

# DRILLING DOWN

The Civil Society Guide  
to Extractive Industry Revenues  
and the EITI

Edited by  
David L. Goldwyn

REVENUE  WATCH  
INSTITUTE

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## The Civil Society Guide to Extractive Industry Revenues and the EITI

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## Foreword

For many oil, gas and mineral-rich countries, development remains elusive; the rich get richer, the poor stay poor, economies stagnate, corruption flourishes and conflict deepens. The extractive industries generate tremendous wealth for more than 50 countries around the world, but many of these nations have been unable to translate the windfalls into long-term growth and improved well-being for citizens.

Over the past decade, an international movement has emerged to counter this “resource curse.” Citizens from producing and consuming countries have joined together to demand better governance and true accountability in the generation and use of natural resource wealth. A sector traditionally veiled in secrecy and managed as the exclusive domain of political elites and large corporations is beginning to open its doors to greater public scrutiny. Civil society groups are finding their way into conversations that are fundamental to the future of every resource-rich country. Governments and companies are beginning to recognize that greater openness can serve their long-term interests.

The Extractive Industries Transparency Initiative (EITI) has been instrumental in increasing citizen participation in this dialogue. The EITI is an international multi-stakeholder initiative of governments, companies and civil society working to strengthen governance and development in producing countries by improving transparency and accountability in the extractives sector. In contrast to Poverty Reduction Strategy Papers (PRSPs) or Environmental Impact Assessments, the EITI process

requires that civil society not only be consulted, but be given a seat at the table and a vote in critical decisions.

Effective EITI participation and monitoring of a country's extractive industries is a daunting challenge for civil society. These industries are technically, legally and financially complex. Commodity markets, accounting practices, and institutions themselves change frequently. Industry structures, rules and practices vary from country to country. Local and international politics play a significant role. And even with EITI participation, much information about the sector remains beyond public scrutiny. It is, in short, no small task for activists to get up to speed on the business and politics of oil, gas and mining.

Add to these hurdles the fact that many EITI activists live in countries which have been wracked by war, and which have little or no precedence for civic engagement in public policy processes. Multi-stakeholder governance is strenuous under the best of circumstances, and in the case of the extractive industries, civil society groups start at a disadvantage, with less information, technical education and influence than their public and private sector counterparts.

Despite these enormous challenges, activists around the world have rushed forward since the EITI's launch just six years ago. The hunger for more extractive industry information, more understanding and more participation is palpable.

The Revenue Watch Institute, with the help of outside industry and EITI experts, has created *Drilling Down* as resource to help effective civil society participation in the EITI. *Drilling Down* offers a comprehensive review of each stage of the EITI process. It describes the role of civil society, the key issues likely to arise at each stage of debate and decision, the opportunities for influence at the various stages, how civil society participants in other countries have handled similar issues, and the results. The guide includes samples of different models and processes, such as Memorandums of Understanding (MOUs), country work plans and auditor selection processes. A comparative analysis of the strengths and weaknesses of each tool provides a civil society perspective, with the aim of maximizing the transparency, integrity and public accountability of EITI implementation.

Revenue Watch is founded on the belief that with the necessary support and expertise, citizens of resource-rich countries can work in partnership with government and industry to reverse the resource curse and introduce democratic accountability into the governance of the extractive industries around the world.

Our effort to offer civil society the same high-quality expertise and counsel available to industry and governments led us to David Goldwyn and his outstanding team, the authors of this manual. Goldwyn International Strategies (GIS) and Chris Nurse of

Hart Group played a critical role in Nigeria's EITI, and Revenue Watch is grateful for their generosity in sharing the invaluable lessons wrought from that experience.

*Drilling Down* is intended for use as a supplement and companion to the EITI Secretariat's *Guidebook to EITI Implementation* and *Guide to EITI Validation*. We hope that this teaching tool will help civil society activists and other interested parties understand the EITI and the specific steps they can take to effectively participate in the initiative.

Vanessa Herringshaw, Juan Carlos Quiroz and Michelle Sieff of Revenue Watch gave exhaustive comments on successive drafts. Revenue Watch communications manager Jed Miller shepherded this project through to publication, with help from Brendan Spiegel, Rachel Hart and Page Dykstra. Revenue Watch would like to thank Judit Kovács, Jeanne Criscola and Ari Korpivaara for their skilled layout and design contributions.

## About the Revenue Watch Institute

The Revenue Watch Institute is a non-profit policy institute and grant-making organization that promotes the responsible management of oil, gas and mineral resources for the public good. With effective revenue management, citizen engagement and real government accountability, natural resource wealth can drive development and national growth. RWI provides the expertise, funding and technical assistance to help countries realize these benefits.

Revenue Watch promotes transparent, accountable and effective management of natural resource wealth to help countries avoid the "resource curse." We take a comprehensive approach to improving governance and development across the entire value chain—from the organization of extractive production, revenue generation and revenue management, through the expenditure processes and development outcomes in resource rich countries.

The Revenue Watch Institute currently supports partners and affiliates in Angola, Azerbaijan, Brazil, Cameroon, Cambodia, Cote D'Ivoire, DRC, Ecuador, Georgia, Ghana, Guinea, Indonesia, Iraq, Kazakhstan, the Kyrgyz Republic, Liberia, Mauritania, Mexico, Mongolia, Niger, Nigeria, Peru, Sao Tome and Principe, Sierra Leone, Tanzania, Trinidad and Tobago, Uganda and Yemen. RWI is based in New York, with a satellite office in London and regional coordinators based in Azerbaijan, Ghana, Indonesia, Malaysia and Peru.

*Karin Lissakers*

Director

Revenue Watch Institute



## Acknowledgements

The guide was prepared by the Goldwyn International Strategies (GIS) team. It is based on our practical experience as advisers to Nigeria's National Stakeholders Working Group and the Nigeria Extractive Industries Transparency Initiative (NEITI). GIS advised the NEITI in its historic financial, process, and physical audits of the oil and gas industries from 1999 to 2004, and again in 2005. We also advised Nigeria on the structure and terms of the 2006 audits, in addition to more intensive and forthcoming Value-for-Money audits. Our up-close and in-depth experience with the challenges faced by stakeholders—we faced a host of them at every stage of the process including launching the EITI, engaging in the procurement of managers, understanding EITI reports, communicating and disseminating the reports, and constructing a follow-up agenda—guided our advice on how other countries can anticipate key decisions and maximize the effectiveness of their participation. We also drew on our experience advising companies on EITI compliance, our work on thought leadership in revenue transparency and governance, and extensive examination of current EITI practices, derived from interviews and open source research.

David Goldwyn, president of GIS, led the development of this guide. Sheila Moynihan, senior associate at GIS, conducted extensive research into current EITI practices, prepared the tables and text boxes, and designed and drafted the training manual. Her care, accuracy, and indomitable good cheer were indispensable to the completion of the project. Cemile Hacibeyoglu, Jamie O'Mealia, and Faarnaz Chavoushi, of GIS contributed research and editorial support.

Christopher Nurse and his colleagues with the Hart Group and the Hart Nurse Chartered Accountants, notably Sam Afemikhe, Andy Allington, and Chris Morgan, utilized their experience as Nigeria's auditor for the 1999–2004 and 2005 audits, as EITI aggregators for Cameroon, and as international advisors on mining issues, to contribute the analytical content for the sections covering accounting, auditing, mining, and fiscal issues, and also reviewed the guide for practical issues arising from the auditor's and aggregator's perspective.

Christopher Mailander, managing director of Mailander & Company, who has been part of the GIS team from the beginning of the effort to define and oversee implementation of the NEITI, provided extensive editorial support. Chris drew on his practical experience working with GIS to help design and manage the NEITI international tenders to select well-qualified auditors and management consultants, as well as his experience designing a communications strategy to disseminate the results of the NEITI report. The sections on auditor/aggregator selection and communications draw heavily on his advice and experience.

Early drafts of the guide were reviewed by Sefton Darby, a key member of the U.K. Department for International Development (DFID), now of the World Bank. Sef and his team generously shared with us numerous examples of current EITI practice and offered invaluable suggestions on the style and substance of this guide.

Jill Shankleman, author of *Oil, Profits, and Peace* (United States Institute of Peace Press, 2006), reviewed an early draft and provided suggestions on style and structure that informed the final form of the guide.

I am deeply grateful to Julie McCarthy and Michelle Sieff of the Revenue Watch Institute for entrusting me with this project; for providing good-natured suggestions on style, structure, and substance throughout; and for shepherding the guide from start to finish.

To all of these contributors all credit is due, for any errors or omissions the guide contains, I take sole responsibility.

*David L. Goldwyn*  
Washington, D.C., 2007





# Introduction

## What Is the EITI?

The Extractive Industries Transparency Initiative (EITI) is an independent, internationally agreed upon, voluntary standard for creating transparency in the extractive industries. At its core, the EITI requires transparency in the payments made by companies and revenues received by governments relating to the exploitation of a nation's extractive resources. This transparency helps empower civil society to hold governments accountable for the management of those resources.

Since the EITI launched in 2002, civil society, governments, companies, and investors have all played an active role in defining this standard. More than 40 countries have pledged to implement the EITI. In October of 2006, the EITI Conference created an international multi-stakeholder board to oversee the governance of the EITI, and established a full-time Secretariat. The EITI Conference also required that countries and companies that commit to participating in the EITI are required to periodically validate their progress in meeting the international standard by submitting their performance for review by an independent third party. The goal of validation is to ensure that countries and companies do what they say they will, and that the implementation program complies fully with the EITI Criteria (see Figure i.1) and Principles<sup>1</sup> (See Figure i.2). As of this writing, no country has yet undergone the validation review.

### Figure i.1: EITI Criteria

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1. Regular publication of all material oil, gas and mining payments by companies to governments (“payments”) and all material revenues received by governments from oil, gas and mining companies (“revenues”) to a wide audience in a publicly accessible, comprehensive and comprehensible manner.
  2. Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.
  3. Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator’s opinion regarding that reconciliation including discrepancies, should any be identified.
  4. This approach is extended to all companies including state-owned enterprises.
  5. Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.
  6. A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.
- 

### Figure i.2: EITI Principles

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1. We share a belief that the prudent use of natural resource wealth should be an important engine for sustainable economic growth that contributes to sustainable development and poverty reduction, but if not managed properly, can create negative economic and social impacts.
2. We affirm that management of natural resource wealth for the benefits of a country’s citizens is in the domain of sovereign governments to be exercised in the interests of their national development.
3. We recognize that the benefits of resource extraction occur as revenue streams over many years and can be highly price dependent.
4. We recognize that a public understanding of government revenues and expenditure over time could help public debate and inform choice of appropriate and realistic options for sustainable development.
5. We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability.
6. We recognize that achievement of greater transparency must be set in the context of respect for contracts and laws.
7. We recognize the enhanced environment for domestic and foreign direct investment that financial transparency may bring.

8. We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure.
  9. We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business.
  10. We believe that a broadly consistent and workable approach to the disclosure of payments and revenues is required, which is simple to undertake and to use.
  11. We believe that payments' disclosure in a given country should involve all extractive industry companies operating in that country.
  12. In seeking solutions, we believe that all stakeholders have important and relevant contributions to make—including governments and their agencies, extractive industry companies, service companies, multilateral organizations, financial organizations, investors and non-governmental organizations.
- 

## What Steps Are Required to Implement the EITI?

The EITI process has four phases: Sign Up, Preparation, Disclosure and Dissemination. The steps countries must follow for each phase are detailed in the Validation Grid (See Appendix A). More detailed explanations of how to implement the steps are contained in the Indicator Assessment Tools (IAT) referred to in the grid (See Appendix B). Countries must declare themselves as either “candidate” countries (those seriously preparing to implement the EITI by completing the Sign-Up Phase) or “compliant” countries (those who have fully complied with all four stages). Countries that wish to be considered “compliant” with the EITI must be validated by November 2008. Countries that wish to be considered candidates were required by the EITI Board to undergo “pre-validation” in the fall of 2007 by demonstrating that they had completed the steps of the Sign-Up Phase.

There are 18 steps that must be completed for countries to be validated as compliant with the EITI. (See Figure i.3)

### **Sign-Up (Steps 1–4):**

The government must issue an unequivocal statement supporting EITI implementation; commit to work with civil society and companies; appoint a senior individual to lead the effort; and publish a fully-costed work plan, with measurable targets and timetables for implementation and an assessment of any constraints on the capacity of stakeholders to participate.

### **Preparation (Steps 5–13):**

This phase includes establishment of a multi-stakeholder group (MSG); engagement of companies and civil society; removal of obstacles to civil society participation; agreement on templates for companies and the government to report payments and

revenues; MSG approval of an organization to reconcile companies' payments and the government's revenues; adoption of measures to ensure that all companies will report payments; and government assurance that reports for both companies and government are based on audited accounts that meet international standards.

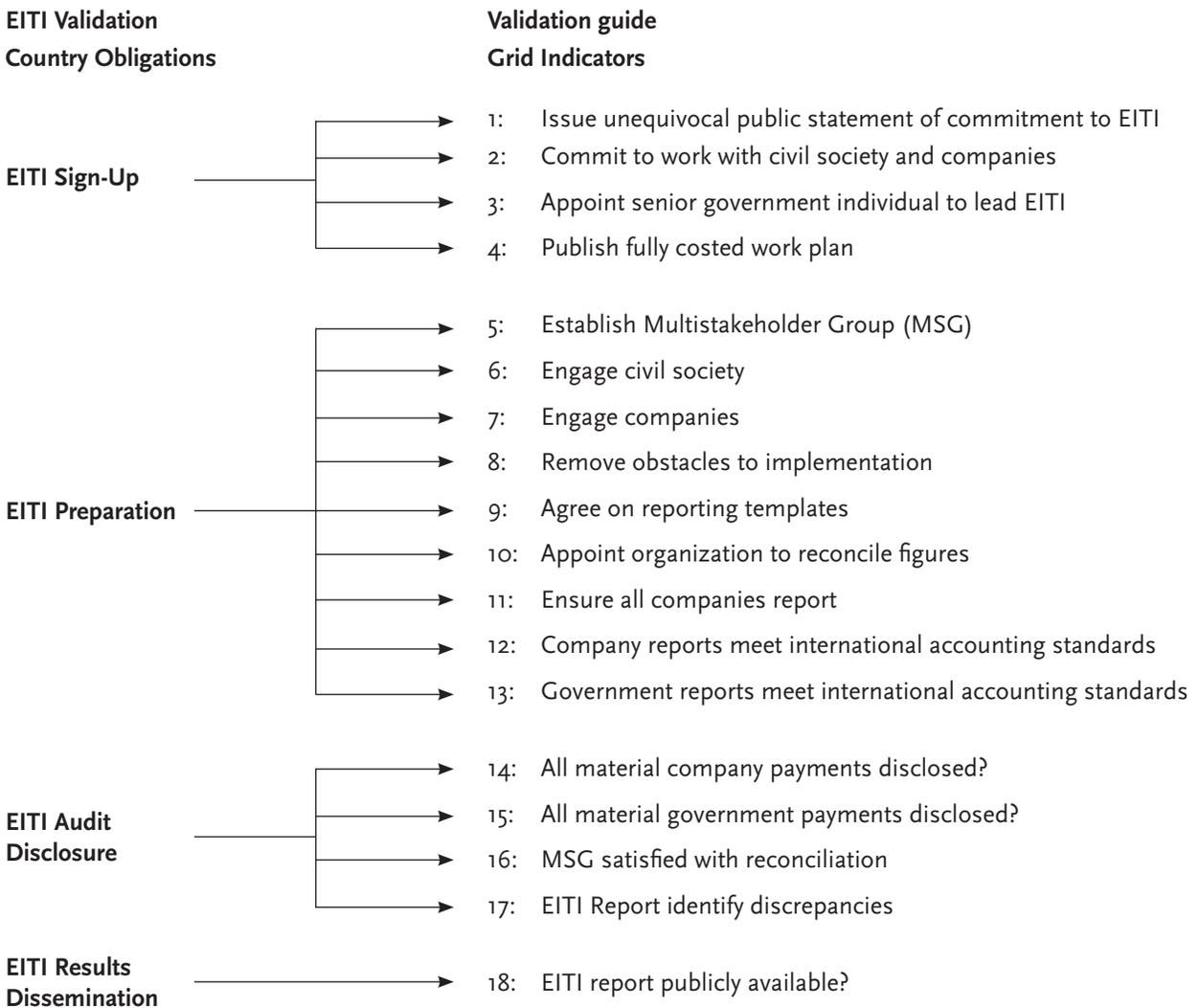
**Disclosure (Steps 14–17):**

All material payments made by companies to the government, and all revenues received by the government from companies, must be disclosed to the organization contracted to reconcile figures and produce the EITI report. The multi-stakeholder group must be satisfied that the contracted organization properly reconciled the figures, and that the report identifies differences and make recommendations for action.

**Dissemination (Step 18):**

The EITI report must be made publicly available in an accessible, comprehensive, and understandable way.

**Figure i.3: EITI Validation Methodology**



## The Need for a Guide to Implementation

The EITI is a tool to help civil society enhance transparency. Civil society organizations (CSOs) need to understand how to use the EITI in order for it to be meaningful. Today, EITI practices vary widely:

- While forty countries have stated their intention to implement the EITI, as of this writing, only eight have issued reports under the EITI (Azerbaijan, Cameroon, Gabon, Ghana, Guinea, Kyrgyzstan, Mauritania, and Nigeria). Of these eight, seven have published a reconciliation of government and company accounts. Covered parties are required to submit audited figures according to international standards. It is important to note that the process of reconciliation under the EITI verifies whether the reports of payments made and revenues received agree, but that reconciliation does not actually indicate whether such amounts are in fact correct.
- No country has yet sought or secured EITI validation, as the validation criteria are new.
- Among the countries that have publicly stated their intention to comply with the EITI, only Nigeria has conducted a comprehensive audit of the accounts of its government agencies and the companies involved in its extractive industries. The Nigerian audits determined that many of the underlying calculations of tax, royalty, and other amounts were incorrectly prepared. Correction of these errors has led to increased revenue collection by the government and recommendations for improving the process of auditing taxes and verifying royalty payments. (See Text Box i.1.)

### Text Box i.1: An EITI Example—Potential Revenue Loss in Nigeria

- The Federal Internal Revenue Service (FIRS) was not proactive in assessing and collecting the Petroleum Profits Tax liabilities of the companies. This resulted in unregulated self-assessment.
- FIRS records of crude volumes had not been reconciled with any information produced by a hydrocarbon mass balance.
- FIRS' record keeping systems were inadequate. FIRS did not maintain its records on a double entry system, nor did it maintain a proper cash-book nor keep any ledger.
- Department of Petroleum Resources (DPR) did not assert any authority to assess and collect royalty liabilities during the review period.

NEITI Audit Executive Summary, p.11

- Of the eight countries that have undertaken the reporting of data, two countries report data on a “disaggregated” basis, meaning that they describe what each company pays in tax, royalty, and other categories and/or by type of payment (tax, royalty, etc.). The remainder of reporting countries report financial data on an “aggregated” basis, meaning that the financial information is reported on a consolidated basis rather than a company-specific and/or category-specific basis. Additionally, some countries require that all companies involved in the extractive industries report their payments, while other countries only require that the major companies do so. (See Table i.1.)

**Table i.1: How EITI Reporting Countries Disaggregate Data**

Country	Disaggregated by Company?	Disaggregated by Payment Type?	Audit or Reconciliation?
Azerbaijan	No	Yes	Reconciliation
Cameroon	No	Yes	Reconciliation
Gabon	No	Yes	Reconciliation
Ghana	Yes	Yes	Reconciliation with some additional testing
Guinea	No	Yes	Reconciliation
Kyrgyz Republic	No	Yes	Reconciliation
Mauritania	No	Yes	Reconciliation
Nigeria	Yes	Yes	Audit

*Source:* Links to country reports for Azerbaijan, Cameroon, Gabon, Ghana, Guinea, Kyrgyz Republic, Mauritania and Nigeria can be found through [www.eitransparency.org/section/countries](http://www.eitransparency.org/section/countries) and Table 3.1.

Many of the most important decisions pertinent to a country’s EITI stakeholders are made in the very early stages of deployment, when civil society groups are weakest in terms of understanding the EITI and least equipped to participate in key decisions that will determine the usefulness of the EITI process. For example, in Azerbaijan a nongovernmental organization (NGO) coalition that was not self-selected agreed to the scope of its EITI inquiry in a Memorandum of Understanding, which determined issues such as the form of reporting (on an aggregated basis) early in the EITI process. The coalition has since evolved to include more than 90 members.

This guide is necessary to help CSOs, companies, and governments understand the decisions that need to be made at each step of the process, and the underlying issues that should inform their decisions. This guide is also needed to educate stakeholders about the reasons why they should go beyond the minimum requirements of the EITI and, even if over time, require a more intensive examination of the information being reported.

**Figure i.4: EITI Basic and EITI Plus****EITI Basic**

- Disclosure of All Payments by Participants in Oil, Gas, and Mining Sectors
- Independent, Third Party Reconciliation
- Reconciliation of Payments Reported, and Discrepancies Found to Be Publicly Disclosed
- EITI Reconciliation Findings to Be Published Regularly

**EITI 'Plus'**

- *Moving from Reconciliation to Audit:*  
Verification and investigation of discrepancies identified
- *Conducting Value-for-Money Audits:*  
Auditing the underlying cost structures in major projects
- *Benchmarking:*  
Comparing performance of projects against other domestic projects and international comparables
- *Physical Audits:*  
Measuring the physical commodities extracted and associated processes
- *Examining Industry Processes:*  
Licensing, portfolio management, state investments, local content
- *Moving Beyond Revenues to Distribution:*  
Allocations, distribution, receipt and usage, at the regional and local levels

**EITI Basic and EITI Plus**

The EITI requires only that material payments made by companies in extractive industries and revenues received by the government are reconciled and that the results are published. The underlying data from the companies or the government must come from financial statements that have been audited in accordance with international auditing standards—unless the stakeholders agree that data is acceptable in another form (usually in whatever form the data is available). This reconciliation, practiced by all but one country implementing the EITI today, is what we refer to as EITI Basic. In a voluntary consensus-driven system, the essential first step is often an agreement to simply enact a reconciliation. But a reconciliation only details whether the amounts reported agree, not whether they are right. Significant problems in the handling of extractive industries revenue often lie beneath the surface: Was a royalty paid on the right amount of production? Was the government's share of production sold at a fair value? Were the costs deducted by companies allowable under their contract? Did the national oil company pay its share of tax or royalty to the central bank on time and in the right amount?

Unless and until there is an examination of the underlying transactions that produce the figures being reconciled, these payments and revenues are vulnerable to errors in calculation, manipulation, or corruption. This is why stakeholders should consider going beyond EITI Basic to EITI Plus. EITI Plus is any deeper examination beyond a reconciliation. It can be an audit of the underlying payments, verification of the physical production itself, or a review of how the key processes in the industry are conducted.

## Outline of this Guide

This guide has three parts. Part I follows the four stages of EITI implementation sequentially. It is designed to help the reader anticipate the key decisions made in each stage and provides questions to ask and issues to address in these early stages.

Part II pertains to advanced issues in extractive industries transparency. It explains the legal and economic framework of extractive industries, from the forms of contracts to the kinds of payments governments receive. This section will help the reader understand what categories of payments should be covered and why they are important. This part of the guide also discusses the key areas where things go wrong in the calculations of what the government is owed, and why stakeholders should press for some level of checking the underlying transactions, or for EITI Plus.

Part III is called “Beyond Basic EITI.” This part of the guide explains why all stakeholders have an interest in evolving the EITI process and the key areas where they should consider expanding the scope of inquiry of the EITI in order to understand the full potential of this undertaking.





P A R T I

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## The Four Phases of the EITI Process

## CHAPTER 1

# *The Sign-Up Phase*

The Sign-Up Phase is the first step toward implementation of the EITI. It is the period when a government must demonstrate its seriousness about the EITI by:

- issuing an unequivocal statement of its intention to support EITI implementation
- making a commitment to work with civil society and companies on EITI implementation
- appointing a senior individual to lead the EITI effort
- developing and publishing a fully-costed work plan, with measurable targets and timetables for implementation, and an assessment of any constraints on the capacity of stakeholders to participate<sup>2</sup>

This is the time—while the EITI effort is first being developed—when civil society organizations should: (1) get organized, (2) establish their objectives, (3) secure expertise from independent professionals who can help fulfill their objectives, (4) engage with senior government officials, (5) begin evaluating the Country Work Plan, (6) participate in the selection of CSO representatives on the MSG, and (7) carefully examine any memoranda of understanding to which CSOs have been asked to formally assent.

## 1.1 Get Organized

Every country has a different kind of civil society and people typically organize around different issues. Some countries may have strong NGOs, or even civil society coalitions, which can provide an anchor for building a larger coalition.

*In Ghana, an advocacy NGO called ISODEC, with a mission of promoting social justice and fundamental human rights, was the anchor of the EITI civil society movement.<sup>3</sup>*

*In Guinea, the President of the National Council of Civil Society Organizations sat on the group that organized the national stakeholder committee.*

It can be very helpful to form an EITI coalition. Different CSOs can contribute different strengths. Some may be familiar with the extractive industries, other may follow budget accountability, and still others may focus on human rights or the environment. By banding together, CSOs can increase their influence, deter governments from playing one group against another, and have a better chance of achieving a broader geographical coverage.

