



# IDeIAS

*Informação sobre Desenvolvimento, Instituições e Análise Social*

## Analysis of the Reconciliation Exercise in the Second Report of EITI in Mozambique

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As part of the implementation of the Extractive Industry Transparency Initiative (EITI) in Mozambique, the second MEITI report was recently officially launched. This report was produced by Ernst & Young Mozambique at the request of the MEITI Coordinating Committee (CC). In response to the international requirements of the Initiative, the report contains information on the payments made by companies in the mining and hydrocarbon sectors reconciled (verified) against the information on revenue received by the government. In addition to this information, the CC-MEITI decided to include in the second report an analysis of the legal obstacles to the implementation of the Initiative and research on the transparency of the fiscal regime.

After the report was finished, it followed the dissemination and vital analysis by civil society organizations (CSOs). This work is also one of the criteria for the full accession of the country to the Initiative. This edition (no. 42) and the next (no. 43) of IDeIAS are contributions to disseminating and debating the information provided by the report, by assessing its content. The present IDeIAS deals with the exercise of reconciling the payments made by, and the revenue received from the extractive sector. IDeIAS no. 43 will deal with the analysis of the legal obstacles to the implementation of MEITI, the research on the transparency of the fiscal regime and the recommendations. It will also include an analysis of the following steps towards complete accession to EITI.

### Payments and revenue: what do the numbers tell us?

The report covers the payments made and revenue received in 2009, and the information is disaggregated by company and by type of payment. The report decided to include all the companies in the hydrocarbon sector registered in

the country in 2009. For the mining sector, the companies were selected in accordance with two main criteria: that they had organized accounts, and that they had made payments of at least 500,000 meticaís. Out of an initial list of 265 companies holding mining rights, 105 made payments in 2009. A total of 36 companies (24 in mining, and 12 in hydrocarbons) were found which met the selection criteria. Of these 36 companies, five were excluded because they did not reply to the report questionnaire.

The payments considered fall into the following categories: corporation tax (IRPC), personal income tax (IRPS), surface tax, taxes on production, institutional capacity building fund, social projects fund, dividends paid to the state and environmental licences.

The coverage is broader than that of the previous report, in terms of the companies and payments included, in response to pressure from the CSOs affiliated to the G20 and to the Civil Society Platform for Natural Resources, and which were later confirmed as fundamental by the Initiative's International Coordinating Committee, before being adopted by the CC-MEITI. The greater coverage of the report and the organized and detailed presentation of the data on the reconciliation of the payments made and revenue received (disaggregation of the IRPC, identification of the nature of the reporting errors and the respective adjustments by company) are an important qualitative evolution when this report is compared with its predecessor. The data in the report show that in 2009 the payments by the companies covered in the report amounted to a total of 1,073,190,170 meticaís<sup>1</sup>. The reconciliation shows that, of this sum, the government was unable to justify 3,043,762 meticaís (0.28%), and the companies were unable to show that they had paid about 3,668,983 meticaís (0.34%)<sup>2</sup>. The total amount

of payments from the sector represents 2.3% of total state revenue in 2009. Our attention is drawn to the fact that the report shows that two thirds of the payments made were discounted from the income of other bodies and not from the companies in the extractive sector. About 25% was discounted from the wages of the workers and 42% was discounted from the revenue of enterprises providing services to companies in the sector (tax retained at source). The direct fiscal contribution of the companies in the extractive sector is derisory (equivalent to less than 1% of state revenue). To a large extent this is explained by the excessive fiscal benefits granted. It is often argued that this feeble contribution is due to the fact that the companies are still at the initial stage of operations and so do not have significant income. Although this may be the case for some companies, it is not true for all of them.

By way of example, let us analyse the case of the company SASOL Petroleum Temane (SPT) which shows the fallacy of this argument and the scale of the problem. The direct monetary payments of SPT (excluding taxes paid by the workers and by the companies providing services) amounted, in 2009, to less than 1% of the value of the country's gas and condensate exports. In the tax on company profits (IRPC), SPT paid 100,000 meticaís (strangely enough, the same figure reported in the first MEITI report, referring to 2008). This is 380 times less than the IRPC paid by the Mozambican counterpart in the project, the Companhia Mocambicana de Hidrocarbonetos (CMH – Mozambican Hydrocarbon Company). Taking into account that CMH holds 25% of the project and SPT holds 70%, this means that the IRPC tax burden for SPT is about 1,000 times less than that of CMH. This derisory fiscal burden, on a company which was beginning to generate profits no more than

1. The report presents two different totals, one for what the companies reported paying, and the other for what the government said it had received. This results from various kinds of reporting errors, as explained in the report. What, then, is the correct figure (or figure closest to the correct value) for the payments made by the sector? Assuming that all the payments or revenue reported were duly justified, when the sums declared by the government and by the companies are different, the higher figure is the correct one (or is at least closer to the correct value). This is how the figure of 1,073,190,170 meticaís that the article considers was obtained.

2. By mistake, the reconciliation report, on page 47, gives figures different from these.

four years after it had begun production, shows how poor the deal was that the government, representing the citizens of this country, struck with that company<sup>3</sup>.

