshold of FCFA 55 million, were selected for the reconciliation scope on the basis of unilateral declaration of Government Agencies in accordance with EITI Requirement 11-b. Our sample (apart from artisanal operators) included 109 companies (71 mining companies and 38 quarry companies) as listed below:

N°	Company name	N°	Company name
1	AFKO CEMENT PRODUCTION	56	HARVEST MINING CORPORATION SA
2	AFRICAN AURA RESOURCES Sarl	57	HDS Cameroun Sarl
3	AK MINING AND SHIPING COMPANY	58	IMPERIAL MINING AND REFINING Ltd
4	ALL BRIGHT MINING RESOURCES S.A.	59	INVEST - AFRICA Plc
5	ARAB CONTRACTOR	60	KETCH
6	AUCAM Sarl	61	KOREA & CAMEROON MINING INC
7	AYISSI NGABA Jean S/C	62	KUKAMA DIAMONDS CAMEROON Ltd (*)
8	BATCHANDJI Pascal	63	L.C.C.
9	BAZA Sarl (*)	64	L.D.C.
10	BEIG3 Sarl	65	LES CARRIERES DU LITTORAL

Figure 6 – Disclosure of government revenues from mining companies below the materiality threshold

Total payment flows reported unilaterally by Government as received from mining companies not included in the scope of conciliation (unreconciled) amount to **FCFA 324,996,114** detailed by company as follows:

Company	Flat fees	Land royalties	Ad Valorem Tax	Extraction Tax	Customs duty	Total
AFRICA AURA	1 482 250	-	-	-	3 513 036	4 995 286
AK MINING	-	-	8 502 480	-	-	8 502 480
AK MINING & C&K MINING	-	-	6 640 680	-	34 164 794	40 805 474
AK MINING & XING RONG	-	-	4 502 744	-	-	4 502 744
AK MINING C&K IMPERIAL MIN	-	-	4 375 440	-	-	4 375 440

Step 3 – Identify reporting entities

Having established a definition of materiality and whether reporting thresholds are needed, the MSG should identify the companies that make payments in accordance with the agreed materiality definition (and thresholds, where applicable) as well as the government entities receiving these revenues (requirement 4.1.c). The MSG is advised to first consider asking the main tax collecting entities to provide a list of companies that meet the materiality criteria. The MSG might wish to cross check the list of identified companies against cadastres, similar registers of extractive industry license holders, the list of companies participating in previous EITI reporting processes, etc.

In some cases it may not be feasible, i.e. for confidentiality reasons or lack of reliable data, for the government to disclose this information to the MSG. In such cases, the MSG might decide that reporting templates should be distributed to all license holders with clear instructions that any company that meet the materiality threshold should be required to report. Alternatively, and given that the government is required to fully disclose all revenues in disaggregate form (requirement 4.7), the MSG may wish to first task the Independent Administrator with collecting data from the government. The Independent Administrator would then be able to present the list of companies that meet the materiality threshold to the MSG for approval.

In countries where state-owned enterprises operate in the extractive sector, it is recommended that the MSG pays special attention to whether the state-owned enterprise operates as a tax payer, a tax collector, or both. The MSG is advised to consult the guidance note on state-owned enterprises for further details.

Step 4 - Document the options considered when exploring materiality, and the rationale for the agreed materiality definition and thresholds.

MSG discussions about materiality definitions and thresholds should be clearly documented in the minutes from MSG minutes (requirement 1.4.b(viii)) and reflected in the Terms of reference for the Independent Administrator. The MSG should agree a statement on defining materiality that can be published and incorporated into the EITI Report. An example is provided in figure 7 below.

Figure 7 – Example of materiality statement

5.1.3. Materiality considerations

Based on the results of the scoping study, the mining and oil and gas companies who paid taxes of more than TzS 200 million (TzS 0.2 Billion) were considered to be material for the second TEITI reconciliation report. Accordingly, 23 companies (15 mining and 8 oil and gas companies respectively), representing more than 99% of the total revenue collected by the TRA , MEM and TPDC during the year 2010, were selected for the second reconciliation report. The scoping study revealed 246 companies contributed only 0.4% of total revenue. Please see Annex 2 for the list of these companies.