*In Nigeria, led by the PWYP coalition, a group of Nigerian CSOs formed a larger coalition that eventually signed a Memorandum of Understanding with the Nigeria EITI to support civil society involvement.*

In some countries, governments may discourage or even intimidate groups from associating. In these cases, a government's commitment to implement the EITI and obtain the EITI brand can potentially be a source of leverage for pressing the government to remove obstacles to civil society freedom of speech or association.

Whatever the circumstances, civil society members should:

- find like-minded citizens who want to press for transparency and agree to form a group or coalition of their own
- agree to meet regularly to stay informed on the process
- keep minutes of meetings so new members can get informed, and create a website so that other citizens can communicate with the coalition

### Text Box 1.1: Mauritania Cyber Forum

Mauritania created a cyber forum as a means of communicating EITI updates. It can be found at: [www.cyberforum.mr/presentation/index.html](http://www.cyberforum.mr/presentation/index.html)

For a comprehensive set of ideas on getting organized, see *Eye on EITI*,<sup>4</sup> a report published by the Revenue Watch Institute.<sup>5</sup> Also, for a step-by-step guide to setting up a Pay What You Publish coalition, see *Follow the Money*.<sup>6</sup>

## 1.2 Know Your Objectives

Before engaging with government officials, CSOs should know what they want out of an EITI program and what their priorities are. These priorities can include some or all of the following:

- Publication of company payments and government revenues (i.e., the publish-what-you-pay concept that led to the development of the EITI)
- Restoring public trust in government institutions that manage extractive industries
- Verifying the physical quantities of oil, gas, or minerals extracted by companies
- Clarifying the share of revenues taken in by local and regional governments
- Publishing the amount of money companies spend in support of local communities
- Educating people about where the country's extractive industries revenue goes
- Improving the government's system for collecting and managing information about extractive industries
- Improving local content rules
- Improving the way the government manages its investment in extractive industries

### Text Box 1.2: Setting Objectives

The Liberia EITI program expressly identifies transparency in the awarding of mineral, oil gas and forestry rights as one of the EITI program's primary objectives.

These priorities will dictate CSO positions on what should go into the Country Work Plan, what the EITI should reconcile or audit, and who will be subject to the EITI process. Remember that the EITI is a voluntary process, so there will likely be negotiations among stakeholders, with differing views about what form the EITI should take. It is crucial to determine what is most important in order to maximize a CSO's negotiating position. At this moment, countries vary widely in their priorities.

*Nigeria's stakeholders, led by the government, sought to restore trust in the entire oil and gas system. They audited five years of activity; audited financial and physical flows; and studied how the government sold its crude for product, supplied it refineries, and managed its information technology systems and processes. Information was disaggregated by company and by type of payment. Nigeria's mining sector was not covered by the EITI, but the country developed legislation to reform the legal structure for the mining sector.*

*In Ghana, the focus of EITI implementation was on the mining sector. The early EITI program performed a reconciliation of the payments of a small number of companies that made up 99 percent of the sector's payments to the government. Oil and gas sectors were still in development, so payments such as signing bonuses or rents were not covered by the EITI.*

*In Peru, audited figures for companies' payments are already required by law to be published. The EITI program in development is focused on the formulas that distribute revenues to the sub-national levels of government, which include those levels of government that can also be held accountable for the spending of extractive industry revenue.*

*In Liberia, the forestry industry is covered under the EITI, as are the mining and petroleum sectors. The EITI in Liberia will include all major forestry companies and the Forestry Development Authority. The objectives of Liberia's EITI include insuring that the awarding of forestry rights and the exploitation of those resources is done in a transparent way and that all payments made by forestry companies to all levels of government and/or state-owned entities are published regularly.<sup>7</sup>*

### 1.3 Get Outside Help

Civil society members should connect with international groups that are active in the global EITI, such as the Publish What You Pay Coalition,<sup>8</sup> the Revenue Watch Institute,<sup>9</sup> Global Witness,<sup>10</sup> and Transparency International.<sup>11</sup> These organizations are each integrally involved in influencing the EITI, and their understanding of the issues can be beneficial to the civil society membership in getting organized. In addition, an affiliation with such organizations can be useful in increasing the visibility, credibility, and potential influence of the local civil society. You should also expect the government to secure outside help for the multi-stakeholder group once it is formed. An external adviser can give impartial advice to the entire group, and ensure that the MSG's work is performed in a manner consistent with international standards.

#### **Text Box 1.3: Outside Help**

Most EITI programs need help getting off the ground. There may be very thin capacity in countries and you may need help preparing the work plan, the budget, scope of work for the audit, or advertisements for bidders, or negotiating the contract with the auditor or aggregator. Having an external advisor to give the multi-stakeholder group independent technical advice can speed implementation and reduce conflict. The World Bank Trust Fund can be one source of funds for such help, or the country EITI budget may include funds for this purpose. One topic for a first stakeholder meeting should be whether and where to get such help to expedite the implementation of the EITI process.

## 1.4 Engage the Senior Official

Once the government has publicly named the senior official in charge of the EITI process—a required step in becoming an EITI candidate—the CSO should promptly meet this official. The objective is to develop a relationship, discuss the process for implementing the EITI, communicate the CSO’s priorities as part of EITI implementation, identify obstacles to participation, and provide input on the Country Work Plan. Before the validation criteria were published in October 2006, many governments developed their EITI concept outside of the purview of the public eye, and CSOs had input late in the process. Going forward, CSOs should be involved as early as possible to maximize their influence and proactively shape the EITI implementation model to be utilized.

## 1.5 Evaluation of the Country Work Plan

The EITI now requires that a government develop and publish a Country Work Plan as the fourth step in the Sign-Up Phase and have it agreed to by key stakeholders. The first draft of this work plan is often worked out by the government, with advice from the World Bank. This is how the government learns what is involved in the process, how long it will take, what the range of costs is, and what is required to be validated by the EITI as a candidate or compliant country.<sup>12</sup>

The requirements to have the work plan fully costed, address capacity constraints, and widely available are very new. No government has yet published a work plan that meets all of these criteria. The requirement that this work plan be agreed to means that civil society will have the opportunity to comment on and change the work plan before the MSG is constituted. CSOs should seize this new validation requirement to request and review the costed work plan as early as possible and ensure that they attend any meetings held to review and approve it.

It is important to think through each phase of the EITI process to make sure there are budget allocations in the Country Work Plan for the Preparatory, Disclosure, and Dissemination Phases. You may want to consider several questions:

- Does the work plan address capacity constraints (e.g., legal or educational constraints for government, civil society, and companies)?
- Are funds allocated for capacity building for the MSG at any stage?
- Is the Secretariat funded, and by whom?
- Are there monies to help CSO members of the MSG travel to meetings?
- Are there funds to translate the final report into multiple languages, if needed?
- Are there funds for workshops during the EITI process to explain to citizens what the EITI means?

Work plans are typically funded through a mixture of funds from the implementing government and international donors. The primary external source for funding the EITI work plans comes from the multi-donor EITI trust fund managed by the World Bank. Other donors sometimes contribute bilaterally to a country's EITI work plan costs.

## 1.6 Participate in the Selection of CSO Representatives on the MSG

The stakeholder group is the key mechanism for effective participation in the EITI by citizen advocates. The EITI requires that civil society is represented, that the representation is fair and independent, and that the invitation to participate is open and transparent as well. *The Sign-Up Phase is the time to question the government's senior official about how the government plans to implement these requirements and to provide CSO input on who the representatives will be.* In some countries (e.g., Nigeria and Azerbaijan) the government selects the civil society members on the MSG, or in the case of Azerbaijan, the Supervisory Board. In other countries, such as Mauritania, members select themselves. The EITI requires that there is an open and transparent process for inviting participation, that anyone selected is truly independent, and that the diversity of civil society stakeholders is adequately represented.<sup>13</sup>

### Text Box 1.4: Self Selection of Civil Society

Self selection takes longer in countries with emerging civil societies, but it saves time in the long run. The government of Mauritania asked civil society to choose three representatives to be part of an EITI committee. Since civil society was so new in Mauritania there were many new groups and coordination was slow. It took civil society three months to organize itself and choose their representatives, but public acceptance of the legitimacy of the representatives was much higher than if the government had simply appointed them.

Peru has a well developed civil society with a number of sophisticated organizations. The Peruvian EITI Action Plan called for three representatives from civil society to participate in the MSG. The Minister opened a website and requested that organizations nominate candidates to represent civil society. Eleven individuals were nominated. These eleven individuals came together and choose three among themselves to be civil society representatives to the MSG – one represented academia, another represented a local NGO, and the third represented an international NGO.

If members of a CSO EITI coalition do select representatives to a multi-stakeholder group, it is important that those not selected take great care not to fall into the trap of criticizing or disparaging those who are. Doing so only weakens the civil society

effort. A better practice is to agree before anyone is selected to (1) create a way to stay in touch, (2) agree to stick together, and (3) agree among yourselves on a list of representatives you can recommend to the government to serve on the multi-stakeholder group (MSG). As a useful reference point, the Azerbaijan NGO coalition has established a clearly laid out governance structure and rules.<sup>14</sup>

## 1.7 What Are the Qualifications for a Civil Society Representative on an MSG?

There are no formally required qualifications, but there are several practical considerations. For example, it is important that the representatives to the MSG are persons who can be effective in a group meeting. They should have the ability to listen and speak well, be problem solvers, have time to go to meetings, and ideally have some knowledge of the extractive industry. They should know when to compromise in order to allow work to start, but also when to stick to their principles so as to preserve the quality of the outcome. MSG representatives should make a commitment to be in touch with other civil society members through some agreed mechanism before and after meetings.

## 1.8 Review of Memoranda of Understanding

One practice that has emerged in the early stages of the EITI is the drafting and signing of memoranda of understanding (MOUs) on the scope of the EITI among companies, governments, and civil society. These MOUs are often drafted by companies as a way of both pressing a government for EITI participation and limiting its scope. They are helpful in providing companies with a way to advocate for the EITI in countries where the government may be reluctant to join the initiative. Knowing of companies' commitment to participate in the EITI can give governments the confidence necessary to join. But companies may also wish to lock in a government commitment that the information they disclose will be aggregated by company. While the MOUs may be amended, as a practical matter for voluntary initiatives just getting off the ground, it can be hard to change the terms in an MOU at the first stakeholder meeting.

*In Azerbaijan, the MOU provided for aggregated disclosure by companies.<sup>15</sup> Nigeria's commitment to disaggregation by company was led by the government.*

The best practice for CSOs is to not sign any MOUs until they have organized a coalition, gotten some outside help, and fully understand the issues. In any case, CSOs should not agree to be bound by the MOU on key decisions that should be discussed by the full MSG once it is constituted. These decisions would include the form of reporting (aggregated or disaggregated), the structure and content of the reporting template, the level of materiality, the process for selecting an auditor, and its terms of reference.

Chapter 1: The Sign-Up Phase		Yes/No
<b>I. Has the government demonstrated its seriousness about the EITI?</b>		
<i>Did the government ...</i>		
1. Issue an unequivocal statement of its intention to support EITI implementation?		
2. Make a commitment to work with civil society and companies on EITI implementation?		
3. Appoint a senior individual to lead the EITI effort?		
4. Develop and publish a fully-costed work plan with measurable targets, timetables, and an assessment of constraints that has been approved by stakeholders?		
<b>II. Are CSO representatives organized?</b>		
<i>Did CSO Representatives ...</i>		
1. Assess whether your country's CSO coalitions can provide an anchor for building a larger coalition?		
2. Seek like-minded citizens who want to press for transparency and agree to form a group?		
3. Agree to meet regularly to stay informed on the process?		
4. Agree to keep minutes of meetings so new members can get informed?		
5. Create a website so that other citizens can communicate with the coalition?		
<b>III. Do you know your objectives?</b>		
<i>Did CSO Representatives ...</i>		
1. Decide what they want to get out of an EITI program?		
2. Decide the order of priorities?		
3. Establish their positions on what should go into the Country Work Plan?		
4. Establish their position on the scope of the EITI (what/whom should be reconciled/audited)?		
<b>IV. Did you get outside help?</b>		
<i>Did CSO Representatives ...</i>		
1. Connect with international groups that are active in the global EITI?		
<i>Did the government ...</i>		
2. Secure outside help for the MSG from the EITI Secretariat, the World Bank and/or other donors and experts?		
<b>V. Are senior officials engaged?</b>		
<i>Did CSO Representatives ...</i>		
1. Meet with the senior government official leading the EITI to develop a relationship?		
<b>VI. Did you evaluate the Country Work Plan?</b>		
<i>Did the government ...</i>		
1. Develop/publish a work plan that is fully-costed, addresses capacity constraints, and is widely available?		
<i>Did CSO Representatives ...</i>		
2. Review the costed work plans as early as possible?		
3. Ascertain whether: (a) the work plan addresses capacity constraints (legal or educational); (b) funds are allocated for capacity-building for the MSG at any stage; (c) the Secretariat is funded; (d) there is money to help CSO members of the MSG travel to meetings; (e) there are funds to translate the final report into multiple languages, if needed; and (f) there are funds for workshops during the EITI process to explain to citizens what the EITI means?		



Chapter 1: The Sign-Up Phase <i>(continued)</i>		Yes/No
<b>VII. Did you participate in the selection of CSO representatives on the MSG?</b>		
1. Are CSOs represented fairly on the MSG?		
2. Is CSO representation independent? Was the invitation to participate open and transparent?		
<b>VIII. Are the CSO representatives to the MSG individuals who are effective in a group meeting?</b>		
1. Do CSO representatives have: (a) the ability to listen and speak well; (b) the ability to solve problems; (c) time to go to meetings; (d) some knowledge of the extractive industry; and (e) the ability to know when to compromise?		
2. Did the representative commit to contact CSOs before/after meetings?		
<b>IX. Has a memorandum of understanding (MOU) been signed articulating the EITI's scope?</b>		
<b>X. Have you successfully completed the Sign-Up Phase?</b>		





## CHAPTER 2

# *The Preparatory Phase*

The Preparatory Phase of the EITI—implementation of Steps 5 through 13 on the Validation Grid—is the most important phase of the EITI process. This is when all of the crucial decisions are made about the multi-stakeholder group itself; the engagement of civil society and companies; what types of payments and revenues the EITI will examine (and in what level of detail); who will perform the reconciliation or audit; what the reports will look like when they are published; and what the government will do to make sure that all parties covered by the EITI process participate as required. One-half of the steps required for EITI validation occur during this phase. It is essential to anticipate now the financial, communications, and other needs the stakeholders will come to have in the Disclosure and Dissemination Phases, so they can be budgeted for and shape the terms of reference for the organization performing the reconciliation, or so that the auditor can deliver his report in the form that is needed.

This guide will address the elements of the Preparatory Phase as follows:

1. Establishment of the multi-stakeholder group (Step 5)
2. Approval of the Country Work Plan (Step 5)
3. Engagement of civil societies and companies (Steps 6–7)
4. Removal of obstacles to participation (Step 8)
5. Preparation of the reporting templates/determination of the scope of the EITI inquiry (Step 9)
6. Appointment of the independent administrator (Step 10)

7. MSG satisfaction with the organization hired to do the work (Step 10)
8. Government action to ensure companies report (Step 11)
9. Government assurance that government and company reports are based on audited accounts meeting international standards (Steps 12–13)

## 2.1 Establishment of the Multi-Stakeholder Group

The EITI requires that a group including private sector, independent civil society representatives, and relevant senior government leaders oversees the EITI effort in each country. The group must establish terms of reference (TORs) for its own operation, including review and approval of a Country Work Plan.<sup>16</sup>

*Who Serves on the MSG?* The EITI requires that stakeholders are adequately (but not equally) represented. This can be hard to assess and depending on the number of civil society seats on the MSG, hard to allocate. One issue is deciding which extractive industries will be covered. Nigeria and Ghana both have oil, gas, and mining industries. In Nigeria, NEITI so far only addresses the oil and gas sectors. When the NEITI was first established, company representatives included international oil companies, a domestic oil company, and Nigeria LNG. In Ghana, which has just discovered oil, the EITI so far only covers the mining industry, and no oil or gas companies are represented on the MSG.

Various government leaders may be included on the MSG. In most countries the oil, gas, or mining state-owned enterprises are included, as well as regulators, finance ministries, and central banks. In some countries the heads of parliamentary or legislative committees will be represented, as will leaders from local governments. The key is for the MSG to have government stakeholders from all levels at the table to ensure they are accountable and cooperative.

Another issue is determining who represents civil society. A critical challenge is to understand how to balance representation among various unions, coalitions, central and regional government representatives, and the media. A well-organized coalition, with rules for filling CSO positions (see Chapter 1), can help ensure that diverse interests and perspectives are effectively represented on the CSO. (See Text Box 1.4 in Chapter 1 for examples of how civil society members can go about selection of their own representatives.) Many countries have adopted a law or process for rotating their representatives. In Nigeria, the NEITI law provides for five-year terms. In Azerbaijan, NGO organizations have established an independent coalition entitled “Improving Transparency in Extractive Industries” that is open to all NGOs.<sup>17</sup> In Kazakhstan, civil society has organized an NGO coalition called “Oil Revenues–Under Public Oversight!” which is also open to all NGOs.<sup>18</sup>

*The Secretariat or Implementation Unit.* A related but critical issue is whether the MSG will have a Secretariat or some kind of implementation unit to support it. The EITI does not require that each program have a Secretariat. Indeed, of the countries who have published reports, only the Kyrgyz Republic, Mauritania, and Nigeria have full-time Secretariats. The other efforts are staffed by a ministry or ministries (See Table 2.1). While it is important that a senior government official leads the EITI effort, as a practical matter to ensure the effectiveness of the effort, it is highly desirable for EITI multi-stakeholder groups to have a full-time Secretariat with a full-time executive secretary or senior staff person to manage administrative issues.

**Table 2.1: Support for Multi-Stakeholder Groups by Country**

Country	Secretariat in Ministry or Independent?	Full Time EITI Director on Staff?
Azerbaijan	State Oil Fund	No
Cameroon	Ministry of Economy and Finance	No
Gabon	The Permanent Secretary of the EITI Work Group is the Financial Counselor of the Minister of Economy, Finances, Budget and Privatization of Gabon.	No
Ghana	Ministry of Finance and Economic Planning	No Information
Guinea	Ministry of Mines and Geology issued a decree creating the Permanent EITI Implementation Committee.	No
Kazakhstan	Established through joint orders of the Minister of Finance and the Minister of Power, Engineering and Mineral Resources	No Information
Kyrgyz Republic	Implementation Committee consists of representatives of various government departments.	No
Mauritania	Independent	No Information
Mongolia	National EITI Council is chaired by the Prime Minister, comprised of representatives of the government, mining companies and civil society; and supported by a small secretariat.	No Information
Nigeria	Independent	No
Peru	Ministry of Energy and Mines	No Information

Source: Azerbaijan [www.eitransparency.org/section/countries/\\_azerbaijan](http://www.eitransparency.org/section/countries/_azerbaijan),  
 Cameroon [www.eitransparency.org/UserFiles/File/cameroon/cameroon\\_minutes\\_feb\\_01\\_07.pdf](http://www.eitransparency.org/UserFiles/File/cameroon/cameroon_minutes_feb_01_07.pdf),  
 Gabon [www.eitransparency.org/section/countries/\\_gabon](http://www.eitransparency.org/section/countries/_gabon),  
 Guinea [www.eitransparency.org/section/countries/\\_guinea](http://www.eitransparency.org/section/countries/_guinea),  
 Ghana [www.geiti.gov.gh/news/newsarticle.asp?id=3](http://www.geiti.gov.gh/news/newsarticle.asp?id=3),  
 Kazakhstan [www.eiti.kz/secretary/](http://www.eiti.kz/secretary/),  
 Kyrgyz Republic [www.eitransparency.org/section/countries/\\_kyrgyz](http://www.eitransparency.org/section/countries/_kyrgyz),  
 Mauritania [www.eitransparency.org/section/countries/\\_mauritania](http://www.eitransparency.org/section/countries/_mauritania),  
 Mongolia [www.eitransparency.org/section/countries/\\_mongolia](http://www.eitransparency.org/section/countries/_mongolia),  
 Nigeria [www.neiti.org/about.htm](http://www.neiti.org/about.htm), and  
 Peru [www.minem.gob.pe/eiti/archivos/dso27-2006-ingles.pdf](http://www.minem.gob.pe/eiti/archivos/dso27-2006-ingles.pdf).

A Secretariat is important for several reasons. First, stakeholders usually have full-time jobs and must be provided with information so they can be prepared for meetings. Second, the lead official will be a government employee. The more senior they are, the more influence they are likely to have, which becomes important to maneuver through difficult bureaucratic obstacles that can arise when pressing challenging EITI audit issues upon government agencies and commercial participants involved in the extractive industries. But recognize that the more senior the lead official is, the busier he will be, and someone must manage the work of the EITI program. Third, most of the work of the stakeholders will be reviewing, critiquing, and approving documents (e.g., the terms of reference for the audit, the bids for the audit, the terms of reference for outside experts, and the audit contract). If these are not well prepared and circulated in advance, civil society cannot be an informed or effectively participate in the EITI process. Many transparency efforts are handicapped because of inadequate support for the Secretariat, unable to manage the volume of information he receives, much less act on it.

*In Cameroon, the EITI Follow-Up Committee cited the lack of provision of materials to CSOs as a handicap to CSO participation. The committee also cited the lack of facilities and personnel as a constraint on its effectiveness.<sup>19</sup>*

The role of the Secretariat is to organize and staff meetings; publish the agenda; coordinate the different government agencies involved in EITI implementation; distribute information to stakeholders in advance of meetings; secure expert advice on audits, communications, and legislation; create and manage the EITI budget; interact with foreign donors; create and maintain a website; follow up on multi-stakeholder group directives; explain to the media what is happening in the EITI process; answer press inquiries; manage the auditors; and identify, publicize, and re-mediate instances in which government or commercial entities are not fully or fairly cooperating with the audit.

*A Suggested Agenda for the First Multi-Stakeholder Meeting.* At the first meeting of the stakeholder group, members should agree on the size, staff, and responsibilities of the Secretariat. Budget will dictate the size of the staff, however, the following best practices should be observed:

- There should be a full-time executive director, appointed by the stakeholder group and removable by the group, with sufficient seniority and experience to move the process forward.
- The Secretariat should provide an agenda and supporting materials well in advance of meetings to allow for preparation and time for representatives to travel to the common meeting location.
- A stakeholder website should be established so that stakeholders can download large documents without receiving them via email—in many developing countries large documents such as audit reports can clog email systems.

- The Secretariat should quickly produce minutes of all meetings and distribute them to all members.
- The Secretariat should prepare and distribute a budget (or explain the budget in the draft Country Work Plan) so that stakeholders know what the EITI program can afford in terms of audit work and staff, and how much they may need to raise from external sources.

Where possible, the Secretariat should have several staff at his disposal including:

- A communications officer who is available; well informed of the EITI activities and processes; able to organize outreach activities, workshops, and conferences and manage the local EITI website; and able to keep the media informed.
- An administrative officer to manage operational budgets, provide expert help, and run the office itself.
- An audit expert to help manage the auditors and to provide stakeholders with information about the audit.

## 2.2 Approval of the Country Work Plan

The EITI requires that the MSG review the Country Work Plan, revise it where necessary, and then endorse it as a group. The Country Work Plan should have targets, timetables, a budget entry for each item, and an assessment of potential capacity constraints. (See examples of the Ghana Country Work Plan in Appendix C and the Kazakhstan Work Plan in Appendix D.) CSOs should examine each category of the work plan. The targets should include all the actions the program may need. For example, if public education about the EITI is a priority, or a briefing on audit procedures is needed for the MSG itself, then workshops and a website should be a target. Timetables should be realistic and in the right order (i.e., capacity building should take place before key decisions are made). Budgets should correlate to tasks. Among the most fundamental issues is how much money is available for the audit or reconciliation, capacity building, and disseminating the report. Ideally, the scope of work of the EITI review would drive the budget and not the other way around.

### *A Ghanaian Example*

*The version of the Ghana Work Plan in Appendix C is a good example of a work plan that describes clear targets. It describes what the aggregators will do in the process of collecting data. The column of actions (targets) is very detailed and there is a multi-year timetable. The work plan, however, does not have any budget information.*

### *A Kazakh Example*

*The Kazakh Work Plan in Appendix D is a good illustration of a format that shows the target actions, a timetable, and costs. Look at the first item, establishment of a*

*Secretariat. The item shows the target, the action taken (a three-person Secretariat headed by a vice minister), and the cost (no funding required). In this case the stakeholder could ask some questions: Is a three-person staff enough? Does a vice minister have time to do this work and his regular job? Will there be funds for Secretariat activities like travel or photocopying?*

### 2.3 Engagement of Civil Society and Companies

The EITI requires that both civil society and companies be engaged in the process.<sup>20</sup> This means that the government and the MSG must make an effort to communicate to the public the government's commitment to the EITI and help overcome any constraints on its capacity to interact with the EITI.

Outreach can take many forms. In Nigeria, the NEITI conducted road shows. Representatives from the auditors and national and local CSOs traveled to the major regions in the country to hold open meetings to explain what the NEITI was trying to do and to listen to what people wanted to say. In Azerbaijan, a website helps companies and individuals access information. Civil society and companies may both have capacity constraints. The EITI may be new to all parties. Workshops and briefing can help educate people about what the EITI actually involves.