Not only is the total payment small, but it is also overvalued. In fact, in the case of the company Cimentos de Mocambique (CM – Cements of Mozambique), which undertakes both extractive activities (extraction of limestone) and non-extractive activities (production of cement), the report does not exclude payments referring to non-extractive activities. This is particularly relevant, because CM appears as the second largest contributor in the mining sector, with a contribution greater than 20% of the total contribution from the sector. This aspect is extremely significant in the present report, since it may significantly adulterate the result of the total discrepancies found, as shown below.

CM is the company with the largest negative difference<sup>4</sup> (the government reports receiving more than the company says it paid). This difference eliminates completely the total discrepancies in situations where the government is unable to report all the payments that the companies in the mining sector declared and reduces by more than 70% the total sum of the discrepancies found in the entire extractive sector.

Curiously, the largest amount that has “disappeared” from the state accounts (the difference where the government reports receiving less than the amount the company declares it paid) refers to payments from a public company, ENH E.P. This difference, 1.5 million meticais, is more than half the total amount that the government is unable to account for, and about 6.5% of the total payments declared by ENH E.P.

The aspects discussed in the two previous paragraphs show the importance of two proposals put forwards by members of the CC-MEITI. The first is that the level of significance of discrepancies (the level that justifies additional work to explain this difference) should also be defined at company level. That is, by using the same percentage of 3% defined by the CC-MEITI for the general level of discrepancy, if the state is unable to account for more than 3% of the payments declared by each company, then the work of reconciliation should continue. This proposal has not yet been accepted by CC-MEITI.

The second proposal is that the report should present separately the sums of the positive differences and the negative differences, as well as

the level of significance of the discrepancies applied to each of these totals. The algebraic sum of all the differences (positive and negative) is not meaningfully useful. A hypothetical example will help illustrate the problem. Let us suppose that the report covers two companies, A and B. Company A paid 100 million meticais which the government did not report. In turn, the government reported that company B paid 100 million meticais, but this company has lost the documents referring to this payment and so did not report it. In accordance with the practice of adding up all the negative and positive discrepancies, the total discrepancy would be zero. However, this does not mean that no money had “disappeared” from the state accounts. The proposal to present the sums separately has been accepted by the CC-MEITI, but the figure that is officially and widely publicized about the discrepancy is still based on the algebraic sum of the differences, which is of no useful significance.

The data disaggregated by company raise the hypothesis that the differences found have been underestimated. Indeed, the report shows that both the companies and the government have difficulty in reporting their accounts correctly. If we look at the mining sector, only for two of the 20 companies (10%) do their accounts coincide with those of the government. In 12 cases the companies reported less than the government and in eight they reported more<sup>5</sup>. These evident difficulties in reporting correct figures give us no guarantees that the side reporting the higher figures has not also committed a mistake of omission. An omission of this type would be difficult to detect during production of the report because the reconciliation work does not include additional research to identify the existence of payments not declared by either of the sides.

A further hypothetical example may help illustrate the problem. Let us suppose that a company paid 100 million meticais in IRPC, but only reported a payment of 50 million meticais, while the government, for its part, reported receiving only 25 million meticais. What does the reconciliation work consist of? In verifying the justifying documents presented by both sides and requesting the side that reported less (in this case the government) to present an explanation for the missing 25 million meticais. It is not part of the reconciliation to research the company documentation to check whether there is any

payment yet to be reported referring to the tax in question. The data from the reconciliation exercise also suggest the presence of this problem. In no situation did the body that declared more than its counterpart make adjustments upwards that would increase this difference<sup>6</sup>.

Finally, it is advisable that all state institutions include supporting documents for the information provided on the report forms. In the report, the General Directorate of Taxes (which reports most of the figures) presented supporting documents, but the National Petroleum Institute and the Institute for the Management of State Holdings only supplied data by filling out the forms.

## Conclusion

The reconciliation of payments made and revenue received in the second MEITI report shows an important qualitative evolution linked to the expansion of the coverage and the disaggregation of the data. The reconciliation exercise makes it possible to identify (or to show) that one of the problems with the management of natural resources for development is the excessive fiscal benefits granted to some companies which reduce the possibility of greater retention and distribution of the wealth generated in the country.

However, some further improvements are necessary and can serve as a lesson for the next report – unfortunately the way in which the CC-MEITI carried out the report did not grant sufficient space for contributions to be made to the report prior to its publication, making it impossible for some of these improvements to be included in the present report (See IDelIAS no. 43 for more details). The most important aspects are: separate payments referring to non-extractive activities in the report; faced with divergences in the sums reported, give an opinion on which is closer to the correct figure; apply the level of significance of discrepancies to the total of the positive and negative sums separately, and by company (not just to the total of sector payments) and guarantee that all companies report their payments. It is advisable that the reconciliation should continue to include IRPS and retentions at source. This information is useful for assessing the total contributions of the extractive sector to the economy and the forms in which they are made. What is important is to disaggregate the IRPC, identifying the indirect payments.

3. The export data from the Bank of Mozambique are in US dollars, and to convert it the average exchange rate on 31/12/2009, of 27.51 meticais to the US dollar, has been used.

4. The report gives the mathematical minus sign to the differences where the State reports revenue higher than the payments declared by the companies and the plus sign to the reverse situation. The reconciler confirms that the data reported are duly justified by valid support documentation, and so anyone reporting a lower figure is in error.

5. The reconciler has no obligation to undertake this exercise unless it is requested, and the terms for doing it are agreed.

6. The complexity of this exercise, and the time and costs necessary, make such a request a delicate matter, but fundamental for greater precision in the sums reported.