The best way to sustain engagement is to stay in touch. Once civil society representatives are designated, some mechanism should be created to stay in communication. Representatives are usually unpaid and have other full-time jobs, like teaching in universities, editing newspapers, or running NGOs. The method and frequency of communication must be reasonable to all parties. In the Nigerian case, a formal Memorandum of Understanding<sup>21</sup> was drafted among the National Stakeholder Working Group, a coalition of civil society members. In smaller countries, less formal mechanisms may be adequate.

Suggested best practices for staying in touch include the following:

- Civil society representatives can meet with civil society members before a meeting to discuss the stakeholder working group agenda and get input.
- Civil society representatives can establish an email listserv to keep all interested parties informed and in regular contact on the EITI and related issues.
- Companies can form industry working groups and meet with other companies before a meeting to discuss the stakeholder working group agenda and get input.
- Stakeholder representatives can communicate meeting results by email, or even by ensuring that the minutes of stakeholder group meetings are posted on an open website.
- Stakeholder representatives can seek the help of civil society (or industry) groups in disseminating information.

Civil society groups have several responsibilities including:

- Use their own networks to spread the word about the EITI program
- Providing representatives with information about public questions or perceptions
- Helping representatives by conducting research or providing expertise
- Encouraging the media to report on EITI meetings and reports

## 2.4 Removing Obstacles to Participation

The EITI requires that civil society groups are independent of governments and able to express themselves without undue restraint or coercion.<sup>22</sup> Some obstacles to civil society participation may be legal or regulatory. If so, civil society groups should communicate to external organizations (e.g., the EITI Secretariat or the local Publish What You Pay Coalition) the nature of such obstacles so that the MSG can help to address them.

Companies may be contractually prohibited from sharing financial information without the approval of the government. In these cases, the government may need to issue an order excusing the companies from their obligation to keep this information confidential. In Nigeria, for example, the president of the country wrote each company to request that they submit information.

Other obstacles may be more practical. If the MSG meetings are held in the nation's capital, it can take time and money for civil society members outside the region to participate. Meetings require advance notice so that representatives have time to travel in order to attend. One practical step EITI multi-stakeholder groups can take to address these concerns is to provide financial assistance for travel to meetings, especially if representatives live outside the capital city. Help paying for transportation and lodging has been made available in Nigeria.

## 2.5 Preparation of the Reporting Templates and Determination of the Scope of the EITI Inquiry

The EITI requires that the multi-stakeholder group agree to the form of the reporting template.<sup>23</sup> This involves more than just an agreement on forms.

### Text Box 2.1: Creating Templates

Grid Indicator and Indicator Assessment Tool 9 of the Validation Guide requires that a multi-stakeholder group be involved in the creation and approval of the templates and that civil society have a chance to comment. The question of what revenue streams should be captured should be decided before the auditor is hired. But generally the auditors will want to prepare the final templates so they can create a useful form in which to receive the information.

The templates should define:

- the revenue streams companies and the government must disclose
- the companies that should disclose information
- the government entities that should disclose information
- the time period the EITI report should cover
- the form (aggregated or disaggregated) in which the information will be reported

These templates establish the core of the entire transparency process, namely, what information will be transparent as a result of the EITI in any country. While the *EITI Sourcebook* provides a form for a template, countries have tailored the form to meet their own needs. Examples of templates from Mongolia are in Appendix J. Most countries, however, have not published their templates. Typically, both companies and government entities need help to understand and complete these templates.

The EITI also requires that stakeholders have help to understand the issues involved in making these decisions, that the stakeholder group discusses them, that wider constituencies have a chance to comment, and that the multi-stakeholder group approves the final templates.

### Text Box 2.2: Peer Training

In Guinea, members of civil society with a finance background were asked to explain the audit process to other civil society members. The Guinean National Organization of Auditors was involved in this process, adding to its legitimacy.

*The Revenue or Benefit Streams Companies and Governments Must Disclose.* The *EITI Sourcebook* provides.

*Benefit streams are defined as being any potential source of economic benefit which a host government receives from an extractive industry. They are not assumed to include indirect economic benefits such as construction of infrastructure or employment of local personnel. All material benefit streams must be reported.<sup>24</sup>*

There are several common forms of benefits paid by companies including:

- Taxes
- Royalties
- Shares of production
- Rents and fees for license areas
- Bonuses
- Dividends and profit transfers
- Asset sales

Royalty payments, taxes on profits, and production sharing to the government are usually the largest of these flows. These payments are made by private companies, as well as by national oil or state mining companies, which are engaged in exploration, production, transportation, or other downstream activities. The specific benefit streams to which a government may be entitled are determined by law, regulation, and by the contracts the government signs with companies. Countries can have different types of financial arrangements within an industry (e.g., differing terms for deep-water versus shallow-water exploration or for gold and copper), as well as different arrangements for mining and natural gas exploration. (A detailed explanation of each of these benefits streams, the varying legal arrangements associated with each, and the challenges that can arise in calculating benefit streams correctly is in Part II of the guide.)

*Be Informed.* It is essential for stakeholders to be informed and stay informed, particularly prior to making critical decisions. Unfortunately, too often this does not happen. Thanks to the new validation criteria, stakeholders should insist on a briefing from the government or an outside expert on what flows the government is entitled to, what amounts the government believes they earned from these streams in the most recent available records, and which government entities received them. This will tell the MSG what all of the benefit streams are, so they can decide if they must all be disclosed, or if the MSG is only primarily interested in very large flows. For example, while payments of taxes on profits are large, payroll taxes or value added taxes paid by companies may not be large amounts. Stakeholders may prefer to spend more of their time and budget looking deeper into whether the largest of the benefit streams were paid accurately rather than verifying whether payments less pertinent to the EITI inquiry (e.g., payroll taxes) were paid correctly.

*Which Companies Must Make Disclosures?* The EITI Criteria requires that “all material oil, gas, and mining payments to government” and “all material revenues received by government from oil, gas, and mining companies” be disclosed.<sup>25</sup> As explained in the sections that follow, this means that all forms of compensation (e.g., money for bonuses, taxes, or royalties) that companies pay must be disclosed, if they are large enough to justify auditing or reconciling them. Every EITI stakeholder group will decide for itself how large (or material) these payments should be. State-owned enterprises, like national oil or mining companies, must also report. EITI Criteria 4 specifically provides that the scope of the EITI also includes state-owned companies.<sup>26</sup> Stakeholders must decide whether all payments should be reported, or just those deemed to be material. It is possible to require all entities to disclose, even if only the major flows are categorized as material and reconciled. (This approach, for example, was taken in Nigeria in the oil sector.) This even puts the burden on small companies, or on individual miners, to complete the templates. Securing these templates can place a heavy burden on the firm doing the reconciliation. An alternative and lesser approach may require only companies of a certain size, or revenue level, to report. (See Table 2.2.)

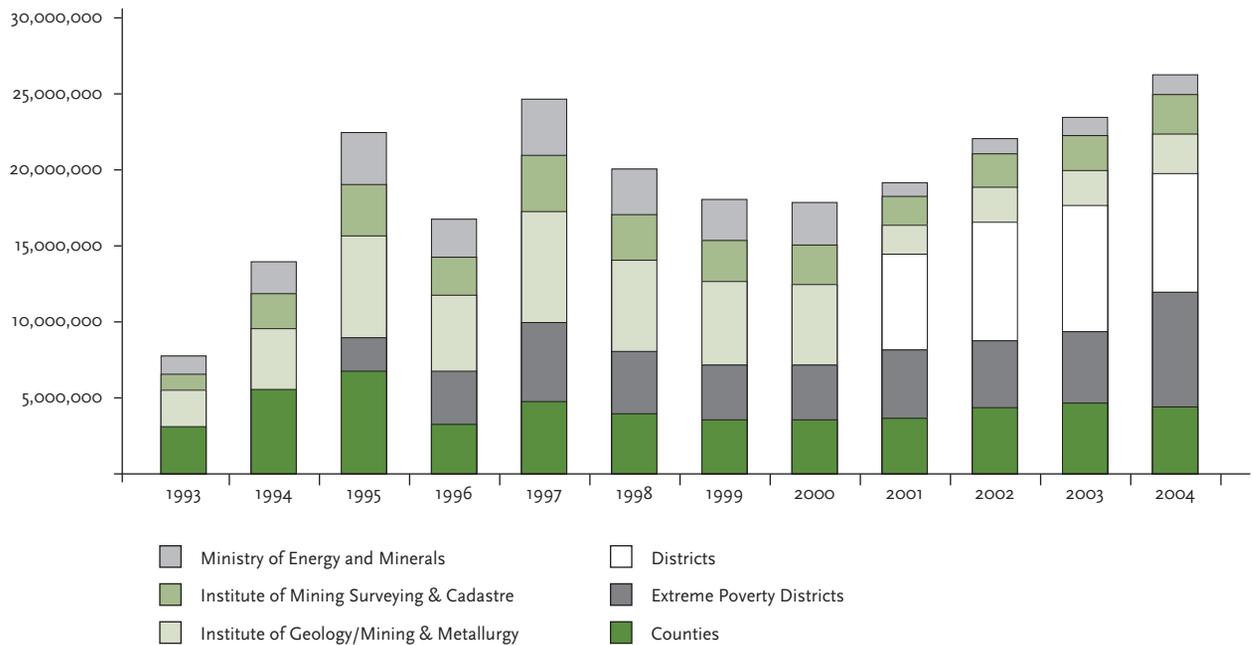
**Table 2.2: Terms of Reference (TORs) to Produce Required Audit Reports**

Opinion Sought	Suggested Wording in Terms of Reference
Detailed explanation of the work done and the findings of that work (“agreed-upon procedures”)	The accountant shall undertake the following procedures and report the results: ...
Opinion on the reasonableness of the presented data (Assurance report)	The accountants shall undertake such procedures as they consider necessary and report whether in their opinion the data presented to them are materially in agreement. Where material differences are identified, the accountants shall report on them.
Audit in accordance with International Auditing Standards	The accountants shall undertake an audit in accordance with International Auditing Standards of the financial statements of [name of legal entities] for the financial years ended [date] and shall report whether in their opinion the financial statements have been prepared in accordance with International Financial Reporting Standards

*Which Government Entities Should Disclose Revenues?* Stakeholders should be briefed on all of the agencies and state-owned enterprises that receive payments. There are often several. A detailed explanation of the many potential government entities that receive revenues and the special issues that arise in verifying their receipts is addressed in Part II of this guide. The key institutions in most countries include the central bank, the tax authorities, regulatory authorities, the national oil or mining company, regional and state governments, and quasi-governmental organizations.

Under Peruvian law, some mining revenues are distributed directly to regional governments and also to governmental departments. Illustrations of these distributions are in Figure 2.1.

**Figure 2.1: Peru Distribution of Mining Tax Payments to Government Entities**



*Which Benefit Streams Are Material?* The EITI requires that all material benefit streams are published. A revenue stream is further defined as material if, “its omission or misstatement could materially affect the final EITI report.”<sup>27</sup> Defining the term “material” in quantitative terms is typically a responsibility of stakeholders and depends on what the EITI program objectives are in your country. For example, a template might be structured to state that all benefit streams over a specific dollar threshold, such as any payments of \$1 million or more, are “material.” A second threshold could be the size of a company’s production or payments. Another threshold might be a percentage, such as any stream that represents at least 5 percent of the total revenues earned by the country in the prior year, or those payments made by companies that contribute 95 percent or 99 percent of all revenues earned. If it is important to understand the impact of companies in the extractive industries at a more localized level, and the stakeholders want a complete picture of the funds flowing to the regions and regional governments, then all payments, or all cash payments, may be material to the EITI effort, even if they are not large. The countries implementing the EITI today appear to define materiality very differently, and a standardized approach to define materiality has yet to emerge.

*In Cameroon, the MSG decided which entities were covered, but did not reveal the materiality standard it applied in the aggregated report that has been published.*

*In Ghana, the payments were made by 8 companies contributing 99 percent of royalty payments in the year that was being audited. Ghana decided not to have the other companies report their payments because it would have been costly to audit a lot of other companies whose payments, when added together, would have amounted to less than one percent of the government's revenue. Payments from the country's smallest miners, which were a fractional amount of total revenue, therefore were not considered "material" and were not required to report. It would have been expensive and difficult to find these individuals, and it was unlikely they would have had any records, much less ones audited to international standards.*

*Nigeria required all companies to report their payments of taxes, royalties, and production shares, but only required the auditors to resolve discrepancies if they represented five percent or more of the total revenue stream.*

*Guinea defined materiality to only include the payments of the six largest mining firms for its 2005 report.*

*Gabon's first EITI report failed to include the government's profit oil revenues, which appears to be a clear omission of a material stream by any definition.*

The EITI implementing countries, other than Ghana and Nigeria, have not been transparent in their processes for defining "materiality," nor possibly the analysis of material benefit streams. In those cases where participation by companies has been voluntary, or where companies have not reported, it is not knowable if material benefit flows were reported. The validation requirement should help eliminate these weaknesses in the future.

Ghana represents an economical approach. Ghana covered the major flows and tried to look more deeply into them. Nigeria represents a comprehensive approach, but the audits were therefore more expensive and time-consuming to produce. Therefore, it is clear that the definition of "materiality" determined by stakeholders is highly influential to the time, budget, number of companies in the sector included in the EITI audits, and the sufficiency by which the EITI objectives are served in that country.

*What Period of Time Should the EITI Cover?* The EITI requires that the MSG define the time to be reported, but the EITI does not say how long this period should be. As Table 2.3 suggests, the practices actually utilized vary significantly. Ghana's first EITI report covered a six-month period from January 2004 to June 2004. Nigeria's initial audits covered a five-year period from 1999 to 2004. It is clear that stakeholders will want to weigh the cost of reviewing past years against the insights that reconciling those years will provide. It is also recognized that the further back a review may extend, the quality of the data may decrease (potentially significantly) due to poor record-keeping and missing documentation.

**Table 2.3: Time Periods Reported on Under Existing EITI Reports**

Country	Number of Reports	Period Covered
Azerbaijan	5	January 2003–June 2006
Cameroon	2	2001–2005
Gabon	2	2004–2005
Ghana	2	2004
Guinea	1	2005
Kyrgyz Republic	1	2004
Mauritania	1	2005
Nigeria	1	1999–2004

*Source:* Links to country reports for Azerbaijan, Cameroon, Gabon, Ghana, Guinea, Kyrgyz Republic, Mauritania and Nigeria can be found through [www.eitransparency.org/section/countries](http://www.eitransparency.org/section/countries) or Table 3.1.

*The Form of EITI Reporting (Aggregated or Disaggregated).* The EITI does not require that the data reported be published in an aggregated or a disaggregated form, as illustrated in Table i.1 in the Introduction.

While all companies that have published EITI reports have utilized disaggregated reporting by payment type (e.g., tax, royalty, production, or share), only Ghana, Guinea, and Nigeria have additionally required disaggregated reporting by specific company.

It is important to note that before companies will agree to complete EITI reporting templates, the stakeholders can expect the companies will want assurance that they are permitted to provide the data to a third party. (See Section 2.7 regarding the government's related obligations.) Companies will also typically want agreement on the form in which the data will be published. The clear preference of CSOs, the Revenue Watch Institute, and many others is for comprehensive disaggregated reporting. In a voluntary initiative, however, consensus must be reached. Companies generally assert that they will suffer competitive injury if the terms of their transactions are known to their competitors. They also fear that the public will not be informed or will not understand the potentially unique circumstances that led to the agreed upon economic terms with the government (e.g., production sharing contracts, joint ventures, and related agreements are of significant technical, financial, operational, and legal complexity). CSOs argue that this is the information the public needs and the EITI can be a platform for educating them.

*It is worth noting that many of the companies that permitted their payments to be reported in a fully disaggregated fashion in Nigeria are present in other countries. Companies are greatly influenced by what the host government wants. In Nigeria, companies found the government's desire for full disaggregation compelling. CSOs might focus their persuasive attention on governments before they engage the companies.*

### Text Box 2.3: Cash versus Accrual Accounting

Companies prepare their financial statements using accruals accounting, which is required by International Financial Reporting Standards; their underlying financial records are organized to enable them to do this. Governments, however, have traditionally maintained their financial records on a cash basis.

To understand the difference between the two accounting methods, consider the following example: you decide to rent an apartment starting on 1 December and the rent is \$1,000 per month; you have to pay 3 months rent in advance. If you were to prepare financial statements at the end of December:

- Your cash basis accounts would show that you actually paid \$3,000 in December
- Your accruals basis accounts would show that rent cost you \$1,000 in December and that you have the benefit of \$2,000 carried forward into the next year.

EITI templates for financial transactions should always be required to use the cash basis. Otherwise, the company transactions cannot be matched accurately with the government transactions. It is for this reason also that company publishing financial statements cannot be a useful source of data for template reporting.

There is a further issue of payments taking place around the end of a financial year, which is a common situation. If a company is due to make, say, a tax payment on 31st December, and issues the payment instruction to the bank on that day, it is quite possible that the payment will arrive in the government's account in the early days of January. This can cause a difference in the amounts reported as paid and received. The MSG, in consultation with the appointed auditor/aggregator should decide how to address this. If your main objective is to establish the amounts received by government, you might decide that the received date should be the more significant of the dates, for reporting purposes. In any event, the auditor/aggregator will need to take account of this timing difference in the design of the templates.

## 2.6 Appointment of the Independent Administrator

Once the stakeholder group determines the scope of the EITI process—whether there will be a reconciliation or a comprehensive audit—the next step is to hire independent expert(s) to fulfill the tasking. The EITI requires that the MSG be content with the organization hired to do the work.<sup>28</sup> This should mean that the MSG not only votes on the organization chosen, but also plays a role in its selection, including the determination of the terms of reference for the organization. Similarly, the MSG should have the

same rights to review and approve the validator, when the time arises. The MSG will choose the validator from a list of organizations provided by the EITI Secretariat.

Stakeholders have a strong interest in ensuring that the firm hired (and potentially other subject matter specialists) have the right qualifications, with no conflicts of interest, and that they obtain a bid that accurately anticipates the cost of performing the work. To achieve this goal, the MSG, generally through the Secretariat, needs to be very clear from the start of the procurement process about what is required and must include all the requirements into the expression of interest or request for the proposal seeking bids.

It is especially important to determine the scope of the EITI process in your country *before* you hire the independent expert, so that they are able to provide accurate, fully-costed, and complete bids. The key issues that need to be decided in advance include the following:

- Number of years to be examined
- Level of materiality
- Entities that will be covered
- Whether the independent expert will rely on existing published audits or test the underlying revenue numbers
- Whether physical volumes of production (i.e., oil, gas, or minerals) will be reviewed
- Whether any industry processes (i.e., licensing or measurement of production will be examined)
- Whether they will be required to have a local partner

*Qualifications of the Auditors/Aggregators.* EITI Criteria 2 requires that where such accounts do not already exist, auditors or aggregators must be credible, independent, and apply international auditing standards. Civil society stakeholders should be vigilant about making sure these standards are enforced.

To be *credible*, the terms of reference for auditors or aggregators should require that they:

- are chartered accountants
- have experience auditing companies in the extractive industry, specifically within your country and potentially on an international basis (see discussion pertaining to *independence* below for countervailing concerns in this regard)
- possess a size and staff to handle the job
- agree that the report will be signed by a chartered accountant

More specifically, depending upon the level of trust the MSG has in existing audit reports, the level of sophistication of the national accounting industry, and whether the EITI process will be a full audit or a reconciliation, you may wish to have an audit firm from a country other than your own, with experience performing audit work at international or EITI standards, act as the independent expert. In Nigeria, where financial flows are audited, not merely reconciled, the NEITI National Stakeholder Working Group has so far required an international audit firm to lead the audit and sign the report, with support from a well-established local audit firm. Local entities can play an important role, depending on the level of professionalism of the local accounting industry, the prevalence of auditing and international standards, and the capacity and independence of the local firms.

To be *independent*, the auditors or aggregators should not currently be engaged in:

- audits of government accounts or industry participants in your country
- consulting to the government or extractive industry companies in your country
- any other activities that could represent major conflicts of interest

*Managing Conflicts of Interest.* In an ideal world, EITI auditors or reconcilers would have international oil, gas, or mining audit experience; would not work for any of the companies operating in your country; would have some local knowledge; and would be interested in the EITI work. However, with only four global accounting firms left in the world, it is hard to find one that does not do business with major oil, gas, and mining companies. It would be a conflict of interest for an audit firm to both audit a company's accounts and then perform the reconciliation, because the firm would be checking its own work.

There are three ways to resolve this challenge:

- Pick a smaller, but nonetheless well-qualified, firm.
- Require a global firm to use an independent team.
- Pick a credible national firm with experience and no conflicts.

Many firms do not operate on a global scale, but are qualified auditors in Organisation for Economic Co-operation and Development (OECD) countries and have had experience auditing national oil or gas companies (or have audited oil and gas firms in their past), but do not do so currently. If they meet the qualifications for the work, these firms would have no conflicts of interest.

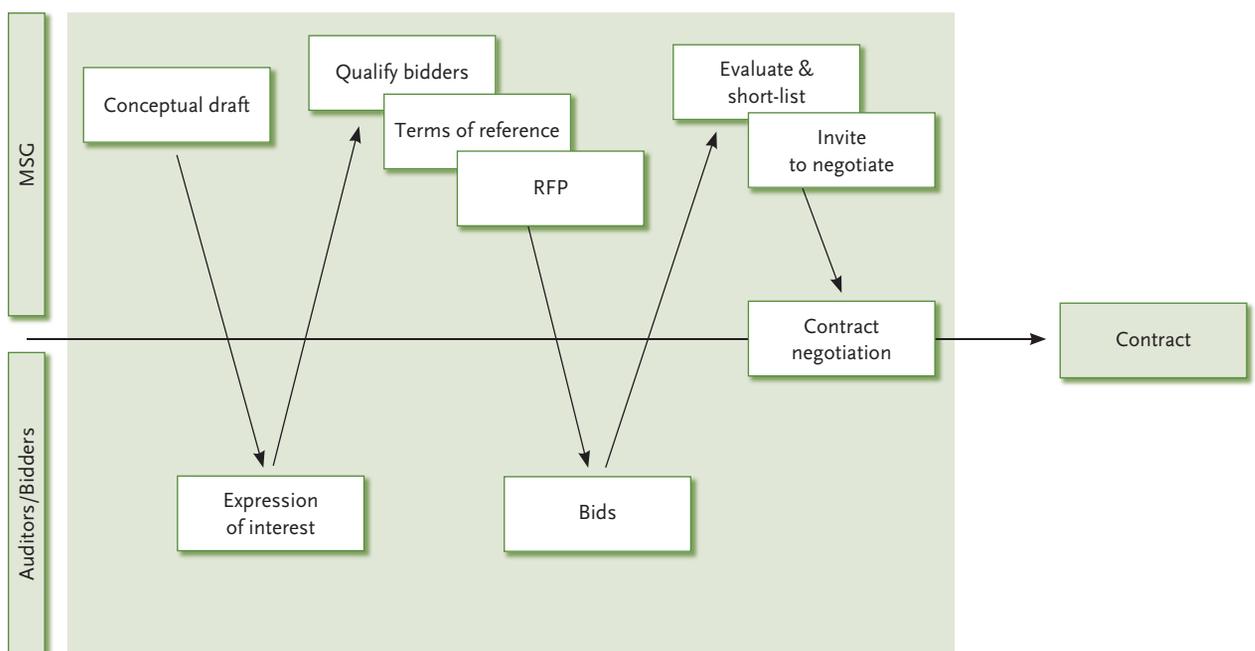
Global firms can also try to reduce conflicts by putting together a team of auditors or experts who do not work on the audit of the national oil company (NOC) or another company operating in the country. They can do this by using a set of auditors from the firm's office in your home country who don't work for the NOC, or using a set of auditors from a firm office in another country.

In these cases it will be important to identify exactly which people will conduct the audit, supervise the work, sign the audit, and assure the MSG that none of the auditors work for any of the other companies operating in your country.

*Local Help.* We believe there is a great advantage in public credibility to be gained by employing an audit firm licensed or chartered in a country other than your own to sign and supervise the audit or reconciliation. The closer the scrutiny of the data, the more important it is to have experts who know how the industry operates. But it is always important to have local knowledge. Knowing the local language and customs can be indispensable to performing audits efficiently. It can also be very expensive to bring in foreign auditors or experts for extended periods of time and pay for their airfare, hotels, and other costs. Another best practice is to have an international audit team partner with a local firm. The local firm must also meet the tests of credibility and independence and not possess the conflicts of interest as described above.

*The Selection Process.* There are many ways in which a tender to select an auditor or an aggregator can be designed and conducted, with many variables to be considered to ensure that the process is in fact transparent, competitive, fair, and meets both international standards and localized needs. MSGs should appoint a subcommittee of individuals who can take part in what can be a time-consuming process. It is important that this committee have CSO representation. The core structure of an international EITI tendering process that has proven successful in meeting these diverse and challenging criteria generally includes the following procedural flow:

**Figure 2.2: EITI Tendering**



*Public Announcement/Advertisement.* The tender process typically is initiated by the placement of an advertisement in major media sources inviting expressions of interest. The advertisement describes in a summary fashion the services that are specifically requested (e.g., the EITI audit or reconciliation; the required qualifications of bidders; the date when the expression of interest from bidders is due; and the policy on conflicts of interest). Responses to the expression of interest will tell you if you have enough firms interested in the work to obtain a competitive offer. It is helpful to advertise the expression of interest in international journals (e.g., *The Economist*, *Financial Times*, and the *Journal of the European Union*). If the World Bank or another development agency is helping to underwrite the EITI work within a specific country, the financing agency may have rules on where and when to advertise for help.

*Terms of Reference/Request for Proposal.* The best way to ensure that you get the right auditor at the right price is to be very clear about what work needs to be done. In some cases this is very simple: the work is to reconcile payments and revenues for all relevant revenue streams and to report discrepancies. In other cases, the scope of work may be more extensive, such as verifying the accuracy of the underlying transactions, the physical production of oil and gas, or the calculation of royalty or tax obligations.

Civil society members should be sure that the MSG has or gets the help it needs to prepare this document. The response to this document by a bidder is the place where civil society members can assess or predict the quality of the work that will be done by the audit. The request for proposal (RFP) should include essential criteria such as periodic reporting to the MSG, creation of reporting templates, and preparation of final reports in comprehensible language.

Qualified bidders should be sent a copy of the RFP and scope of work and asked to submit a technical bid and a financial bid based on the RFP.

*Short-Listing Bidders.* When bids come in, if the competitive field is large, the MSG should reduce the number of candidates to the most competitive firms. A subcommittee should decide on the technical criteria it will use to score or rank bidders before reviewing the bids. These criteria might include: experience conducting audits in the relevant sector (oil, gas, or mining), experience with the EITI, experience in any specialized requirement for your EITI audit (e.g., diamond mining or liquefied natural gas sales), the adequacy of the work plan, staff capacity, language ability, and whether they have a reputable local partner in their consortium. MSGs may also want to interview the bidders at this point or ask them to make presentations to the MSG.

*Bidders' Conference.* Bidders will invariably have questions about the request for proposal. In order to ensure that all bidders are competing on a level playing field, it is a good idea to have a conference call enabling any bidder to ask a question, get an answer, and share that response with all bidders simultaneously. An alternative is to allow bidders to submit questions and email the answers to all bidders.

*Invitations to Negotiate.* Once the MSG has a short list of bidders based on technical qualification (perhaps three or four firms), the MSG committee should open the financial bids and rank them. While one option is simply to award the contract to the low bidder, the bids may in fact vary significantly. One bidder's work plan may be thorough, but more expensive. Another bidder's work plan might be superficial, or involve limited verification of underlying data, but come from a firm that has no conflicts of interest whatsoever. By giving each bidder an invitation to negotiate, rather than making a cursory or compulsory decision to make the award to the lowest-cost bidder, the MSG can ask all short-listed bidders to refine their bids, offer a price based on work requirements desired by the MSG, seek verification of exactly what staff will supervise and conduct the audit, ensure a high level of quality, and ensure that there are no conflicts of interest. Once these answers have been provided, the committee can make a recommendation that can be explained to the MSG and to civil society.

*Contracts.* The contract between the MSG and the auditor should specify the scope of work, reporting obligations, payment schedule, confidentiality obligations, and steps to be taken in the event of a dispute. If the form of the contract is provided with the RFP, the signing of a contract should be a relatively simple matter. The contract should be made available and approved by all members of the MSG before signature.

## 2.7 Monitoring Progress

*The Importance of Progress Reports.* An audit or reconciliation can take from six months to a year to complete, depending on the scope of work and the quality (or even existence) of records. Members of an MSG and civil society need to know what is going on in the time between the beginning of work and issuance of the final reports.

Stakeholders should require that the organization chosen issues written and in-person progress reports on the scope of work, as well as a series of other "deliverables" so that civil society members on the MSG can learn about industry practices and keep informed about whether the audit process is working.

It is not unusual for auditors or aggregators to encounter problems. Small companies may ignore their requests for data. Templates may be filled out incorrectly. Even government agencies may have trouble filling out the templates correctly. Some parties may even seek, intentionally or unintentionally, to obstruct the audit. When problems occur they need to be addressed quickly and the MSG needs to take action to see that they are resolved. (See Chapter 3 for a discussion of why discrepancies arise and what to do about them.) Auditors/aggregators or administrators should provide the MSG with a list of any companies or government entities failing to cooperate on a monthly basis. Prior to taking any regulatory or legal action, "naming and shaming" is an effective way to get cooperation from these companies. Civil society members should be vigilant to ensure that the MSG takes the steps needed to compel coopera-

tion by all companies. While Nigeria's auditors were required by their contract to provide monthly in-person and written progress reports, we are aware of no other country that has required this.

If problems are not being resolved, the civil society members can put public pressure on the government to take action by writing newspaper articles or op-eds or encouraging civil society members on the MSG to have government agencies demand cooperation.

*What Reports Can the MSG Expect?* The MSG should request key materials from the independent expert, including:

- Draft reporting templates for covered entities to complete
- A draft list of entities to be covered
- Monthly progress reports

These items should also be part of the terms of reference. The MSG members should also request government documents, including:

- A list of all entities that participate in the sector (including those who produce the resource(s), who have signed contracts that could involve payments in the year to be audited)
- A contact list of responsible officials from each relevant government agency
- An order of some kind from the government telling public and private entities to cooperate with the audit

After the work is under way, civil society members should request additional materials, including:

- Monthly progress reports by the auditor/aggregator
- Indications as to whether covered entities are cooperating
- Indications as to whether the government is alleviating or ignoring roadblocks

*When Should Reports Be Made Public?* In a transparency program, the goal is to be as open as possible. But the EITI is designed to give the auditors or aggregators complete access to full and often confidential information, while publicly reporting revenues, either aggregated or disaggregated by category and/or company. In almost any configuration, the amount of information published will be less than the amount to which the experts have access. In addition, interim reports of the independent expert may reveal very significant discrepancies that are later resolved. Intense public criticism and misunderstanding can result from the reporting of these results. For this reason, it may be prudent from time to time to allow the experts to report certain information—like trouble verifying a payment—to the MSG, but not to the general public. Auditors and aggregators need to raise issues, but it is not helpful for them to create

public confusion or premature criticism of a company or a government agency until they have fully investigated a concern. For this reason, the MSG should have the right to keep preliminary reports confidential if they so choose, but not final reports.

*Managing Confidential Information.* One important issue that arises in the work of the multi-stakeholder group is how to treat information. While one instinct is that all information the stakeholder group receives in a transparency effort should be transparent, in practice this does not always produce the best results. For example, the draft terms of reference for the independent expert should not be released until they are publicized on an equal basis, so that no single competitor has an advantage over another. The budget for the EITI exercise should not be public, so that vendors do not simply use that budget as their price, rather than being forced to develop well-conceived audit programs and taskings, and competitive financial bids to prospectively carry out the work.

## 2.8 Has the Government Ensured that All Companies Will Report?

The EITI (Validation Grid Indicator 10)<sup>29</sup> requires that all companies, whether state-owned or private, must report their payments. Governments are to enforce this requirement by passing laws, issuing regulations, or entering into written agreements or memoranda of understanding that make this obligation binding. This was a much-needed requirement in Gabon, as participation in payment disclosure was voluntary. Stakeholders need to raise two issues for the MSG, related to Validation Step 9 (completion of the templates). One issue is what categories of payments should be reported. The second is whether all companies must report, or only the ones whose payments are considered material.

One view is that all companies participating in the oil and gas industry should be asked to report, even if some of them are very small and their revenues may not be material. There is no way to verify the aggregate amount of revenues unless everyone reports. Having all companies report will also help regulators determine if the government has collected taxes, royalties, or other payment from the companies, even if the payments or the companies do not meet the materiality threshold. Some implementing countries have determined that the cost of demanding reports by all companies is prohibitive or that reports by small producers are not informative, and thus do not require them to report.

The mining industry may present special complications. Some participants in the mining sector are quite small. The EITI will need to determine whether and how to address artisan mining and solo entrepreneurs who may not keep records. Special outreach may be required in order to help small participants cooperate in the EITI, or they may be excused from reporting entirely.

Most of the countries that have published reports so far have only required current producers or major companies to report, based on their desire to capture the material flows. Only Nigeria has required all companies to report, although some have not complied. This reporting requirement has now been made permanent through Nigeria's EITI law. However, having a law in place is not always sufficient; you need people willing to use it and drive the process.

## 2.9 Has the Government Ensured that All Company Reports Are Based on Audited Accounts to International Standards?

The EITI requires that all company and government reports must be based on data drawn from accounts that have been audited to international standards. (See Validation Guide Grid Indicator 12 and 13, and accompanying Indicator Assessment Tools.)<sup>30</sup> Governments are to enforce this requirement by passing legislation requiring figures to be prepared to this standard, amending national accounting standards to bring them up to international standards, or signing agreements in which companies agree that their figures will be up to international standards. The EITI also requires that where company information is not up to international standards, the government and company must agree to a timeline to bring them up to standard. This requirement that information be audited to international standards is one of the most important, but also one of the weakest parts of the EITI process, for three reasons.

First, EITI reconciliation is not very informative. The *EITI Sourcebook* emphasizes that payments declared by the paying entity be confirmed by comparing them to a corresponding declaration of receipts by the receiving entity. The sourcebook requires the auditor to check that the two declared figures agree. This very limited requirement has the following implications:

1. If a transaction is omitted by both parties, it cannot be detected by the auditor based upon the information available.
2. There is no requirement to check that the amounts are correct (the auditor is not asked to consider whether the amounts paid were the amounts that should have been paid).

Second, Grid Indicators 12 and 13 pose a material weakness to the integrity of the EITI. These indicators state that "where figures submitted for reconciliation are not tied to audited standards, the multi-stakeholder group is content with the agreed way of addressing this."<sup>31</sup> This exception can permit the accounts to be reported even if they do not meet international standards.

Third, it is important to understand that if existing audited accounts are used, it is still important to have proof that they were audited to international standards:

*Our view is that stakeholders should strive to have the company reports and accounts audited, rather than reconciled, wherever consensus can be achieved to do this. An audit provides much more reliable information and will reveal information about company and government practices that will be of more value to an effort to enhance governance and transparency than a reconciliation.*

*If information is to be reconciled, stakeholders should be informed who audited the company or government report being provided, what international standard they were audited to, and whether the information is still accurate at the time the report is being submitted. The individual company and government agency reports should be signed by the company's or agency's chief executive or chief financial officer. Each company's auditors should be asked to sign off on the company's EITI report stating that it is consistent with previously audited accounts.*

*In any event, the kind of report the auditors or aggregators produce will depend on what the MSG requires them to do; a description of the kinds of reports auditors produce, and the international standards that apply to them are in Text Box 2.4.*

### Text Box 2.4: What You Get in an Audit Report

Qualified accountants are bound by the standards of their professional bodies in each country and of the International Federation of Accountants. In all their work they have to act with, for example, integrity and objectivity (the so-called ethical standards). For different types of work there are also specific standards setting out what accountants should do and what they can say in their reports. If they do bad work or contravene the standards, they can be investigated by their professional bodies.

Accountants issue formal reports on EITI work, which refer to the standards they have applied. There is no specific standard for EITI reports but the accountant will decide which standards apply, based on what the terms of reference say. Common situations that may arise are:

1. The TOR set out the work that the MSG wants the accountants to do, and to report on what they find.
  - In this case, the report will refer to the International Standard on Related Matters. It will state the work that was done and will state the findings. This is called a “report on agreed-upon procedures.” Gabon provides an example of a report in this form.
2. The TOR require the accountant to review data that is provided by the MSG, though without setting out the detailed steps the accountants should undertake.
  - Here, the accountants will decide what they need to do to be satisfied with the data; they will not usually report what they did, but will give an opinion on the data. The MSG should request recommendations from the accountants regarding the most current international standards for auditing and assurance. For additional information, please also refer to: <http://www.ifac.org/IAASB/ProjectHistory.php?ProjID=0008>.
3. The TOR require the accountant to undertake an audit of sets of financial statements.
  - The accountants will work in accordance with International Auditing Standards and report whether in their opinion the financial statements are in compliance with a defined reporting framework; usually this framework will be the International Accounting Standards (note that accounting standards are different from auditing standards). This type of report is unlikely to be issued for EITI purposes, as it would be prohibitively expensive.

Reports should be read carefully in order to understand what the accountants have done and to what standard. If the MSG has appointed someone other than a professional accountant to undertake your audit then these principles will not be mandatory for the appointee.

These professional standards do not generally specify the detailed work that the accountant should do in each set of circumstances, because every assignment is different. Rather, they specify the thought process that the accountant should follow in deciding what needs to be done in order to complete the report that has been requested. Only in the first of the examples above can the MSG know from the report exactly what has been done. In the other two examples, the accountants may do a variety of things that, they believe, will enable them to issue their report but the report will not say what has been done, nor lay out the results.

The implications for the MSG are this: if you want to know in detail what the accountants have done, you need either (a) to write their TORs using the “report on agreed-upon procedures” format; or (b) request an opinion-type report but with a supplementary report, which the accountants probably will not want published, stating what they did in order to arrive at their opinion; and/or (c) require the accountants to make a presentation to the MSG and to answer specific questions about their work and findings.

Chapter 2: The Preparatory Phase		Yes/No
<b>XI. Has an MSG Group been established?</b>		
1. Does the MSG include adequate representation from the private sector, CSO representatives, and senior government (including legislative) leaders?		
2. Does the MSG establish: (a) terms of reference (TORs), (b) which extractive industries will be covered, (c) who will represent civil society, and (d) whether the MSG will have a Secretariat or some kind of implementation unit to support it?		
3. If there is a Secretariat, does it: (a) organize and staff meetings; (b) publish the agenda; (c) coordinate the different government agencies involved in EITI implementation; (d) distribute information to stakeholders in advance of meetings; (e) secure expert advice on the audit, communications, or legislation; (f) create and manage the EITI budget; (g) interact with foreign donors; (h) create and maintain a website; (i) follow up on stakeholder group directives; (j) explain through the media what is happening in the EITI process; (k) answer press inquiries; and (l) manage the auditors, including flagging lack of cooperation with the audit?		
4. Has a full-time executive director been appointed by the stakeholder group and is that person removable by the group? If possible, does the Secretariat also have a communications officer, an administrative officer, and/or an audit expert?		
<b>XII. Has the Country Work Plan been approved?</b>		
1. Did the MSG review the work plan, revise it where necessary, and then endorse it as a group?		
2. Does the work plan have targets, timetables, a budget, and an assessment of capacity constraints?		
<b>XIII. Are CSOs and companies engaged in the EITI process?</b>		
1. Did the government and MSG publicly communicate the government's commitment to the EITI?		
2. Is there a mechanism for CSO representatives to stay in touch with the CSOs?		
3. Do CSO representatives meet with CSO members before MSG meetings?		
4. Do stakeholder representatives communicate MSG meeting results?		
5. Do CSOs: (a) use their own networks to spread the word about the EITI program, (b) provide representatives with information about public questions or perceptions, (c) conduct research or provide expertise, and (d) encourage the media to report on EITI meetings and reports?		
6. Have obstacles to participation been removed? Are civil society groups operating independently of the government and able to express themselves without undue restraint or coercion? If companies are contractually prohibited from sharing financial information without the consent of the government, has the government written a letter to issue an order excusing the companies from their obligation to keep this information confidential?		
7. If the MSG meetings are held in the nation's capital, are representatives given advance notice so they have time to travel in order to attend? Are they given financial assistance to help pay for transportation and lodging?		



Chapter 2: The Preparatory Phase <i>(continued)</i>	Yes/No
<b>XIV. Are the reporting templates prepared/the scope of the EITI inquiry determined?</b>	
1. Did the MSG discuss the templates?	
2. Did wider constituencies have a chance to comment on the templates?	
3. Did the MSG decide whether the NOC should be regarded as a source of benefit streams?	
4. Was the MSG briefing by the government or an outside expert on: (a) what flows the government is entitled to, (b) what amounts the government believes they earned from these streams in the most recent available records, and (c) which government entities received them?	
5. Did the MSG decide whether all payments should be reported, or just ones deemed to be material?	
6. Were companies assured that they are permitted to provide the data to a third party?	
7. Do the templates show the: (a) revenue streams companies and government must disclose, (b) covered companies, (c) covered government entities, (d) time period the EITI report should cover, and (e) form that the information will be reported in?	
<b>XV. Has an auditor/aggregator been hired?</b>	
1. Prior to hiring an auditor/aggregator, did the MSG decide on: (a) the number of years to be examined, (b) the level of materiality, (c) the entities to be covered, (d) whether to test underlying revenue numbers, (e) whether to review physical volumes of production, (f) whether to examine any industry processes, and (g) whether to require a local partner?	
2. Do the terms of reference for auditors/aggregators require that they: (a) are chartered accountants; (b) have experience auditing companies in the extractive industries of your country, and potentially internationally; (c) possess a staff to handle the job; (d) agree that the report will be signed by a chartered accountant; and (e) have no major conflicts of interest?	
3. Has the MSG appointed a subcommittee to select the auditor/aggregator?	
4. Has the MSG published an expression of interest that describes: (a) the services that are requested, (b) the qualifications of bidders, (c) the date when expressions of interest are due, and (d) the policy on conflicts of interests? Is the expression of interest advertised in international journals?	
5. Is the RFP very clear about what work needs to be done?	
6. Does the RFP include essential criteria such as periodic reporting to the MSG, creation of reporting templates, and preparation of final reports in comprehensible language?	
7. Were qualified bidders sent a copy of the RFP and scope of work?	
8. Were qualified bidders asked to submit a technical bid and a financial bid based on the RFP?	
9. Has the committee decided on the technical criteria it will use to score or rank bidders before reviewing the bids?	
10. Was a bidders' conference conducted?	
11. Did the MSG committee review and rank the financial bids after selecting the short list?	
12. Were short-listed bidders issued an invitation to negotiate?	
13. Does the contract between the MSG and the auditor specify the scope of work, the payment schedule, the obligation for confidentiality, and the steps to be taken in the event of a dispute?	
14. Is the MSG content with the auditor/aggregator hired? Did the MSG: (a) vote on the expert, (b) play a role in its selection, and (c) play a role in designing the terms of reference for the organization?	



Chapter 2: The Preparatory Phase (continued)		Yes/No
<b>XVI. Did you evaluate the Country Work Plan?</b>		
<i>Did the MSG ...</i>		
1.	Decide when reports should be made public?	
2.	Decide how to manage confidential MSG information?	
3.	Request that the auditor/aggregator provide: (a) draft reporting templates for covered entities to complete, (b) a draft list of entities to be covered, (c) monthly progress reports, (d) indications as to whether covered entities are cooperating, and (e) indications as to whether the government is alleviating or ignoring roadblocks?	
4.	Request that the government provide: (a) a list of all entities that participate in the sector, (b) a contact list of responsible officials from each relevant government agency, and (c) an order from the government telling public and private entities to cooperate with the audit?	
5.	If problems are not being resolved, do CSOs put pressure on government to take action?	
6.	Did the government ensure that all companies report by passing laws, issuing regulations, or entering into written agreements or memoranda of understanding?	
7.	Did the government pass legislation to: (a) require figures to be prepared to this standard, (b) amend national accounting standards to bring them up to international standards, or (c) sign agreements with companies in which they agree that their figures will be up to international standards?	





## CHAPTER 3

# *The Disclosure Phase*

### 3.1 What the EITI Requires

The Disclosure Phase begins when the auditor or aggregator delivers the EITI report to the MSG. This phase determines whether the auditors or aggregators were able to do their job in accordance with the terms required by the MSG.

The Disclosure Phase of the EITI has four requirements:<sup>32</sup>

1. All material oil, gas, and mining payments made by companies and required to be disclosed to the organization preparing the EITI, must have been disclosed.
2. All material oil, gas, and mining revenues received by the government and required to be disclosed to the organization preparing the EITI, must have been disclosed.
3. The multi-stakeholder group must be satisfied that the organization employed to do the reconciliation or audit did so satisfactorily.
4. The EITI report must identify discrepancies and make recommendations for action.

### 3.2 What Should the EITI Report Contain?

Stakeholders should expect that the EITI report will explain how each of these four requirements is met. As described in Chapter 2, when the MSG decides the terms of reference for the EITI report, it will determine the questions of what companies and government entities must report, what payment and revenues are material, and the form of the EITI report itself. When reading the EITI report, stakeholders should look for the following disclosures:

- The report should state that all material oil, gas, and mining payments made by companies were disclosed to the auditor/aggregator.
  - The report should define what a material level of payments was and it should be the same as decided by the MSG in its work plan.
  - The report should specify what its definition of payments was and it should be the same as decided by the MSG in its work plan.
  - The report should describe all the companies that participated and any that did not fully cooperate by name.
- The report should state that all material oil, gas, and mining revenues received by the government were disclosed to the auditor/aggregator.
  - The report should define what a material level of revenues was and it should be the same as decided by the MSG in its work plan.
  - The report should specify what its definition of revenues was and it should be the same as decided by the MSG in its work plan.
  - The report should state which agencies participated and any that did not fully cooperate.
- To assess their satisfaction with the report, the report should describe how the reconciliation/audit experts did their work.
  - Did they test the underlying transactions (as suggested in Section 3.7)?
  - Did they rely on preexisting government and company audit reports? If so, how did they determine that the preexisting reports met international auditing standards?
- What international standard did each of the underlying reports meet?
  - What requirements did they impose on reporting companies and government agencies to verify full and truthful reporting?
- Were reports signed by senior executives of the reporting companies?
- Did the company's auditors certify that the financial statements were still true and accurate?
- The report should expressly state whether the auditors were able to fully reconcile all payments and revenues and to what level of accuracy.
  - The report should identify the amount of all discrepancies found<sup>33</sup> and declare whether they are material (as defined by the MSG in its work plan).

- The report should state whether the auditors believe any actions should be taken to reduce discrepancies or to improve the ability of the country to fulfill EITI validation criteria.

Once the MSG is comfortable that all of these steps have been taken, it can then decide, ideally by a vote of the MSG, whether it is satisfied that the organization hired to do the reconciliation or audit did so satisfactorily.<sup>34</sup>

### 3.3 Current EITI Practice

The reports issued by experts to EITI countries are varied. Some, like Nigeria and Ghana, reported a variety of discrepancies. Others, like Azerbaijan and the Kyrgyz Republic, did not report whether or not discrepancies occurred. Table 3.1 shows excerpts from public EITI reports that detail concerns or challenges encountered by the experts and reported to the MSG.

Table 3.1: Discrepancies Encountered by Independent Experts

Country	Discrepancy	Expert	Report Website
Azerbaijan	No material discrepancy.	Deloitte & Touche	2003 Report: <a href="http://www.eitransparency.org/UserFiles/File/azerbaijanreports/azerbaijanaccountreport2003.pdf">www.eitransparency.org/UserFiles/File/azerbaijanreports/azerbaijanaccountreport2003.pdf</a>
	<p>Compensation on the non-performance of the contract terms differed by U.S. \$3.8 million because of an extractive company not party to the MOU.</p> <p>A difference of 264.3 billion AZM in other taxes was due mainly to errors in reporting by two local EI companies.</p>	Deloitte & Touche	2004 Report: <a href="http://www.eitransparency.org/UserFiles/File/azerbaijanreports/azerbaijanaccountreport2004a.pdf">www.eitransparency.org/UserFiles/File/azerbaijanreports/azerbaijanaccountreport2004a.pdf</a>
	<p><i>Crude Oil</i></p> <ul style="list-style-type: none"> <li>▪ Payment by EI company not party to the MOU.</li> </ul> <p><i>Gas</i></p> <ul style="list-style-type: none"> <li>▪ Use of different measurement units of the volume of gas received from one extractive company.</li> <li>▪ Gas transferred to the government by one extractive company which is a party to the MOU not included in company schedule.</li> <li>▪ Gas transferred to the government by one extractive company which is not a party to the MOU not included in company schedule.</li> <li>▪ The government's schedule includes 6,430 thousand cubic meters of gas which relates to one local extractive company which is a party to the MOU.</li> </ul> <p><i>Transit Duties</i></p> <ul style="list-style-type: none"> <li>▪ Payment made as part of commercial activities and as such not reportable under the terms of the MOU.</li> </ul> <p><i>Transit Fee</i></p> <ul style="list-style-type: none"> <li>▪ Transit fees paid by two extractive companies which are not parties to the MOU.</li> </ul> <p><i>Bonuses on Signing and Other Related Bonuses</i></p> <ul style="list-style-type: none"> <li>▪ The amount paid by an extractive company that was not a party to the MOU.</li> </ul> <p><i>Profit Tax</i></p> <ul style="list-style-type: none"> <li>▪ One local extractive company reported only the 2005 profit tax and not the 2004 profit tax paid during 2005, as required under the MOU.</li> </ul>	Deloitte & Touche	2005 Report: <a href="http://www.oilfund.az/download2/eiti_report_31122005_en.pdf">www.oilfund.az/download2/eiti_report_31122005_en.pdf</a>
	Did not report on whether discrepancies were revealed	Deloitte & Touche	<a href="http://www.oilfund.az/index_en.php?n=10012">www.oilfund.az/index_en.php?n=10012</a>

Country	Discrepancy	Expert	Report Website
Cameron	No material discrepancy reported.	Hart Group & Mazars	<a href="http://www.eitransparency.org/UserFiles/File/cameroon/Cameroun_EITI%20Report_2005_Maro7.pdf">www.eitransparency.org/UserFiles/File/cameroon/Cameroun_EITI%20Report_2005_Maro7.pdf</a>
Gabon	No material discrepancy reported.	Ernst & Young	<a href="http://www.eitigabon.org/FRAN/PUBLICATIONS/rapport_2005/Rapport_EITI_Gabon_2005_version_definitive_050407.pdf">www.eitigabon.org/FRAN/PUBLICATIONS/rapport_2005/Rapport_EITI_Gabon_2005_version_definitive_050407.pdf</a>
Ghana	There was a shortfall of eighty nine million and forty thousand cedis in the amount declared for disbursement by the Internal Revenue Service to the Office of the Administrator of Stool Lands.	Boas & Associates	<a href="http://www.eitransparency.org/UserFiles/File/ghana/ghana_first_aggregated_report_to_June_2004.pdf">www.eitransparency.org/UserFiles/File/ghana/ghana_first_aggregated_report_to_June_2004.pdf</a>
Guinea	No material discrepancy reported.	Richard Michel & Ismael Nabé	<a href="http://www.eitransparency.org/UserFiles/File/guinea/guineacommunique2005english.pdf">www.eitransparency.org/UserFiles/File/guinea/guineacommunique2005english.pdf</a>
Kyrgyz Republic	Did not report on discrepancies.	Kyrgyz Republic did their own audit	<a href="http://www.eitransparency.org/UserFiles/File/kyrgyz/kyrgyzgovreportenglish.pdf">www.eitransparency.org/UserFiles/File/kyrgyz/kyrgyzgovreportenglish.pdf</a>
Mauritania	No material discrepancy reported.	Ernst and Young	<a href="http://www.cnitie.mr/documentspublic/RapportITIE.pdf">www.cnitie.mr/documentspublic/RapportITIE.pdf</a>
Nigeria	Noticeable discrepancies between the Fixed Assets Additions set out in the Audited Financial Statement and the PPT Returns.  Assessment of royalty by DPR differs significantly from the actual payments made by the producing companies.	Hart Group	

### 3.4 Dealing with Discrepancies

The EITI report may describe discrepancies between government and company accounts. It is important to understand why discrepancies occur and what to do about them. The major concerns arise when government entities and covered companies do not cooperate or numbers do not match.

### 3.5 What Happens When Government Entities Don't Cooperate?

Governments have an obligation to make sure that all government entities that receive revenue disclose them.<sup>35</sup> Government entities can be required to provide auditors with a lot of information. The central bank can be asked for records of payments. Regulators can be asked for amounts billed for royalties and the amounts they actually received. Tax authorities can be asked for taxes assessed and paid. National oil, gas, and mining companies can be asked to verify the volume for a resource produced so auditors can check to see if taxes and royalties were paid on the complete amount. Ministries of finance can report amounts received and disbursed.

Governments can fail to cooperate for several reasons:

- Poor or absent records
- Lack of understanding or knowledge of the EITI process
- No culture of disclosure to nongovernmental agencies
- Lack of capacity to produce the data
- Handwritten records
- Resistance

Civil society has several duties:

- To know when there is a problem
- To make sure the MSG understands the source of the problem
- To ensure action is being taken to resolve the problem
- To identify if there are structural problems to be addressed

Poor record-keeping is often a challenge. If there has never been an audit before, authorities may not have kept records, kept poor records, or destroyed records after a period of time.

If the problem is poor record-keeping or the lack of an effective record keeping system, civil society should be sure to request that the auditors make a recommendation on what is needed to bring the record keeping up to international standards, and civil society should add this to its reform list.

If the problem is purely resistance by an agency, this can indicate a lack of commitment to the EITI and civil society can play a useful role in putting public pressure on the recalcitrant agency to cooperate. This can, if necessary, be done through public statements and press conferences, editorials in national and local newspapers, appearances on radio, and reaching out to international civil society organizations and the EITI Board, who can in turn focus outside attention on government's non-performance.

### 3.6 What Happens When Companies Don't Cooperate?

Under the EITI, the government has an obligation to make sure that all companies report payments covered by the EITI process.<sup>36</sup> The auditor/aggregator should report whether companies completed their information templates or not.

Companies should be highly motivated to cooperate. Failure to respond to a request by the government could potentially result in a loss of their license to operate. In countries where there is an EITI law, there can be criminal penalties.<sup>37</sup>

There are several reasons why a company might not report, including:

- Failure to get the notice
- The belief they are not required to report
- A lack of capacity to complete the form
- Resistance

### 3.7 When Numbers Don't Match

Discrepancies occur when the financial numbers do not match. For example, in Azerbaijan, there were discrepancies in the inflows to the government due to differences in rounding numbers, payments by companies that are not parties to the MOU, and incomplete reporting.<sup>38</sup> In the Nigeria EITI audit, auditors found that companies reported making payments to the Central Bank of Nigeria that the bank had no record of receiving.<sup>39</sup> Likewise, the central bank reported that it received payments that the companies had no record of making.<sup>40</sup> In Azerbaijan, the auditors reported that certain transactions could not be confirmed because one party to a transaction did not cooperate with the EITI.

All auditors who find discrepancies will work with both sides to find out why their numbers are different. In many cases auditors will seek to verify if each side (i.e., both the government and the company) has accurately recorded the underlying transaction. A discrepancy can be innocuous, such as one side recording a royalty payment as a tax payment. But a discrepancy can also be a “red flag” warranting investigation as to whether there is a more significant underlying problem (e.g., the failure of an entity to record the amount it paid the government or the amount the government received).

#### **Text Box 3.1: Finding Discrepancies**

In the Nigerian case auditors uncovered 1.56 billion naira in unpaid invoices due for crude oil, from the Nigerian National Petroleum Company to the government.

In the Nigerian example, out of 365 discrepancies, all but 11 were resolved. There were errors in how payments were recorded, who was recorded as having paid, and in what categories payments were recorded (i.e., some were recorded as tax payments rather than royalty payments). Many of the discrepancies occurred because the recipient did not accurately identify the payer; other payments were mismatched because companies reported transactions on an accruals basis rather than the cash basis.

When, after exhaustive enquiry, a transaction remains unmatched, a request should be made to the paying entity to have the transaction traced through the banking system. The trace should produce definitive information about the account to which the payment arrived.

The auditors should report on any discrepancy that was not resolved and what they did to try to resolve it. The auditors should opine on what needs to change in order for similar discrepancies to not occur in the future.

### 3.8 Who Should Resolve Discrepancies?

In most cases, it is the duty of regulatory agencies to resolve differences that are reported by auditors. It is not the duty of auditors or reconcilers to resolve differences once they verify that the numbers reported by each side are accurate representations of that entity's records, and after they have made good faith efforts to resolve the discrepancy. In some cases, an MSG may want the auditors/aggregator to further investigate a discrepancy identified. In these instances, the scope of work for the auditors/aggregator should make clear what the duties of the auditor/aggregator are, or it should be amended to reflect any further investigation and activities required by the MSG.

### 3.9 Should Reports Be Delayed to Resolve Discrepancies?

Neither governments nor companies like it when there is a discrepancy. Attention is focused on the differences and public outcry can be severe. But there is a tradeoff between getting the EITI report published on time and continuing to investigate discrepancies.

**Text Box 3.2: Oil Royalties: Resolving Discrepancies—An EITI Example**

In Nigeria, if for any reason there are differences between the operator and agency's figure, they are usually resolved through a joint reconciliation exercise. The figures computed by the operator and the DPR computations do not usually agree. Such differences could arise as a result of:

- Typographical errors;
- Use of different production figures; and
- Use of different API gravity.

The Reconciliation Committee consists of representatives of the operator and four from the agency, namely: Inspection Division, Resource Management Division, Engineering and Standard Division and the Finance and Accounts Division. This is a labor-intensive exercise.

The best practice is to be very strict about sticking to reporting deadlines. Strict enforcement of deadlines encourages all parties to report their data on time or suffer the consequence of delay. Reports can be delayed a long time by parties who want to continue to examine a dispute, but do not do so expeditiously. Auditors can always issue a report after an audit is completed to report the resolution a discrepancy.

**Text Box 3.3: Discrepancies in Oil Royalties—An EITI Example**

In one EITI audit the tax authority faced several challenges including:

- Poor exchange of information between government entities making it difficult for comprehensive information to be available;
- Interface bottlenecks with the central bank on communication about payments made; and
- Information critical to the assessment and checking of tax computations was in the possession of different agencies and there was no statutory obligation for these entities to make it available to the tax authority.

**3.10 Current EITI Practice**

A survey of current EITI reports shows varying degrees of usefulness when it comes to educating the public. For example, the Nigeria and Ghana reports are very informative. The Nigeria EITI report has an executive summary and large annexes with information about what was examined and how, and contains thorough recommendations about what reforms are needed. The Ghana report provides tables that detail financial flows, identifies discrepancies and weaknesses in governance systems, and sets forth targeted areas for reform.

Other reports are less informative. The 2005 Guinea report provides tables with financial flows, discrepancies, and flows to local communities, but has no information about weaknesses in governance or any recommendations. The Kyrgyz report provides a table with financial flows, but no narrative that informs the public as to what decisions were made about which government entities or companies to cover, and provides no insights as to the integrity of government systems. Azerbaijan's report is among the least informative. The report effectively is a table with aggregated financial flows but no explanatory narrative about what was aggregated or how the report was prepared. The report provides no recommendations of any kind.

### 3.11 Civil Society's Duty

Civil society groups should look for reports of discrepancies in the EITI audit report. They should ask why they occurred and if the systems of recording the data by governments and companies are up to international standards. In some cases, a discrepancy may reveal that records are not accurate or that regulators are not checking to see that funds are collected.

Chapter 3: The Disclosure Phase	Yes/No
<b>XVII. Does the EITI report identify payments, revenues, and discrepancies?</b>	
<i>Did the report ...</i>	
1. Define what a material level of payments is? Is it the same as decided in the work plan?	
2. Define what a material level of revenues is? Is it the same as decided the in the work plan?	
3. Define what its definition of payments is? Is it the same as decided in the work plan?	
4. Define what its definition of revenues is? Is it the same as decided by the work plan?	
5. State which agencies participated and any that did not fully cooperate?	
6. State which companies participated and any that did not fully cooperate?	
7. State whether auditors/aggregators tested the underlying transactions?	
8. State whether auditors/aggregators relied on preexisting government/company audit reports? If so, how did they determine if IAS was met, and what international standard did each of the underlying reports meet?	
9. State what requirements they imposed on companies/government agencies to verify full and truthful reporting?	
10. Describe all the companies that participated and any that did not fully cooperate?	
11. Describe all the government agencies that participated and any that did not fully cooperate?	
12. Disclose all material oil, gas, and mining payments made by companies and required to be disclosed?	
13. Disclose all material oil, gas, and mining revenues received by the government and required to be disclosed?	
14. State whether they were able to fully reconcile all payments and revenues and to what level of accuracy?	
15. Identify the amount of all discrepancies found and declare whether they are material?	
16. Include a plain language executive summary?	
<i>Did the government ...</i>	
1. Meet its obligation to make sure all government entities that receive revenue disclose them?	
2. Meet its obligation to make sure that all companies report payments covered by the EITI?	
<i>Did CSOs ...</i>	
1. Look for reports of discrepancies in the EITI audit report?	
2. Make sure the MSG understands the source of the problem?	
3. Ensure action is being taken to resolve the problem?	
4. Identify if there are structural problems to be addressed?	



Chapter 3: The Disclosure Phase <i>(continued)</i>		Yes/No
<i>Did Auditors/Aggregators ...</i>		
1. Work with both sides to find out why numbers are different?		
2. Report on any discrepancy that was not resolved and what they did to try to resolve it?		
3. Opine on whether action should be taken to reduce discrepancies?		
4. Opine on whether action should be taken to improve the country's ability to achieve EITI validation requirements?		
<i>Did the MSG ...</i>		
1. Decide that the organization hired to do the reconciliation or audit did so satisfactorily?		
2. Establish who should resolve discrepancies?		
3. Establish whether reports should be delayed to resolve discrepancies?		



## CHAPTER 4

# *The Dissemination Phase*

### 4.1 What the EITI Requires

The Dissemination Phase begins when the MSG has approved the EITI report and is ready to publish and distribute it. EITI Validation Step 18 requires that the EITI report be made publicly available in a way that is publicly accessible, comprehensive, and comprehensible. Examples provided by the EITI in Grid Indicator Assessment Tool 18 include distributing paper copies to stakeholders, making the report available on the Internet, holding outreach events, making the report available in appropriate languages, and making sure it is written clearly and understandably.

As Table 4.1 illustrates, the reports published to date meet some but not all of these criteria. Azerbaijan,<sup>41</sup> Cameroon,<sup>42</sup> Gabon,<sup>43</sup> Guinea,<sup>44</sup> Mauritania,<sup>45</sup> Nigeria,<sup>46</sup> and Ghana<sup>47</sup> have all posted their reports on the web. Nigeria conducted road shows<sup>48</sup> before and after the reports were released, but many of these reports are in technical language. Few detail what benefit streams were deemed material, and none describe whether or how the underlying accounts met international standards. These weaknesses demonstrate the need for CSOs and CSO representatives on MSGs to pay close attention to the form of the EITI reports, and what is done with them once they are published.

Table 4.1: Dissemination of EITI Reports

Country	Comprehensive	Comprehensible	Available	Website
Azerbaijan (5th Report)	<b>No</b> <ul style="list-style-type: none"> <li>No explanation</li> <li>No recommendations</li> <li>No description of IAS</li> <li>No company payments</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>Plain language</li> <li>Clear format</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>Online</li> <li>In English</li> <li>In Azerbaijani</li> </ul>	www.oilfund.az/index_en.php?n=10012
Cameroon	<b>Yes</b> <ul style="list-style-type: none"> <li>Tables and explanation</li> <li>Recommendations</li> <li>Company payments &amp; government receipts</li> <li>Methodology</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>Plain language</li> <li>Clear format</li> <li>Glossary</li> <li>Executive summary</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>Online</li> <li>In English</li> <li>In French</li> </ul>	www.eitransparency.org/UserFiles/File/cameroon/Cameroun_EITI%20Report_2005_Maro7.pdf
Gabon	<b>Yes</b> <ul style="list-style-type: none"> <li>Tables and explanation</li> <li>Recommendations</li> <li>Sector background</li> <li>Methodology</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>Plain language</li> <li>Clear format</li> </ul>	<b>Ok</b> <ul style="list-style-type: none"> <li>Online</li> <li>In French</li> </ul>	www.eitigabon.org/Fran/PUBLICATIONS/rapport_2005/Rapport_EITI_Gabon_2005_version_definitive_050407.pdf
Ghana	<b>Yes</b> <ul style="list-style-type: none"> <li>Tables and explanation</li> <li>Recommendations</li> <li>Sector background</li> <li>Methodology</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>Plain language</li> <li>Clear format</li> <li>Executive summary</li> </ul>	<b>Ok</b> <ul style="list-style-type: none"> <li>Online</li> <li>In English</li> </ul>	www.eitransparency.org/UserFiles/File/ghana/ghana_first_aggregated_report_to_June_2004.pdf
Guinea	<b>Ok</b> <ul style="list-style-type: none"> <li>Tables</li> <li>Company payments &amp; government receipts</li> <li>Limited explanation</li> <li>No recommendations</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>Plain language</li> <li>Clear format</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>Online</li> <li>In English</li> <li>In French</li> </ul>	www.eitransparency.org/UserFiles/File/guinea/guineacommunique2005english.pdf

Country	Comprehensive	Comprehensible	Available	Website
Kyrgyz Republic	<b>No</b> <ul style="list-style-type: none"> <li>▪ Tables</li> <li>▪ Limited explanation</li> <li>▪ No recommendations</li> <li>▪ No company payments</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>▪ Plain language</li> <li>▪ Clear format</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>▪ Online</li> <li>▪ In Russian</li> <li>▪ In English (unofficial translation)</li> </ul>	<a href="http://www.eitransparency.org/UserFiles/File/kyrgyz/kyrgyzgovreportenglish.pdf">www.eitransparency.org/UserFiles/File/kyrgyz/kyrgyzgovreportenglish.pdf</a>
Mauritania	<b>Yes</b> <ul style="list-style-type: none"> <li>▪ Tables and explanation</li> <li>▪ Recommendations</li> <li>▪ Sector background</li> <li>▪ Methodology</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>▪ Plain language</li> <li>▪ Clear format</li> <li>▪ Glossary</li> </ul>	<b>Ok</b> <ul style="list-style-type: none"> <li>▪ Online</li> <li>▪ In French</li> </ul>	<a href="http://www.cnitie.mr/documentspublic/RapportITIE.pdf">www.cnitie.mr/documentspublic/RapportITIE.pdf</a>
Nigeria	<b>Yes</b> <ul style="list-style-type: none"> <li>▪ Tables and explanation</li> <li>▪ Recommendations</li> <li>▪ Sector background</li> <li>▪ Methodology</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>▪ Technical language</li> <li>▪ Clear format</li> <li>▪ Glossary</li> <li>▪ Executive summary</li> </ul>	<b>Yes</b> <ul style="list-style-type: none"> <li>▪ Online</li> <li>▪ In English</li> </ul>	

## 4.2 Enforcing the Validation Criteria

The first thing CSOs (and CSO representatives on the MSG) should do is assess whether the criteria have been met. As noted in Chapters 1 and 2, the best way to ensure that a plain language executive summary of the EITI report is prepared is to put the requirement in the auditor/aggregator's terms of reference and ensure that the budget includes funding for translation, road shows, and photocopies of the executive summary. In addition, it may be appropriate and necessary for the MSG to budget for a professional writer to draft an executive summary of the reports in a manner more accessible and understandable to the lay reader or average interested citizen. At a minimum, the report itself should be presented publicly. If possible, there should be multiple presentations, with the auditors/reconcilers present, in many parts of the country to permit civil society groups and the media to gain a better understanding of the transparency-related findings and to ask questions. The obligation to hold these public briefings should be included in the terms of reference for the auditors or other experts.

### 4.3 Making Use of the Reports

The three most important things civil society can do with the EITI reports are:

- Understand the results
- Communicate the results
- Follow up with reforms

### 4.4 Understanding the Results

Audit reports can be hard to understand, even when auditors try to write them in plain, non-technical language. The questions CSOs need to ask fall into four groups:

- Were the auditors able to reconcile the flows in a manner that meets the EITI standards?
- What governance problems were revealed?
- What company behavior problems were revealed?
- What reforms did the auditors recommend?

### 4.5 Were the Auditors Able to Verify All Revenue Flows? If Not, Which Flows Were Not Reported, and Why?

The most basic piece of information the reconciliation will provide is how much money the government earned from resource extraction. The report should tell you:

- how much the government earned in total
- how much was earned from taxes, royalties, or other categories
- whether the payments reported by companies matched the revenues received by governments
- whether all material flows were reconciled
- how the oil was converted to cash and what price the government was paid (if the government was paid in oil)
- whether the price the government received was a market price, or quantifiably verifiable and reasonable (although the EITI does not require this)
- whether there were any discrepancies
- whether the report meets the standard agreed to by the MSG

### 4.6 Some Current Examples

*An Aggregated Report.* The report of the government of the Republic of Azerbaijan (host government) on aggregated receipts from the extractive industries January–June 2006 is shown in Table 4.2:<sup>49</sup>

Table 4.2: Azerbaijan Aggregated Report (Reporting Period: January–June 2006)\*

	Value		Volume	
	Million US\$	Million AZN Manat	Oil	Gas (natural, associated)
1	2	3	4	5
<b>1. Receipts by Host Government from the foreign companies</b>			8,779	
<b>Host Government's production entitlement (including indirect entitlement through the host state owned company) in foreign company's</b>				
1.1 Oil Production Stream				
– in kind (mln barrel)				
– in cash				
1.2 Gas Production Stream				
– in kind (thousand cubic metres)				
– in cash				1,408,371.0
1.3 Base metals Production Stream				
– in kind (thousand tons)				
– in cash				
1.4 Precious metals Production Stream				
– in kind (thousand ounces)				
– in cash				
<b>2. Receipts by Host Government from the local companies</b>				
<b>Host Government's production entitlement in local company's</b>				
2.1 Oil Production Stream				
– in kind (mln barrel)				
– in cash				
2.2 Gas Production Stream				
– in kind (thousand cubic metres)				
– in cash				3,460.0
2.3 Base metals Production Stream				
– in kind (thousand tons)				
– in cash				
2.4 Precious metals Production Stream				
– in kind (thousand ounces)				
– in cash				

	Value		Volume	
	Million US\$	Million AZN Manat	Oil	Gas (natural, associated)
1	2	3	4	5
<b>3. Other Host Government receipts from foreign companies (including receipts collected through the host state owned company)</b>				
3.1 Royalties				
– in kind				
– in cash				
3.2 Profit tax		213,005		
3.3 Other tax (excluding employee income tax, social tax and withholding tax)				
3.4 Dividends				
3.5 Signing bonuses and other bonuses	1,000			
3.6 License fees, entry fees and other considerations for licenses				
3.7 Other receipts, in total, including:				
– acreage fees	1,286			
– transit fees	7,932			
<b>4. Other Host Government receipts from local companies</b>				
4.1 Royalties				
– in kind				
– in cash		42,907		
4.2 Profit tax		11,608		
4.3 Other tax (excluding employee income tax, social tax and withholding tax)		136,095		
4.4 Dividends				
4.5 Signing bonuses and other bonuses				
4.6 License fees, entry fees and other considerations for licenses				
<b>Total</b>	<b>10,218</b>	<b>403,615</b>	<b>8,779</b>	<b>1,411,831.0</b>

\* Report of the Government of the Republic of Azerbaijan (host government) about aggregated receipts from the extractive industries Reporting period: January-June 2006 [www.oilfund.az/index\\_en.php?n=10012](http://www.oilfund.az/index_en.php?n=10012).

Table 4.3: Nigeria Disaggregated Report\*

## Paid by Companies

US\$ Millions	1999	2000	2001	2002	2003	2004
Shell Petroleum Development Company	225	444	437	346	565	845
Mobil Producing Nigeria Limited	257	418	405	309	460	627
Chevron Nigeria Limited	172	308	299	217	266	323
Chevron Oil Company of Nigeria	9	18	14	11	8	15
Texaco Overseas	9	18	14	12	8	9
Elf Petroleum	110	252	255	201	280	561
Nigerian Agip Oil Company	61	124	141	118	134	241
Pan Ocean	2	7	10	8	11	20
Addax Petroleum	6	36	34	0	1	0
Amni	4	6	0	2	0	2
Atlas	6	11	9	13	6	1
Dubri	0	0	0	0	0	0
Consolidated Oil Producing Limited (Concoil)	3	9	6	3	5	2
Continental	2	28	59	33	45	25
Express Petroleum	0	1	1	0	0	0
Nigerian Petroleum Development Company	0	0	10	6	3	0
Philips Oil Company	22	61	60	55	73	103
Cavendish	0	0	0	0	0	0
Moni Pulo Petroleum Development Company	0	40	33	34	40	39
<b>Total</b>	<b>888</b>	<b>1,781</b>	<b>1,787</b>	<b>1,368</b>	<b>1,905</b>	<b>2,813</b>

## Recorded by CBN

US\$ Millions	1999	2000	2001	2002	2003	2004
Shell Petroleum Development Company	218	474	462	346	523	845
Mobil Producing Nigeria Limited	319	453	404	285	460	627
Chevron Nigeria Limited	172	337	275	201	266	323
Chevron Oil Company of Nigeria	2	27	0	6	8	15
Texaco Overseas	16	27	26	6	10	9
Elf Petroleum	103	239	256	185	280	561
Nigerian Agip Oil Company	59	129	144	104	155	241
Pan Ocean	2	6	14	7	9	18
Addax Petroleum	6	33	32	0	1	0
Amni	4	6	0	2	0	2
Atlas	6	10	9	12	6	1
Dubri	0	0	1	0	0	0
Consolidated Oil Producing Limited (Concoil)	5	16	15	12	36	25
Continental	2	28	24	24	11	16
Express Petroleum	0	1	1	0	0	0
Nigerian Petroleum Development Company	0	0	0	0	0	0
Philips Oil Company	25	61	61	59	55	83
Cavendish	0	0	0	0	0	0
Moni Pulo Petroleum Development Company	0	24	37	26	12	21
<b>Total</b>	<b>939</b>	<b>1,871</b>	<b>1,761</b>	<b>1,275</b>	<b>1,832</b>	<b>2,787</b>
<b>Difference (Companies, CBN)</b>	<b>-51</b>	<b>-90</b>	<b>26</b>	<b>93</b>	<b>73</b>	<b>26</b>

**Disaggregated by Payment Type. Financial flows received by the Federation in the years 1999–2004 from the specified companies in respect of the identified classes of financial flows.\*\***

## Reported As Paid by Companies

US\$ Millions	1999	2000	2001	2002	2003	2004
Petroleum Profits Tax	758	3,230	3,615	1,829	3,225	6,275
Royalty	888	1,781	1,787	1,368	1,905	2,813
Gas flaring penalty	24	24	28	20	23	21
Reserves Additional Bonus repayments	61	—	—	—	—	274
Signature bouses on license award	25	—	137	37	235	53
<b>Total</b>	<b>1,756</b>	<b>5,035</b>	<b>5,567</b>	<b>3,254</b>	<b>5,388</b>	<b>9,436</b>

**As Recorded CBN**

US\$ Millions	1999	2000	2001	2002	2003	2004
Petroleum Profits Tax	659	3,286	3,549	1,698	3,287	6,557
Royalty	939	1,871	1,761	1,275	1,832	2,787
Gas flaring penalty	22	22	25	20	38	28
Reserves Additional Bonus repayments	61	—	—	—	—	— <sup>***</sup>
Signature bouses on license award	25	—	137	37	235	53
<b>Total</b>	<b>1,706</b>	<b>5,179</b>	<b>5,472</b>	<b>3,030</b>	<b>5,392</b>	<b>9,425</b>

\* Table 4.3 shows the royalty payments and revenues disaggregated by company as illustrated on page 19 of the 1999–2004 NEITI Financial Audit Report. Royalties is just one of the benefits streams disaggregated by company in the NEITI Audit report.

\*\* NEITI Financial Audit 1999–2004, page 12.

\*\*\* Included by CBN in Petroleum Profits Tax.

## 4.7 What Governance Problems Were Revealed?

The report should explain whether there were any problems encountered in the course of the preparation of the report that suggest the government needs to improve the way it manages the sector. Those preparing the EITI report should be asked:

- whether there were any problems getting access to good data
- whether records were complete
- whether records were computerized
- whether they tested any of the underlying transactions to ensure that the numbers they reconciled were themselves accurate

The kind of problems identified by the auditors or aggregator might include:

- Poor record-keeping by central banks or tax authorities
- Lack of verification of tax payments by tax authorities
- Lack of verification of royalty calculations by regulator
- Lack of cross checks between volumes of oil, gas, or minerals produced and taxes or royalties owed
- Lack of automation in record-keeping
- Policy disagreements over calculation of amounts owed for taxes, royalties or other issues

### *A Ghanaian Example*

*The Ghana report<sup>50</sup> revealed that the agencies responsible for collecting mining payments (i.e., tax and regulatory agencies) did not collaborate; that there was no formalized system for checking the grade of gold declared by the mining companies; that*

*there were no regulations or guidelines for the utilization of mineral royalty receipt; and that there were no good records of disbursement of royalties from the regional administrator of lands to beneficiaries.*

#### **A Nigerian Example**

*In the Nigerian audit, the auditors found that the auditor general did not keep accurate records of accounts and that there was great variation in the way companies calculated their obligations to pay the petroleum profits tax, and in the calculation of royalties.<sup>51</sup>*

#### **An Azerbaijani Example**

*In Azerbaijan, there were discrepancies in the inflows to the government due to differences in rounding numbers, payments by companies that are not parties to the MOU, and incomplete reporting.<sup>52</sup>*

## **4.8 What Company Behavior Problems Were Revealed?**

The auditors should be asked whether they encountered any problems obtaining the cooperation of companies, including:

- Did all companies submit complete and accurate templates?
- Which companies failed to cooperate?
- What actions were taken with respect to non-cooperating companies?
- Did reports of payments made to governments match what companies had previously reported (if there were any prior reports)?

*In Mauritania, the EITI report indicated that 13 mining and 7 oil companies failed to respond to the templates.<sup>53</sup>*

## **4.9 What Reforms Did the Independent Experts Recommend?**

The EITI Validation Guide<sup>54</sup> requires that auditors or aggregators make recommendations for improvement. Civil society should ask questions directly, or through representatives on the MSG, to make sure that a thorough response to this obligation is given. The experts will have access to a great deal of information about how government entities and companies keep records, and in many cases, how the industry is regulated. It is only through their recommendations for improvement that civil society will gain an insight into how to improve the overall governance of the sector.

The auditors/aggregators should be asked:

- Does the government's system for recording payments meet international standards, and if not, what changes should be made?
- Does the government test or audit tax or royalty payments in a fashion that meets best international practice?
- Were the government's financial statements audited in accordance with international auditing standards (even if the MSG has agreed to another standard)?
- Was the companies' data taken from financial statements that were audited in accordance with international auditing standards (even if the MSG has agreed to another standard)?
- Are the laws and regulations governing the obligations upon government entities and companies to make payments clear and effective?

## 4.10 Communicating the Results

*Decide What Is Important.* Civil society groups should come to their own conclusions about which aspects of the EITI report are important to communicate: Is it how much money the government has to spend and what it did with the money? Is it the share of the government's money sent to states and localities? Is it the weakness of government systems and the need to improve them? Or, is it the refusal of some companies to participate in the EITI?

*Help Disseminate the Reports.* Civil society groups should offer suggestions on where the report should be presented to the EITI Secretariat and stakeholder group in their country. It may be to union leaders, business leaders, universities, or local communities (including, most notably, those in producing areas), and each may need a personal explanation of the EITI report. Civil society groups should both conduct briefings themselves and request that the MSG conduct such briefings. In addition, civil society groups can:

- Write guest editorials in national and local newspapers;
- Go on radio talk shows to talk about the EITI experience and reports;
- Lead workshops to explain the results;
- Encourage media outlets to write editorials on the EITI report's results; and
- Ask international advocacy groups to help translate the report to local languages and disseminate the results.

## 4.11 Follow Up with Reforms

Once the first EITI report is published, civil society members will need to translate the information into concrete results. The EITI is a tool for empowering citizens with the information needed to hold governments accountable. Some key follow up steps include:

- locking in subsequent audits
- increasing the frequency of reporting
- crafting a reform agenda
- deepening the transparency process

*Locking in Subsequent Audits.* In many countries, implementing the EITI is a commitment that has been made by a president or prime minister who supports transparency. But for the EITI to be sustainable, it needs to become part of a country's laws. Civil society members should work to pass some form of legislation that requires annual EITI audits and imposes an obligation upon the state-owned companies and all private companies to make specified disclosures under the country's EITI laws. In some countries, such as Nigeria, members of the legislature have served on MSGs and may provide advocacy and support for EITI legislation.

In addition, civil society members may want to consider adding the following requirements:

- Establishing diverse requirements for the composition of the multi-stakeholder group
- Securing stand-alone funding for the EITI Secretariat and EITI audits, as well as funds for a robust communications effort
- Creating a framework for penalties applicable to those entities that fail to comply with the EITI audits
- Instituting mandates or other guidance on the form of reporting required, including most notably, the utilization of either aggregated or disaggregated reporting

*Increasing the Frequency of Reporting.* The EITI requires annual reporting, but your country's regulatory authorities can request more frequent reporting of payments of taxes, royalties, and other funds. In addition, reports of oil or gas production, or the extraction of minerals, can and should be reported on a monthly or quarterly basis. While an MSG may elect not to publish this information until it has been audited or reconciled, it will help the work of the auditors or aggregators, and will increase the vigilance of your country's regulatory authorities if they are obliged to collect and examine payment information on a regular basis. Nigeria, for example, publishes a quarterly *Economic Performance Report*.<sup>55</sup> Confidence in the EITI process can be enhanced if

information is published promptly (e.g., within a few weeks after the end of the period to which it relates). If entities are made aware that their data will be published, they are likely to take special care to ensure the information is correct.

*Crafting a Reform Agenda.* When an EITI audit is completed, the auditors are obliged to report discrepancies and provide recommendations on actions to be taken. These conclusions should be the starting point for the creation of a civil society reform agenda for the executive and legislative branches in your country, and in some cases, the judicial branch as well. While we address the need for countries to consider moving from the so-called EITI Basic to the EITI Plus form of implementation in Part III of this guide, we suggest the following actions as a way of advancing reforms from any EITI report.

#### **Text Box 4.1: Reform Recommendations: Institutional Capacity**

“The need for institutional capacity building at DPR has been commented on in previous reports over several years. The general situation continues to be weak, characterized by low availability of information and a lack of computer systems. A serious effort is required to address this.”

NEITI Financial Systems Report, p. 13

*Potential Reform Agenda for the Executive Branch.* In some cases, experts will report that the rules and regulations concerning payments of taxes or royalties are unclear,<sup>56</sup> or that the capacity of a regulatory agency needs to be improved in order for the agency to effectively monitor the sector.<sup>57</sup> These kinds of reforms are fundamental to the ability of government to hold companies accountable, and to its ability to ensure that the country gets the best value for its resources. Civil society can pursue executive branch reform by:

- making a priority list of reforms that need to be taken
- meeting with the head(s) of any relevant agency to ask if they have read the EITI report and what they plan to do
- encouraging the MSG to make reform of the relevant agency a topic for an MSG meeting
- asking the legislative committee with oversight responsibility over the agency to hold hearings on reforms
- supporting budget requests for the agency to get funds for capacity improvements
- encouraging newspapers and media to write articles and editorials on the topic of agency reform
- making positive statements in support of agency heads when they implement reforms in fact

*Potential Reform Agenda for the Legislative Branch.* Civil society groups should consider what actions a country's legislature should take after an EITI report is released.

The auditors might recommend:

- stricter enforcement of the rules for cooperating with audits
- increased funding for regulatory capacity
- changes in the laws governing the licensing of national resources for exploitation
- reporting of audit agencies or EITI auditors to both the legislative and executive branches of government

**Text Box 4.2: Reform Recommendations: Institutional Capacity**  
**—Improve Measuring Systems**

In Nigeria, a mass hydrocarbon balance was never calculated. The physical audit revealed the lack of measurement at the wellhead. The auditors' proposed reforms calculate the MHCB annually and improve measuring systems.

EITI Executive Summary p. 15

Civil society members should also assess whether the EITI system itself is adequate by asking:

- Is reporting complete?
- Is reporting frequent enough?
- Does the EITI Secretariat have the resources to do its job well?
- Are there adequate funds for communicating results?
- Are there sufficient funds for educating journalists, civil society members, and others on how the industry operates?

Civil society should also follow the money the government has earned. Key questions to ask are:

- How was the government's share spent?
- Was it saved or spent?
- How much went to state or local authorities?
- Are these amounts public?

Civil society members should also encourage legislatures to be more proactive by conducting oversight of key regulators and interested industry participants (e.g., the national oil, gas, or mineral company). Oversight is conducted by holding hearings or meetings in which legislators ask how an agency is implementing its statutory obli-

gations. This is a good vehicle for civil society members to meet with legislators and suggest questions they can ask.

Chapter 4: The Dissemination Phase	Yes/No
<b>XVIII. Understanding the Results</b>	
<i>Were the auditors able to reconcile the flows to the EITI standards? Did the report state ...</i>	
1. How much the government earned in total?	
2. How much was earned from taxes, royalties, or other categories?	
3. Whether the payments reported by companies matched the revenues received by the government?	
4. Whether all material flows were reconciled?	
5. If the government was paid in oil, how the oil was converted to cash and what price the government was paid?	
6. Whether there were any discrepancies?	
7. If the report meets international standards and/or standard agreed to by the MSG?	
<i>What governance problems were revealed? Did the report state ...</i>	
1. Whether there were any problems getting access to good data?	
2. Whether records were complete? Were records computerized?	
<i>What company behavior problems were revealed? Does the report tell you ...</i>	
1. Whether all companies submitted complete and accurate templates?	
2. What companies failed to cooperate?	
3. What actions were taken with respect to non-cooperating companies?	
4. Whether reports of payments to the government matched what companies reported?	
<i>What reforms did the auditors recommend? Was the auditor/aggregator asked ...</i>	
1. Whether the government's systems for recording payments met international standards? If not, did the report suggest improvements?	
2. Whether the government tests or audits tax or royalty payments in a fashion that meets IAS?	
3. Whether the government's financial statements meet IAS?	
4. Whether companies' financial statements meet IAS?	
5. Whether the laws and regulations governing companies' obligations to make payments are clear and effective?	



Chapter 4: The Dissemination Phase <i>(continued)</i>		Yes/No
<b>XIX. Communicating the Results</b>		
<i>Did CSOs ...</i>		
1. Come to its own conclusions about what is important to communicate about the EITI report?		
2. Suggest to the EITI Secretariat and MSG in their country where and how they should present the report?		
3. Request that their MSG conduct briefings on the EITI report and also conduct such briefings themselves?		
4. Write guest editorials in national and local newspapers?		
5. Go on radio talk shows to talk about the EITI experience and reports?		
6. Lead workshops to explain the results?		
7. Ask international advocacy groups to help translate the report and disseminate the results?		
<b>XX. Follow Up with Reforms</b>		
<i>Did the MSG ...</i>		
1. Take steps to lock in subsequent audits?		
2. Take steps to increase the frequency of reporting?		
3. Take steps to craft a reform agenda?		
4. Take steps to deepen the transparency process?		





P A R T II

DRILLING DOWN

# Understanding Business Operations in the Extractive Industries

## CHAPTER 5

# *The Legal and Economic Framework*

EITI stakeholders need to understand how the country's natural resources—oil, gas, or solid minerals—are converted into money. By knowing how the country's system works, stakeholders can identify what payments or benefit streams should be reported by companies, and what government agencies should be required to report receiving them. Knowing how the country earns its revenues—by company payments of taxes, royalties, or shares of the oil, gas, or mineral produced—is also the first step in understanding where things can go wrong. There is enormous room for miscalculation or worse when it comes to how companies calculate what they owe. If governments do not check whether the correct amounts are being paid and publish their findings, financial systems are vulnerable to corruption and mismanagement. This chapter of the guide explains how risk and reward influence the types of legal systems and contracts that govern the extractive industries. Chapter 6 describes the forms of contracts that prevail in the extractive industries. Chapter 7 describes the ways governments are paid. Chapter 8 describes which government entities manage these resources. Chapter 9 describes the way governments should be checking on these amounts and other areas where financial systems are vulnerable to corruption or mismanagement. The hope is that this information will arm civil society to be able to hold government institutions accountable. If they are not doing the kind of checking that is needed, then the EITI should be a tool for ensuring that this checking gets done.

## 5.1 The Legal Framework

A country's legislation, regulations, and contractual arrangements determine how the resource is developed and what payment the country receives in return for giving a company the right to extract the resource. This is a two-way relationship; both parties need each other, so each party has to believe that the terms are fair. These contracts and laws, governing taxes and other payments, define what payments companies must make and to which entity they must pay them. To provide a context for this discussion, we describe the role of risk and reward in determining the legal framework for a country, the major types of contractual arrangements, and the types of payments those contracts produce.

### Text Box 5.1: National Oil Companies

Many countries choose to have National Oil Companies take responsibility for exploration, development and export of oil reserves, or have them partner with other companies to do so. In these cases the NOCs also pay tax and royalty or other forms of compensation to the government. The government has an interest in making sure the NOC is an efficient producer and accurately pays the amount of money owed the government for the public treasury. The government may also have interests other than ensuring the NOC is an efficient producer. It may want it to take on duties such as managing social programs or creating employment. In any case citizens benefit from making the government's requirements and the company's performance transparent.

## 5.2 Risk and Reward: Factors That Influence the Terms in a Contract

Oil, gas, and mining contracts can be very long and complex, as drafters attempt to account for every eventuality that could occur during the term of the contract (which can be decades), and then try to predetermine what the parties should do when events occur that were not otherwise foreseen.

Yet, the key terms and main issues involved in a contract are relatively few. At their core, these terms include:

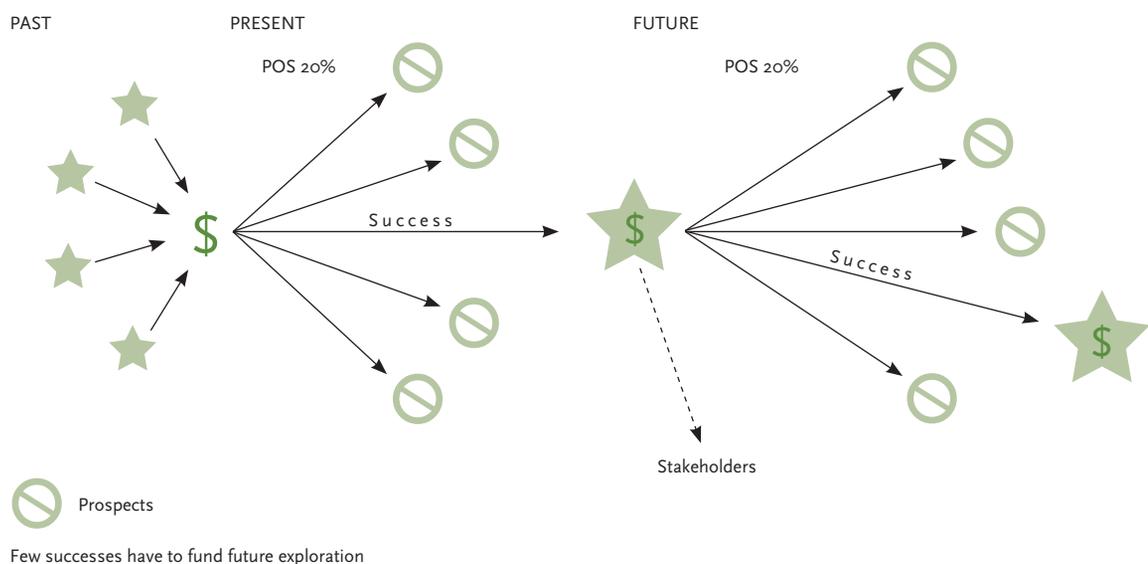
- Who will pay for exploration and development?
- How will production costs be financed?
- Who will manage the operation?
- How will the resource that is produced be shared or sold?
- In what order will the parties get paid?

These factors are treated differently in each of the different types of contracts.

It is important to understand that extractive industry companies are in the risk business. Companies take risks with regard to exploration and fluctuations in a commodity's price, and also must provide financing for exploration and development as well as technical expertise and operational management. In return, companies seek a fair reward, a fair rate of return on capital, and control of the program.

All commodity exploration involves risk, but the risk is a calculated one. The calculation is based on the probability of many different factors. On balance, the company needs to ensure it gets involved in enough successful operations (i.e., the reward) to pay for the money lost on failed exploration ventures (i.e., the risk).

**Figure 5.1: Sustainable Reward vs. Risk**



For example, assume there are five opportunities to explore in five different countries. Studies undertaken in these countries and have found that there is a 20 percent chance of discovering oil in each of the prospects in each country under consideration—that is, a 20 percent probability of success (POS). The expectation is that one in five of these prospects will actually be commercially successful. To be sustainable for the oil company, one successful venture must generate sufficient funds to drill five or perhaps more exploration wells in the future.

Contract terms negotiated in a production sharing contract, or set out in legislation, should give a company a fair reward for the risk it undertakes. If the risk is high, then the contract terms are generally more favorable to the company.

There are many unknowns when contracts are negotiated. If the exploration acreage is in an unproven oil basin then assumptions must be made on the prospects, such as the probability of oil being found, the probability of it being technically exploitable, how much oil will flow from the well (known as the “flow rate”), how long it will take to get enough production to pay for the work that has been done, and so forth.

Once a basin is proven to contain oil, some of these unknowns will disappear, for example, the source rock will have been proven to exist. The risk will therefore be less, and countries will often change the terms for the next generation of contracts, seeking a higher return to the government, to reflect the reduced risk. Later, when all the best prospects have been drilled, or a mine is at the end of its useful life, the fiscal terms may relax again to attract companies to explore the smaller or more marginal prospects.

Contract terms therefore can vary greatly. For example, in a hydrocarbon basin, terms will depend on the attractiveness of the acreage and when, in the life of the basin, the contracts were executed. Other outside factors, such as the perception of the trend of future oil prices at the time the contracts were negotiated, also influence the terms. The same is true of natural gas or mining contracts. If prices are expected to be low when the contract was signed, developers would have perceived financial risks as high and sought terms that would have made a project viable in a low-price environment. (This is true of international oil companies, but also of national oil companies deciding whether or not to invest in new production.) This was the case for the contracts signed in the late 1990s when oil, gas, and commodity prices were low. Alternatively, when commodity prices are high, and expected to remain high, as they have been from 2004 to 2008, host countries will perceive the price risk as low and demand terms that do not require a project to be successful in a low-price environment. In the oil industry, in the late 1990s and early 2000s, for example, \$20 per barrel had been the median price for decades, so companies required that projects be viable at \$15 per barrel of oil. Areas like Canada’s oil sands were not viewed as commercial. But in recent years, with oil prices well above \$40, and averaging \$60–\$70 per barrel, oil sands projects that require a global oil price of \$30–\$35 to be viable are viewed as highly commercial.

The significance of these variables for EITI Basic is that aggregators or auditors should seek to ensure that the terms of the many different types of contracts are being enforced. For EITI Plus, stakeholders should examine whether the form of their country’s contracts, and the terms they offer, are appropriate for the kinds of risks present in the country and in world markets.

## CHAPTER 6

# *Primary Types of Contracts*

The various types of contracts used in the extractive industries determine the rights and obligations of the government and the commercial operators. These contracts, in their varying forms and purposes, allocate the risks of the venture between the parties, and the rewards to be realized if they are successful.

The three main types of contracts are: (1) production sharing contracts, (2) concession agreements, and (3) technical service agreements.

Other forms of contracts, such as margin agreements and risk service agreements, are less common and will only be briefly addressed in this guide. It is also worth noting that new variations on the primary forms of contracting are continuously being developed and evolve as governments and industry players refine their understanding of the business, react to new needs and objectives, and respond to the realities of the marketplace.

Members of civil society need to understand these types of contracts, at least generally, in order to:

1. understand how the parties' performance under contracts affects the income or returns to the government from the extractive industry (known in the industry as the "government take")
2. assess whether these arrangements are the right ones for the country

## 6.1 Production Sharing Contracts

Production sharing contracts (PSCs) are a kind of barter transaction whereby the company develops a field under the oversight of the government. The company or contractor provides all the funding, including all risk capital, and recovers its costs in the oil it produces. (PSCs for natural gas are extremely rare. In the mining sector, governments can demand payment of royalties in kind, but do not utilize the PSC structure.)

Separately, the profit is shared between the government and the company in an agreed-upon formula, and is distributed between the two parties in oil. The sharing arrangements in most countries also deal with taxation, so once the government has received its share of profit oil it does not also tax the company on production. In a PSC, the government owns the resource, even though it agrees by contract to compensate the company for developing the field through “in-kind” payments.

### Text Box 6.1: Government Management of PSC Projects

Stakeholders may want to look carefully at how the government, in the form of a national oil company or other entity, manages its PSC projects. In a PSC system the contractor is given operational control in the field. The contract is managed through a management committee, which is usually made up of equal numbers of state enterprise participants and contractor participants. The management committee monitors the pace of oil exploration and production, as well as the costs incurred for the project; exercises oversight and control function by the joint development of annual work plans, budgets, major contracts, and plans for strategic development of the oil and gas discoveries. All such activities are subject to approval by the NOC prior to deployment.

*What Is the Benefit Stream for EITI Purposes?* The primary benefit stream (or source of payment) from a PSC is the government’s entitlement to its share of the production. Producing companies may also owe other kinds of taxes and payments.

*What Are the Key Accounting Issues for EITI Purposes?* The key issues for the EITI associated with this form of contracting include:

1. Calculating the share of in-kind payments
2. Calculating the equivalent cash value for in-kind payments.

In an oil PSC, the term “cost oil” is defined as the amount of oil the contractor keeps as repayment for exploration, development, and production costs. “Profit oil” is the remaining oil, and is allocated between the commercial operator and the government in previously-agreed-upon proportions. Sometimes there is a third category of “tax oil” which is the share of oil paid to the government representing its share of taxes (versus

its share of profit). Some countries include the amount of oil that is owed to government for taxes in the share of profit oil.

#### **Text Box 6.2: Calculation of Profit Oil**

Key issues for the EITI are payments of cost and profit oil, valuation of the profit oil by the government, other taxes paid by the companies, and how the oil is converted in to money (by the company on behalf of the government or by the NOC itself). Key process issues, beyond basic EITI, are the way companies calculate cost oil and the adequacy of the government's management of the sector.

#### **Text Box 6.3: Calculation of Cost Oil**

Look at how costs are controlled, how effectively the government representatives on the management committee do their job and how the financial cost is converted into a number of barrels. (See Appendix E.)

The formulas for calculating these shares differ in every country. They can be found in the contract itself or are sometimes prescribed by law. The EITI auditors or aggregators should make sure these formulas are correctly calculated by companies and governments to ensure that the country gets its correct share of revenue.

It is often difficult to precisely determine what share of oil the government is entitled to from each PSC, even by plain reading of the contractual terms. An auditor would need to know how much the field produced in a given year, then apply such analysis to the contractual terms in order to determine how much the company was permitted to keep for its costs (i.e., the cost oil), what was left over (i.e., the profit oil), and what portion of the profit oil was owed to the government under the terms of the contract. For a more detailed discussion of how to calculate the company's allowable costs and cost oil, see Appendix A. For a detailed discussion of how to calculate a company's profit oil under a PSC, see Appendix B. For an illustration of how to calculate how much of a company's equity share it is permitted to retain under a PSC (the combined amount of oil the company may retain, inclusive of both cost oil and profit oil), see Appendix C.

*What Are the Key Governance Issues Arising from PSCs?* A state enterprise oversees the management of the PSC, so the operation of a PSC requires bureaucratic approval of all decisions, especially approval of costs for recovery of cost oil. It is invariably the case that some costs will not be approved or not be approved in a timely fashion—in some cases, even when the costs legitimately should be approved. In advanced stages, stakeholders may want to examine whether the PSCs are being managed effectively by the designated state enterprise.

Other issues arise when the government is a partner in a concession or a PSC. These may include:

- Can the government pay its share?
- Does the government's role pose a conflict of interest for the joint company?
- Are the joint company's audited accounts adequate for the EITI's purposes?

See Appendix E for a discussion of these issues.

## 6.2 Concession Agreements

A concession agreement licenses a company (or, more typically, a lead company and its joint venture partners) to develop a geographic area. The rights to the resource (e.g., oil or copper) are legally held by the commercial operator. The concession holder finances all the costs of exploration, development, and production. The government typically receives a royalty, fees for acreage size, and taxes paid by the joint venture, as well as bonuses and social taxes. In the mining sector, a mining law or canon may set out the terms for compensation and implementing regulations. Contracts may also provide for special terms, including relief from royalties or special allowances. If the government is a partner in the joint venture, it also receives a share of the production corresponding to the share it owns.

*What Are the Benefit Streams for Purposes of the EITI?* Royalties, fees for acreage size, mining levies, and payments of taxes paid by the joint venture, as well bonuses and social taxes.

*What Are the Key Accounting Issues for Purposes of the EITI?* The key issues are whether the company correctly calculates its payments of taxes, royalties, and other fees, as provided by the concession agreement. Issues arising from the calculation of taxes and royalties are addressed in Chapter 7.

### **Text Box 6.4: Checking Royalty Calculations**

EITI only requires that an auditor reconcile the companies' calculation of royalty (and export duties and VAT if allocable) with the government's and report if they match. Stakeholders can consider requiring an auditor to test these numbers in one of several ways. One is to check the company's calculation of the net volume of oil or gas it produced with the government's calculation to see if they agree. If the royalty is variable (by world price or by volume of oil produced), the auditor can check the sums of government and companies to ensure they both calculated the royalty obligation collected.

### 6.3 Technical Service Agreements

Under technical service agreements, the government retains control of the resources and enters into an agreement for a company to provide technical services in the form of exploration work, construction, and managing the development. The government keeps the resource that is produced and the company gets paid in cash or commodity (i.e., oil).

Under this type of agreement, the remuneration is not based on production but on activities (e.g., man-hours rendered by the contractor). These are generally not attractive to oil companies but may be considered as a way to access prospective acreage or, subsequently, some risk-related field development activity. These types of agreements have been signed in some of the OPEC countries in the Middle East including Iran, Kuwait, and Saudi Arabia, for limited periods for specific studies or for certain construction projects.

*What Are the Benefit Streams for EITI Purposes?* Technical service agreements would not be covered under the EITI, as the company makes no payments to the government.

### 6.4 Other Types of Contracts

Margin agreements and risk-service agreements are two additional, but rarely utilized, types of contracts. They are used primarily in the oil sector and are discussed in this guide only for purposes of comprehensiveness.

*Margin Agreements.* Margin agreements were part of some old concession agreements and are not normally a part of new concession agreements. In a margin system, the concession holder produces oil and receives a fixed percentage of the market price, or a fixed amount per barrel of oil (adjustable in some circumstances). Although the margin is usually low (e.g., \$2 per barrel), the arrangement can be attractive for oil companies in times of low oil prices. These types of terms still exist in Abu Dhabi and Oman, but are not used for new contracts there.

*Risk-Service Agreements.* Risk-service agreements exist in a concession system under which the concession holder pays royalties and taxes. Under these arrangements, the buyer of the oil is the NOC, which buys oil at a prescribed low price. Such agreements still exist in some parts of South America (e.g., Argentina). This type of contract gives the NOC all the benefit of upside in the oil price while constraining the concession holder to produce and get its profit within the ceiling of the price limit.

## 6.5 What Are the Benefit Streams for EITI Purposes?

The producing company reports its production and the taxes, royalties, or other fees to be paid on that production. With profits constrained by what is in effect a price cap, the amount the company pays for profit taxes will be smaller than in other systems.

## CHAPTER 7

# *Primary Forms of Government Revenue*

The EITI requires that all material oil, gas, and mining payments to the government must be published. Governments take in revenue from the exploitation of oil, gas, and minerals in different ways, but primarily through:

- Taxes
- Royalties
- Payments in-kind
- Bonuses
- Dividends
- Rents

Indirect benefits, such as the provision of a road or bridge in exchange for the right to purchase a share of a producing oil field or to develop a mine, are not required to be disclosed in the EITI templates. For reasons discussed below, stakeholders may want to consider including them.

As noted in Chapter 5, the government's share from oil, gas, or mining operations varies depending on the level of geological, political, or commercial risk at the time of an investment. The government "take" is an aggregate of the financial share of taxes, royalties, shares of production, and other cash generated from operations. Table 7.1 illustrates the broad range of government take from oil and gas operations.

**Table 7.1: Government Take from Oil and Gas Operations by Country**

Country	Take %
Cameroon	11
Mexico	31
Canada	35
U.S. Gulf of Mexico	42
Philippines	46
Brazil	48
Kazakhstan	52
Cote d'Ivoire	55
U.S. Texas onshore	59
Equatorial Guinea	60
Azerbaijan	62
Nigeria (deep water)	65
Gabon onshore	73
Sudan	77
Russia Sakhalin 2	81
Norway	84
Nigeria onshore	87
Iran	93

Source: U.S. General Accounting Office, May 1, 2007.

## 7.1 Taxation

Governments earn income from the extractive industries through various kinds of taxes. The general forms of taxation are described below, in addition to several of the ways in which such tax regimes are modified to accommodate particular local needs or objectives.

### Text Box 7.1: Estimated Tax Liabilities

In the case of oil production, the amounts of money are usually large, so taxpayers make payments as they produce the oil (typically monthly), using estimates of the tax liability. At the end of the year, these estimates will be compared to an accurate calculation of the tax liability for that year and this may result in an over- or under-payment requiring final reconciliation.

*Taxes on Profits.* Many countries tax a producer's profits from extraction. These are taxes that are levied on the difference between revenues and costs. In some cases, there is both a basic rate of tax and an additional tax on excess profits, or profits incurred when prices exceed a certain level.

*The United Kingdom levies corporate taxes as well as petroleum revenue taxes. Nigeria levies a petroleum profits tax (PPT). Angola levies a petroleum income tax. Kazakhstan levies an excess profits tax. The United States levies a windfall profits tax.*

Two issues to consider include:

- Are these taxes properly calculated? (i.e., are the amounts declared for costs accurate and allowed to be deducted by the operator);
- Are the taxes being paid on time?

*Corporate Tax.* A corporate tax is levied on a company's profit, calculated from gross sales minus operating costs, capital charges, interest and depreciation, depletion allowances, and any other deductibles. It generally varies from 15 to 45 percent of net profits, but for hydrocarbon production it can sometimes be as high as 85 percent of net profits. It is payable in cash to the relevant inland (or tax) authorities.

The scope of permissible "operating costs" is critical to the calculation. For the EITI, be aware that there are many disputable items in operating costs. Many international extractive companies have set up centralized procurement organizations in third countries—the cost seen by the local entity will be an invoice from that procurement organization, not from an independent supplier, so there may be poor transparency as to what the external cost might have been. Usually such organizations will add a percentage markup to cover their administrative and overhead costs, and perhaps make a profit.

Another area of obscurity can be the way in which expatriate human resources costs are charged to the local operation. Such costs are likely to be high, relative to local equivalent costs, but the international company will charge on-costs (overhead) and a profit element, in addition to basic salary costs and any direct costs (e.g., relocation, housing, or incremental education). The composition of such costs will rarely be apparent to the local company.

**Text Box 7.2: Tax Holiday**

In order to encourage investment, governments sometimes agree to a 'tax holiday,' a period of years when no taxes are levied or a free depreciation period is permitted and the initial investment can be entirely written off against tax payments. Tax holidays have fallen from favor, as they tend to be regarded negatively politically, and their impact on the cash flow of a start-up mine is not great, due to the fact that the mine would have been loss-making and not paying profit taxes in early years anyway.

In an oil and gas company, exploration costs are hard to tie back to physical activity. The majority of exploration costs are likely to be abortive, so there will not be anything tangible to see. Good control systems are required to monitor and manage exploration costs. Such costs are usually tax deductible, so they will directly affect the amount of tax paid by the company.

**Text Box 7.3: Taxation Regimes**

The EITI only requires that the company and government calculations of tax obligations match. But since these calculations can be complex, stakeholders should ask whether the firms that have audited the companies have tested their calculations and attest that the reports adhere to international accounting standards. This ensures that someone has checked the calculations to be sure that only allowable costs are deducted and that the calculations are right. Stakeholders also need to understand that in a tax system, the government may not earn a great deal from oil production in the early years, when companies are recovering the substantial costs they have invested to produce the oil.

The EITI may also be a platform for looking at whether the tax system is the right one for the country, if it maximizes value, attracts investment and/or if simpler systems may be easier to monitor and enforce.

*Local Income Tax.* Countries may require companies operating in local areas to pay taxes directly to local governments (e.g., Kyrgyzstan). Such taxes may be related to payroll costs, or may be a percentage of profits tax. These arrangements are intended to ensure that some benefits of mining are retained locally.

Occasionally, the mine makes direct cash or in-kind contributions to the local communities. Such contributions, however, need to be handled with extreme sensitivity as they may fuel conflict between communities which provide labor, skills, and services to the operation yet benefit unequally from these arrangements. This recently happened to a major gold mining operation in Peru, giving rise to significant local friction and some violence.

*Personal Income Tax.* Personal income tax can be levied on expatriate senior personnel.

*Value Added Taxes.* Most countries have a value added tax from 10 to 20 percent, which is assessed on activities that add value to a product or service provided. These taxes accrue directly to the government and are related to the economic activity created by the mining sector.

*Import and Export Taxes.* Import and export taxes are levied by most countries on imported goods in order to encourage domestic production. Sometimes, taxes are levied on exported goods in order to generate additional tax revenues for the government. For new projects, some countries waive these taxes to encourage inward investment.

*Excess Profit Taxes.* An “excess profits tax” may be defined in relation to the profitability of the venture, so that this tax may only be applied when the project has a rate of return exceeding a specific and predetermined level (e.g., 20 percent). Alternatively, a “basic tax” may be applied to the profit of all projects; further tax may only be applied to specific projects due to the unique character of their size or location. In these instances, such a tax is described as “ring-fencing.”

#### *A Papua New Guinea Example*

*Papua New Guinea was in the forefront of the development of additional profits tax and adopted one of the most complex systems.*

<i>Sector</i>	<i>Basic Profits Tax Rate</i>	<i>APT Rate</i>
<i>Mining</i>	<i>35%</i>	<i>35%</i>
<i>Petroleum</i>	<i>50%</i>	<i>50%</i>

*Additional profits tax is applied when “net cash receipts” are positive, or in other words, when the sum of assessable income, less allowable deductions, exceeds capital expenditure and income tax paid. (Otherwise they are carried forward and adjusted for exchange rate fluctuations.) This usually means that the APT begins when the cost of investment has been recovered. The APT percentage is applied, in essence (the formulas are complex), to the profit remaining after deduction of the basic profits tax.*

*Windfall Revenues and Taxation.* During the recent surge in metal and other commodity prices brought about by the expanding economies of China and India, many companies made substantial profits that led countries to assess an additional profits tax, which was not specified in the original contract. In these cases the additional profit tax is sometimes known as a “windfall tax.” Increasingly, countries include these in their contracts, with the trigger point defined by a formula linked to pay-back on the original investment, agreed return on investment (ROI) rates, the commodity price against a base line, and gross profit. If the formula is well conceived, both parties should be satisfied with the distribution of “unexpected profits.”

*Dividend Withholding Tax.* When companies transfer dividends or net profits from one country to another, there may also be a dividend withholding tax, which can be an additional tax on profits. This is usually in the range of five to fifteen percent. Some countries have double taxation treaties with other countries so that dividends or profits are not taxed twice. This can have the effect of reducing the amount of tax paid in the exporting country or of canceling the tax altogether.

#### **Text Box 7.4: Taxation Over the Life of a Project**

Most tax rates are fixed or at least periodically set by the government at a specific rate. But countries want companies to have an incentive to get every last drop possible from a well or mine, in order to extend the life of a country's resource. Tax rates often allow for companies to have incentives to keep producing even when costs are high and production is low. This is the inverse of the excess profits tax, where governments may vary tax rates so the government earns more when prices are high. In some contracts the tax rate may change depending upon triggering criteria such as the profitability of the venture as measured by the historical earning power or internal rate of return (IRR or ROR) of the venture, or the R/C ratio (cumulative contractor Reward/Costs ratio) sometimes called the R-Factor.

*Note on the Oil Reference Price.* A number of taxes are based on the revenue of a project. Oil revenue is oil production multiplied by oil price. Although reference oil prices, or spot prices, are openly published (e.g., Brent or West Texas Intermediate) the prices actually paid for crude oil exported from a country can vary widely.

#### **Text Box 7.5: Establishing the Oil Reference Price**

Check how the various prices compare and find out whether the tax reference prices are reasonable.

The oil price is influenced by a number of factors. Although the price tends to be linked to its API density, the real value of crude oil is based on the products it yields in a refinery (called a "refinery net-back valuation"). Once a field has been discovered, its crude is sent for analysis. Based on its yield, a value can then be assigned to it. A refinery margin (the amount it costs to refine the oil into a product) would then be deducted from its product value. Some oil that is very heavy (like oil sands), or has a lot of sulphur or other impurities, requires a costly process to turn it into a useful product. These crudes, which require more expensive methods to convert into product, are priced lower than light sweet crudes that cost less to refine. Oil will have to be transported from the field to the refinery, so a transport cost will also be deducted to give a value at the export point, normally where crude is loaded into a tanker.

If the crude has been transported through a pipeline, especially one crossing international boundaries, such as those in Russia and Central Asia, then a tariff and other transport costs will be deducted to arrive at a net-back price at the sharing point, or the point at which the crude has been fiscally measured for tax purposes. At the fiscalization point, the crude volume is very accurately measured. At this point the crude can be given a value and will be linked to regularly-traded crude such as “Brent- $\$1.50$  per barrel.”

There are other factors that can affect the oil price actually realized or make it difficult to establish a proper price. If the crude is produced in relatively small quantities, it may be difficult to sell to third parties at an arm’s length price or an independent market-related price. If all the crude has to be sold to a local refinery, its real equivalent international price might also be difficult to establish. Some countries formally post a price for crude that is higher than what could be achieved in the marketplace (thereby effectively representing another form of tax). In other countries, crude is sold before the price is known and the price is set retroactively based on a basket of other crudes (a practice utilized in Oman).

If a crude has to be mixed with another crude of a different quality, how will the value of each crude be established? In Russia, most of the crude is sold as Urals blend, which is made up of many different qualities of oil from many fields. Currently, there is neither compensation for better quality crude oil entering the system, nor penalties for poorer quality crude oil.

Another complicating factor may be one of timing. If crude leaves the sharing point to go through a long pipeline, it may be another two weeks before the crude reaches the export point and is sold. If the crude price has changed in the meantime—which it will have—what price should one use at the sharing point?

The NOC can be a price setter for the crude that is lifted on its behalf. Prices for tax purposes can be set at standard differentials (subject to API) from that published price. In Nigeria, for example, the government sells its own crude at a price based on quoted benchmarks. The price used for tax purposes for producers of Nigerian crude, however, is a differential below that price, giving a benefit to companies.

All these points need to be addressed in the contract so that it is clear how the oil price will be established, particularly when third party arm’s length export sales cannot be regularly made.

*Significance for the EITI.* Auditors or aggregators need to understand what the agreed oil reference price is in each contract to ensure that the correct amount of tax (or royalty) is being paid.

## 7.2 Royalties

*What Is a Royalty?* Royalty refers to a sum of money paid by a holder of a concession to the government. It is payable by the company that produces the resource, whether it is a private or state-owned company. It is a revenue-based tax, but the actual definition of what revenue is taxed can vary greatly. A royalty can be charged or paid on the gross amount of revenue generated from the amount of oil, gas, or mineral produced, with no deductions for costs and irrespective of whether the project is making a profit. It can also be either gross or net sales of the resource, and can vary on a sliding scale, depending on how profitable the operation is. Examples are set out in Table 7.2 below. The amount is calculated on a formula set out in legislation or in the relevant license agreement. It is usually based upon a percentage of the value of the oil or mineral extracted. Royalties usually constitute a major source of income for the government.

### Text Box 7.6: Oil Royalties—An EITI Example

In Nigeria, the EITI auditors reported a dispute as to whether the legislation required the measurement of oil at the wellhead or elsewhere. Difficulty in accurately measuring the wellhead production had led to a practice of determining the volume at the point of export because this is the most effective point of being able to accurately measure the volumes.

At least notionally, a royalty represents the landowner's share in kind from the oil and gas produced from the concession area. In countries such as the United States, royalties may be payable to individuals, who by that country's constitution can own both the surface and subsurface right on properties. However, in most countries, oil and gas may be extracted only under authority special legislation or a license granted by the government.

### Text Box 7.7: Calculating Oil Royalties

The amount of royalty to be paid on oil production is usually based on the following parameters:

- Field by field production figures of the operating company;
- Corresponding API gravity of each field;
- Prevailing prices for the oil produced; and
- A royalty rate (calculated as a percentage of value or at a rate per barrel).

Table 7.2: Types of Royalties

Type of Royalty (tax base)	Countries Using this Method (example rates)	Comment
Sales Revenue	Ghana 3%–12%	Rate varies according to the operating ratio (broadly, the ratio of profit to gross revenue): Up to 30%: royalty of 3% Over 70%: royalty of 12% Sliding scale in between
	Mozambique 8%–12% for diamonds 3%–8% for other minerals	Rate is negotiable depending on mine size.
	Arizona, USA At least 2%	Determined by a commissioner.
Net Sales Revenue	Botswana 10% on precious stones 5% on precious metals 3% on other minerals	
	China Mineral resources compensation fee (various rates, eg: Coal 1%, Gold 4%)	
Profit	Australia Northern Territory 18% on net back proceeds less production and other costs	Each Australian province establishes its own royalty framework.
	Ontario, Canada 10% of profits	
Unit based	China (a money amount in Yuan/tonne)	Specified in law for each mineral.

*Payment of Royalties.* Royalties can be paid in cash or in kind. If a government chooses to be paid in cash, then the company sells all of the production and pays royalty on all of it. When governments choose to be paid “in kind,” for example, a portion of the physical oil derived from the total production is delivered to the government’s representative (typically the national oil company of that country). Governments often elect to take oil or gas royalties in kind when there is a need to supply local refineries or consumers for local product consumption. Royalties would typically be payable on all production (including that taken for refining) unless the concession agreement provided otherwise. The contract should clearly state on which production the royalty is levied.

*On What Volume is Royalty Paid?* Companies typically pay royalty on the production that is “produced and saved” and subsequently sold. Not all hydrocarbons produced at the wellhead are saved. Some are consumed in the production process itself, such as for generating electricity. Some are lost, due to evaporation, leakage, or even theft in the production operations, so royalty is not paid on wellhead production.<sup>58</sup> It is also extremely difficult to measure wellhead production as it is coming out of the well,

because oil, gas, and water are extracted during a multiphase flow in proportions that are not continuously stable—often coming out in slugs that can vary from 0 to 100 percent oil content. Once the oil is stabilized (with the water separated out and the gas either delivered to a gas gathering system, compressed and re-injected into the reservoir, or flared), the oil volume can be fiscally measured. At this stage, measurements are very accurate. Royalties can then be determined on the fiscally-measured crude oil.<sup>59</sup>

A key issue in the mining sector is the commingling of minerals. A company may have a license to mine diamonds or copper, and may have agreed to royalty rates for those minerals. If it extracts a small but significant amount of another mineral (e.g., gold), then it should pay royalties on that as well. It is important that the production of other minerals is checked and the fiscal regime makes provisions for a company paying different royalty rates on different minerals.

*Fixed Rates.* Countries utilize many alternative methodologies for levying royalties. Some countries have fixed percentage royalty rates. The royalty is then a fixed percentage of the revenue generated by selling the oil and gas produced. The actual amount of the royalty can range significantly from country to country (e.g., a typical rate on oil producers in many European and Middle Eastern countries is 12.5 percent, but is as much as 30 percent in other countries).

Royalties in the mining sector can be assessed on gross sales in the form of a percentage, for example five percent royalty on the value of gold sales, or two percent royalty on the value of copper sales. Mining royalties may be levied, for example, at \$1 per ton of a particular mineral and \$2 per ton of another. Published regulations tabulate the rates applicable to each mineral. Regulations specifying monetary amounts per ton quickly become outdated (due to inflation).

*Variable Rates.* Some countries have varying royalty percentage rates that, for example, may increase as production increases. Exact relationships between royalty rates and production, or other parameters, will be articulated in the individual contracts.

#### ***A Nigerian Example***

*Nigeria has a 20 percent royalty rate for oil fields located onshore. For offshore fields the royalty rate decreases from 18.5 percent for shallow water depths (0 to 100 meters) down to 4 percent for water depths of 800 to 1000 meters, with no royalty payable at water depths greater than 1000 meters. This variation reflects the higher economic cost of deep-water drilling and risk to the company of exploration at greater water depths.*

#### ***A Ghanaian Example***

*Ghana's mineral royalty is a production-based tax, levied in accordance with its Minerals and Mining Act, which provides for a royalty that ranges from three percent to six percent of the total revenue obtained from the holder of the mineral license. The*

*percentage is based on the profitability of the venture. Profitability is defined as the operating ratio, which is the ratio between the operating margin and the gross value of the mineral extracted. The operating margin is the value of the total mineral extracted minus operating costs. In 2004, all companies paid a mineral royalty of three percent.*

Some countries have historically utilized royalty-based schemes, but have since abandoned the practice. In the United Kingdom, for example, a royalty scheme established at 12.5 percent was abolished for Northern North Sea oil fields developed after 1982 and for Southern North Sea gas fields after 1988. The royalty scheme has been retained for the fields developed earlier.

*In-Kind Payment.* Royalties can be paid “in kind,” and under PSC agreements a government can be entitled to receive an actual share of the production. In the United States, Congo, and Angola, royalties can be paid in kind. Typically, such production-sharing is utilized to allocate rewards within the oil or gas sectors. The key issues for the EITI include:

- How the crude or gas is sold
- The procedures for setting the price and selecting to whom the resource is sold
- How the money flows back to the government after the resource is sold

*Domestic Supply Obligation.* Contracts sometimes require that a certain volume of oil must be supplied to the local market. This oil is usually sold at international prices, but in some contracts a portion is to be supplied at a lower price. This is called a domestic supply obligation at reduced prices, and therefore effectively represents a form of tax on revenue. For example, in some PSCs in Indonesia, the contractor receives the full market price for oil produced from a field over the first five years. After that time, 25 percent of production has to be sold at 10 percent of the market price to the government. Since the revenue ultimately generated by the producing company is lower (because less oil is sold to the market), the royalty it pays is lower as well.

### 7.3 Bonuses

*Signature Bonus.* A company pays the government a signature bonus when a contract is won in a bid, or simply when a contract has been concluded or signed by the parties. It is a legitimate expenditure in the contract and is often tax deductible and/or cost recoverable in a PSC. It can range from hundreds of thousands of dollars to over \$100 million, depending on the projected realization from the acreage. The signature bonus is a source of revenue realized up front and is not dependent upon the success of the venture.

*Discovery Bonus.* A discovery bonus may be paid to the government when a company discovers a field.

*Production Bonus.* A production bonus may be paid when production starts or when production reaches certain daily levels. These should be tax deductible and/or cost recoverable. The terms of the bonus are set out in the contractual arrangement with the government. This payment tends to arise under a PSC but can also be found in a concession agreement.

## 7.4 Dividends

A dividend payment is a distribution of profit to shareholders of the development company. When a government participates in a development company through an actual shareholding in the company, the government can become entitled to dividends. Such a dividend payment to the government is a benefit stream and should be disclosed in the EITI reports. The procedure for declaring and paying a dividend will be found either in the corporate law of the country or local jurisdiction, or in the corporate bylaws and other organizational documents of the company itself.

### Text Box 7.8: Payments of Dividends

While EITI only requires that a payment of a dividend be reconciled with the government's receipts, some countries may wish to look deeper to determine if dividends are being paid when they are due or if the government's shareholder in a joint venture has chosen to reinvest it. It is necessary to define the timing of a dividend and to specify at what point the dividend is considered to be a benefit. The possibilities include at the time:

- The underlying profits are earned;
- The dividend is declared by the directors;
- The dividend is approved by the shareholder meeting; or
- The time the dividend is actually paid.

The usual solution is to treat the dividend as a benefit at the time the payment is made. However, other possibilities could be equally valid if, for example, a dividend had been approved, but the government had not requested for it to be paid. This could happen if the government had offsetting obligations to capitalize the company for new development, in which case it could be argued that there were in effect two separate transactions: (i) The payment of the dividend; and (ii) The (equal and opposite) new investment being made by the government. If such circumstances arise and the amounts involved are significant, the MSG should consult with the auditors and agree how to report it.

## 7.5 Rents on Concessions

Rents are payments made in respect of the right to hold a concession, which can be either a lease or license.

*In Nigeria, for an Oil Prospecting License, the annual rent payable is computed on the basis of the area of the concession licensed in square kilometers multiplied by the annual rent payable with respect to that area. That annual rent can vary depending on the location of the field.*

The regulator should notify the company of the amount of rent due. The company should remit it to the designated account, as instructed.

The following additional fees are also payable in respect of a license:

- Annual Rent
- Application for License
- Processing Fee
- Application for Renewal
- Application to Withdraw
- Application to Assign
- Application to Terminate

Concession rentals are paid either on the anniversary of the concession or in advance. In most cases the amounts of rent and associated fees are not significant in the overall total of government income derived from the extractive industries.

## 7.6 Indirect Benefits

Companies and governments often draw attention to the economic benefit of their presence in the country (e.g., the additional employment they create or the contribution they make to infrastructure, such as roads and power supplies). The EITI, however, does not require reporting on the indirect benefits flowing to the country from the extractive industries.

However, the distinction between the indirect benefits realized by a country and “local taxes” actually incurred can be a fine one. For example, if a company is required as a license condition to construct and maintain a school near its operations, should that be counted as a benefit? If a bidder agrees to build a large infrastructure project such as a highway or railroad, in exchange for a preferential right to access mining or oil and gas acreage, the MSG may want to know the value of the contribution to assess whether the nation receives good value for money for the transaction. If a mining concession makes payments to states or local communities not required by its contract, local stakeholders

want to know how much they are, even if these payments are small in relation to the total benefit streams and might not be considered material on that basis. Under the EITI, MSGs have the flexibility to agree on whatever terms fit their needs.

*Verifying Indirect Benefits.* It is hard to verify company payments directly to local communities or other indirect benefits because the beneficiaries are often widely dispersed. Where there is no single destination for the funding, there can be no practical mechanism to confirm the amounts declared by the payer. Voluntary disclosure of these benefits also has risks. The quantification of the value of the benefit can be subjective and the claimed costs can be loaded with overheads attributed to such activities. By publishing these amounts, the MSG can be viewed as validating or lending credibility to purported benefits that cannot effectively be analyzed and reconciled. If these kinds of benefits are permitted or required to be reported, then the MSG will need to ensure that all companies report them and that adequate accounting and disclosure rules are set out so that the amounts can be appropriately verified, if material. For additional discussion about valuing indirect benefits, such as government loans for the construction of facilities, see Appendix I.

## 7.7 Putting It Together

In Chapter 6 we reviewed the different kinds of contracts. In this chapter we have reviewed the various ways that governments take in money under these contracts. There is tremendous variation within and among countries. In every case where the EITI is implemented it will be necessary for stakeholders to be briefed by the host government regulator or national oil company, by local operating companies, or both, on the kinds of contracts and the various forms for government take they provide, in order to know which benefit streams are realized and which are material. In cases where the government has hired foreign companies to conduct oil, gas, or mining extraction, the government may need to waive the contractual requirement that companies keep this information private. For this reason it would be good to have the government invite the companies to brief them on their contracts if this information is not public. Outside experts can be helpful as facilitators, but no one will know as much about the details of the contractual arrangements as the host government and the relevant companies.

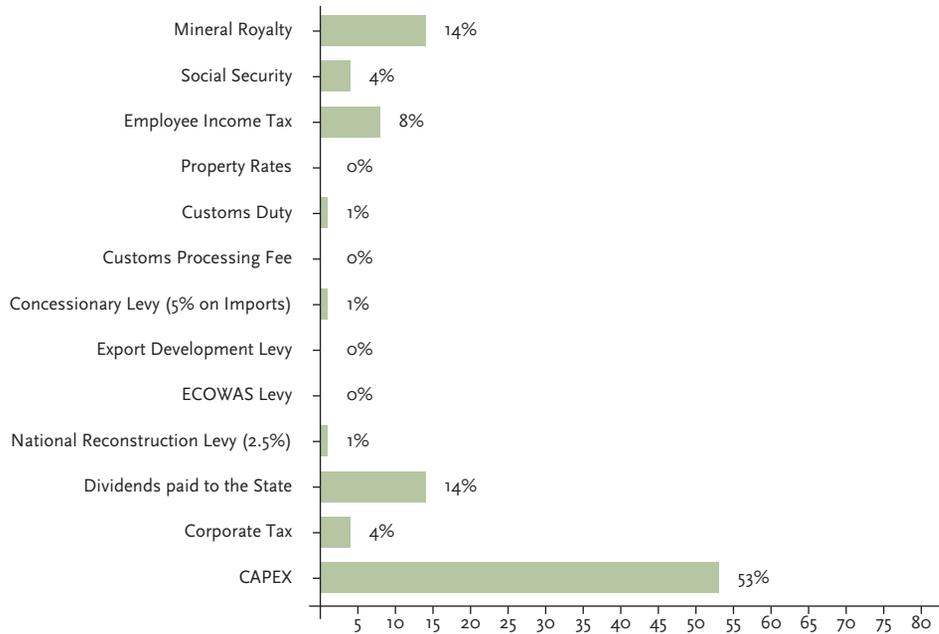
In this section, we look at examples of this variation in the oil and mining sector, and consider the ways in which natural gas production and liquefied natural gas production (LNG) demonstrate this variety.

### *A Mining Example*

*A look at Ghana's mining sector illustrates the multiple ways that governments earn revenues. Ghana assesses a corporate tax (25 percent of net profit), royalties (3 to 6 percent, depending on profitability), dividends (10 percent shareholding of every leaseholder), plus reconnaissance and prospecting fees, mining leases, ground rent, and other fees.*

*In 2005 Ghanaian mining companies made \$185 million in statutory payments of different kinds. The breakdown is illustrated in Figure 7.1.*

**Figure 7.1: Ghana Mining Sector Statutory Payments Category**



### Text Box 7.9: Form of Governmental–Commercial Relations

The form of contractual relations between the government and commercial firms engaged in natural resource development, and the specific terms of such a contract, is critical to a country's EITI deployment in the following ways:

**Financial Flows to be Analyzed:** The revenue streams to be audited may range from tax and royalty payments under concession agreements to oil distributed to the government under production sharing contracts.

**Key Audit Issues:** Key issues for the EITI audit will include: (i) Identifying what payments of royalty and tax were made by the companies and whether they are confirmed as being received by the government; (ii) Whether oil distributions under PSCs were correct; and (iii) What the government did with its share of oil and where the financial proceeds from the sale of its oil ended up.

**Additional Issues:** Assessing the financial transactions at a more detailed level, necessary to fully understand the effectiveness of the government's fulfillment of its management and oversight responsibility, will require determining: (i) Whether payments are made on a timely basis by companies; (ii) Whether the amounts were correctly calculated; and (iii) Whether any monies paid by companies to the national oil company are in turn paid by the national oil company to the government treasury in a timely and accurate manner.

### *An Oil Example*

As Text Box 9.1 in Chapter 9 illustrates, one country can have both concession and PSC systems, and can have variable rates for different concessions. The table describing both Nigeria's oil concessions and PSCs illustrates that different joint ventures have splits of production, and that the royalty on the concession-based joint ventures varies by water depth. It also illustrates that Nigeria's relatively recent PSCs are not yet producing, so the government and company shares (which will be based on the cost recovery permitted the company under each contract) are not yet known.

*Is Natural Gas Different?* The fiscal arrangements for the exploration and production of natural gas are very similar to oil, although different terms are often given for the development of non-associated gas over associated gas, with increased time given for the development of the former in order to identify an appropriate market. Natural gas can be exploited under concession, production sharing, or margin arrangements. Governments earn their take for natural gas production from taxes and royalties, and they can also earn fees by allowing natural gas pipelines to transit their territory.

#### **Text Box 7.10: Fiscal Arrangements with Natural Gas Production**

Similar to oil production, the key revenue streams for the government associated with natural gas production will be tax and royalty payments under concession terms, and payment or provision of profit gas under PSC terms. Key audit issues will be whether these payments are made on time by companies, if applicable law and regulations are being complied with, and whether valuation of cost gas and profit gas have been carried out correctly.

*Liquid Natural Gas.* If a local market is not available and sufficient non-associated gas volumes have been discovered, governments will consider the possibility of building an LNG plant for exporting the gas as a liquid in specially built LNG carriers. In such cases, because the investment in the upstream and downstream LNG facilities will be in the range of \$3–\$7 billion, the government will usually take a share in the plant, providing additional revenue streams for the government. For example, the government share in QatarGas and RasGas is 65 to 70 percent; for OmanLNG, it is 51 percent; and for Nigeria LNG, it is 49 percent. The general trend is for governments to take a greater shareholding in new ventures (e.g., Oman Qalhat LNG the government share is nearly 75 percent). The government share is usually externally funded.

For LNG plants, the revenue streams can be complex. Gas is sold into the LNG plants and yields income for the upstream producers, which are taxed under the various fiscal regimes. The upstream and downstream operations are usually separate, although the Qatar operations are fully integrated. Profits are generated from the sale of LNG after deduction of processing costs and transport costs, which are subsequently taxed. LNG prices tend to be linked to oil prices. Natural gas liquids (NGLs) and condensates

are valuable by-products of the liquefaction process, and the profits on these by-products are also taxed. In some countries (e.g., Qatar), a royalty is charged on the NGLs. If the government or government entity owns the tankers, then these will earn tariff or charter income. If the government owns a share in the LNG project, then it will also be entitled to its share of the project income or dividend flows. There will also be the project financing costs for the government if there is external funding, and there are often tax holidays as well (up to 10 years in some cases).

#### **Text Box 7.11: Assessing LNG Projects**

Each LNG project will be uniquely structured. The key issues for the EITI will be to identify the relevant revenue streams and ensure that payments and receipts are correct and in compliance with the various contracts.

In some cases, countries can earn monies from the fees they charge to have oil or gas pipelines cross their country. These fees, called transit fees, can be significant sums. For example, the Baku-Tbilisi-Ceyhan oil pipeline crosses Azerbaijan and Georgia before reaching Turkey. While Georgia is not a producer of the oil, or a recipient, it earns a fee on every barrel that crosses Georgia. Stakeholders should know if pipelines cross their territory, how much the fee is, what the annual revenues are, and determine if these amounts are significant or “material” in their view. If so they can be disclosed and reported.

For purposes of the EITI, particularly the creation of templates in Grid Indicator 9 and the determination of which benefit streams are material, stakeholders need to understand how the allocations are distributed within their country for every sector covered by the EITI, as demonstrated in Figure 7.1.



## CHAPTER 8

# *Which Government Entities Manage Revenues?*

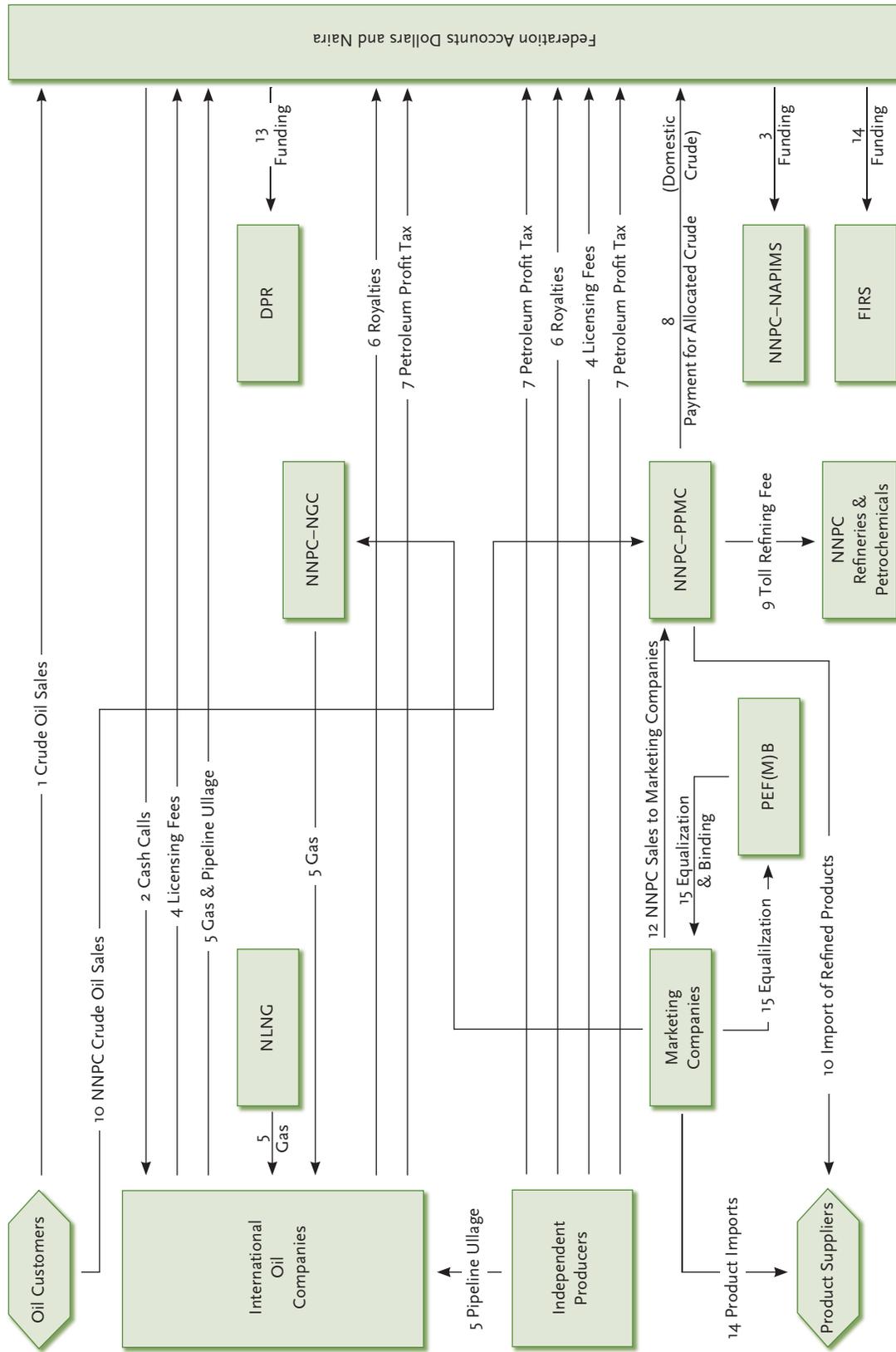
The EITI requires the government to prepare a template for its receipts from the extractive industries. These receipts are then to be compared against the payments that the companies have declared paying to the government, with any discrepancies between these receipts and payments to be disclosed. This sounds straightforward, but in reality, the process of reporting and reconciliation under the EITI can be very complex.

### **8.1 Every EITI MSG Should Require a Mapping**

To enable financial flows to be traced, an essential first step is to prepare a mapping of the financial flows. This will show, in a simplified overview form, who is making what payments and where they are paying them. Most countries undertaking the EITI have not published their overview mappings.

Nigeria, again, represents an exception to this general finding. Nigeria has delineated its varied financial flows into “oil flows” (flows of a type that occur only in the oil and gas sector), and “non-oil flows” (flows such as payroll taxes that apply to any kind of entity and are not special to the extractive industries). Figure 8.1 is a graphic mapping of the flows of oil and non-oil funds. Figure 8.2 is a legend or description of the various entities and the categories of financial flows. For example, the chart shows that crude oil (item 1 on the legend and numbered “1” on the diagram) is paid from the crude customer into the federation dollar and NAIRA account. The point is that EITI stakeholders cannot know which entities to hold accountable until they know who is in the chain of custody for both physical resources and financial flows.

Figure 8.1: Mapping Nigeria's Oil and Revenue Flows\*



\* NEITI Financial Audit Baseline Analysis of Financial Flows Mapping and Interim Report 8th August 2005 P 5.

**Figure 8.2: Mapping Nigeria's Oil and Revenue Flows—Legend**

1. **Crude Sales**  
NNPC sales of crude oil to the crude oil market, notifying CBN of the sales value and alerting them to the forthcoming receipt of funds for credit of the relevant Federation account at CBN in USD.
2. **Cash Call**  
Cash call payments, as per IOC budget approved by NNPC and FGN, are made to the JV operators from the Federation Account in USD on a calendarised basis.
3. **NNPC–NAPIMS Funding**  
NNPC–NAPIMS prepare an overhead budget that is settled from the Federation Account in USD.
4. **Licensing Fees**  
IOC's and independent oil companies negotiate with DPR and then make payments to the Federation Account at CBN in USD and Naira.
5. **Gas and Pipeline Ullage**  
This represent gas purchased by NNPC–NGC and NLNG from the JV IOC's and pipeline ullage fees payable by the independent producers to the IOC's. The Federation's share of JV gas and ullage income is remitted to the Federation.
6. **Royalties**  
The royalties calculated are paid over the IOC's and the independent oil companies to the Federal Reserve Account in New York in USD—the amounts calculated and paid over are advised to DPR by the IOC's and independent oil companies.
7. **Petroleum Profit Tax**  
PPT is calculated on a monthly installment payment plan and is paid over by all producers to the Federal Reserve Account in New York in USD with advices of these communicated to FIRS.
8. **Proceeds of Payment of Crude by NNPC–PPMC (Domestic Crude)**  
Payment by NNPC–PPMC for crude oil originally allocated for refining. Whatever part of this crude is not refined is sold by NNPC–PPMC.
9. **Toll Refining Fees**  
This fee is paid in Naira by NNPC–PPMC to the NNPC refineries in respect of refined products.
10. **NNPC Crude Oil Sales**  
Proceeds in USD from sales of NNPC allocated crude that has not been refined. Refer note 8.
11. **Import of Refined Products by NNPC**  
Payments in USD for refined products purchased from the international market.
12. **NNPC Sales to Marketing Companies**  
Sales revenue in Naira from refined products sold to the Petroleum Products Marketing Companies at Federal Government subsidized price.
13. **DPR Funding**  
DPR receives funding from Federal Ministry of Petroleum Resources for operating overheads.
14. **FIRS Funding**  
FIRS receives funding from Federal Ministry of Finance for operating overheads.
15. **Petroleum Equalisation Fund**  
The PEF(M)B make payments in Naira to the Marketing Companies for long distance bridging. PEF(M)B also manage the uniform pricing mechanism. The Marketing Companies make payments in Naira to the PEF for product movements costs below the national transportation average and draw from the fund for transportation costs above the national transportation average.

**Definitions**

CBN	Central Bank of Nigeria
DPR	Department of Petroleum Resources
FIRS	Federal Inland Revenue Service
IOCs	International Oil Companies
JV	Joint Venture
NAPIMS	National Petroleum Investment Management Services (government regulator)
NGC	National Gas Company
NLNG	Nigeria LNG Company
NNPC	Nigeria National Petroleum Company
PPMC	Petroleum Product Marketing Company
PPT	Petroleum Profits Tax
USD	U.S. Dollars

## 8.2 Typical Government Entities and Their Roles

The following is a list of the typical leading institutions and entities within a government that are most centrally involved in these financial flows and what stakeholders should ask of them.

*The Central Bank.* The best evidence that a payment was received by the government is that it has been identified in the central bank. The government usually has a single officer who has titular accountability for all government finances (income and expenditure). It is legitimate to ask that officer to provide a template of government receipts from the extractive industries.

*Taxation Authority.* The taxation authority is primarily responsible for assessing and collecting taxes. It is first necessary to determine whether the tax authority actually collects money, or if it merely manages money flows that pass directly from taxpayers to the government. This should be clear from the mapping of financial flows. If the money goes directly into a central treasury account, then the confirmation of the total should be available from the government. Information about the individual contributors to this total will probably only be available from the tax authority.

### Text Box 8.1: Calculating Taxes Under a Concession Agreement—The Methodology

A concession agreement is subject to a royalty at a predetermined rate on gross revenue and a tax at a rate on profit or taxable income (TI).

Gross revenue is total receipts received from production times the price of oil at the time of its sale. Royalty is levied on the gross revenue. Net revenue is gross revenue, less royalty paid. The profit (or taxable income) is net revenue, less costs incurred.

Costs will typically be categorized into the operational expenditures (Opex), and capital expenditures (Capex). Capital expenditures usually include those to acquire assets having a life of more than one year, including such items as buildings, tankers, pipelines, production facilities and so forth. These costs are depreciated according to fiscal depreciation rules and rates.

Total costs are then operating costs (Opex) plus fiscal depreciation (Depr) of capital costs.

$$\text{Taxable Income} = \{[(\text{Production} \times \text{Price of Oil}) - \text{Royalty}] - (\text{Opex} + \text{Depr})\}$$

The tax payable is then calculated by multiplying the taxable income by the applicable tax rate.

If the tax authority account receives money from companies, further inquiry is necessary to determine whether such monies can be regarded as having been received by the government. If, for example, money received into a tax authority account is simply

accumulated and transferred intact into a central treasury account, the receipt into the treasury account is probably best regarded as the receipt by the government. However, the government will lack detail on the composition of the amount, for which the data of the tax authority will be needed. On the other hand, if the tax authority receives money from taxpayers that it uses to maintain its own establishment and then passes the balance on to the treasury account, it will be important to determine where, in fact, the actual “receipt” by the government takes place.

*Regulatory Authority.* There is usually an industry regulatory authority, and this is usually the organization that manages the collection of industry-specific benefit streams, such as mineral royalties. The issues are similar to those that concern the taxation authorities and it is necessary to establish whether the authority actually receives money or whether it merely manages the flow to the government’s account.

*National Oil Company.* The role of the national oil company (NOC) needs to be carefully considered. In some countries, the national oil company has a role as a kind of ministry of the oil sector. As such, it may be reasonable to regard it as part of the government. In other countries, the NOC has much more independence, to the extent that its role might appear more akin to a private sector oil company with a state shareholder.

A key issue to focus on is whether the NOC has a major role in transactions that are in kind. To achieve transparency, particular attention will need to be given to how the NOC value in-kind benefit streams, because this is a place where significant discrepancies can occur. For example, for calculating the profit barrels to be shared under its production-sharing contracts, the Republic of Congo uses the “fiscal price” (an agreed price per barrel) for converting “costs in dollars” into “costs in barrels.” The use of such a reference price in the reporting templates would have to be accompanied by notes describing which entities sold the oil, who benefited from the sale, what prices were obtained, and how those prices compare to the reference prices. In addition, the notes could describe how the reference prices compare to accepted international benchmark prices.

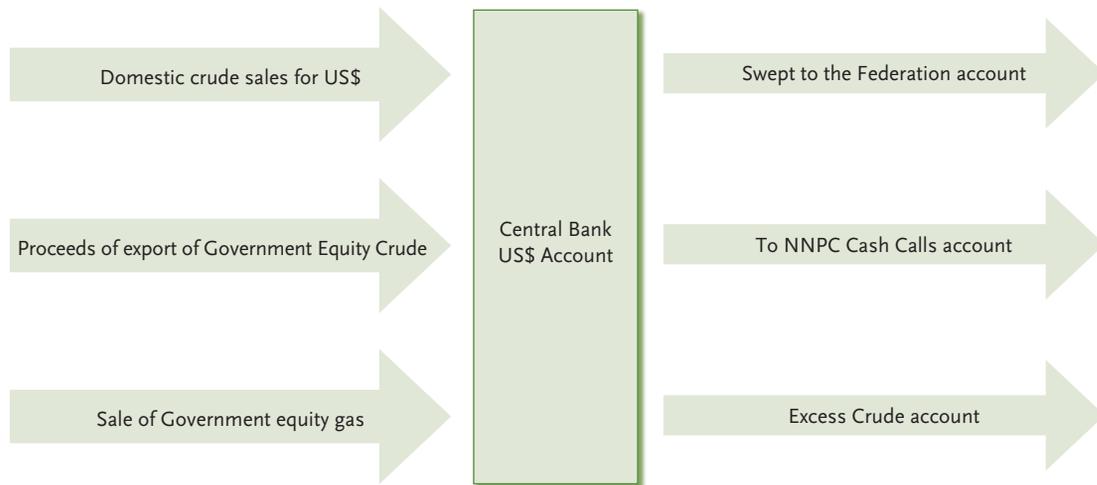
For example, in Nigeria, the Crude Oil Marketing Department (COMD) of the NOC sells government crude to a panel of approved lifting contractors at prices derived from international benchmarks. The COMD’s responsibilities in this regard include:

- Selection of contract holders
- Contract preparation and signing
- Crude oil lifting arrangements
- Clearance with relevant officials
- Fiscalization, before and after loading
- Vessel loading

- Valuation and invoicing
- Revenue accounting and reporting
- Interface with Federal Accounts Allocation Committee

The proceeds and utilization of crude and gas sales by COMD are as follows:

**Figure 8.3: Main Transactions on the Central Bank Account**



Domestic crude sales may be settled in either U.S. dollars or Nigerian naira, at the option of Nigeria’s NOC, the Nigeria National Petroleum Company (NNPC). Not all payments are necessarily paid into this account.

The diagram indicates the use of a clearing account for the proceeds of the sale of “in-kind” benefits. The account is managed as if it were a central government account, so all receipts into the account are regarded as government benefit income and the payments side is of interest only as part of the extension of the EITI, which Nigeria chose to implement.

*Regional and Local Government.* Some benefit streams might be paid directly from companies to regional or local governments. These are benefits realized by the country and, if the material is within the scope of reporting under EITI implementation, subject to the considerations noted previously about the reportability and reliability of the various types of payments made at a more localized basis. In these cases, the MSG may request that these payments be verified even if they are not material, simply to help all stakeholders understand where the money goes within the country. Relevant organizations at the regional and local level should be requested to confirm receipt of extractive industry proceeds. It can often be difficult to secure meaningful information from a regional and local government. The level of sophistication in financial manage-

ment and reporting at that level of government can be limited. If the requisite level of skill is sub-optimal, the government will need to undertake an extensive labor-intensive effort to identify relevant receipts, which can have a negative impact on both the timetable and cost of EITI implementation. On the other hand, at the election of the MSG, improvement of fiscal accountability at the sub-national level can be a primary objective of an EITI program.

In some countries, such as those where aggregate government receipts are already published, the EITI may help to make the distribution of receipts between the central government, regional governments, and local communities transparent.

#### *A Peruvian Example*

*Peru has a relatively high standard of accountability and transparency in the collection and distribution of oil, gas, and mining revenues. This effort is part of a broader process of fiscal decentralization; it builds upon existing legislation regarding access to information, and is consistent with Peru's commitment to the G8 Transparency Compact. There is a great deal of domestic interest in how these revenues are distributed at the sub-national level, in terms of which levels of government are beneficiaries, as well as what social purposes are being served.*

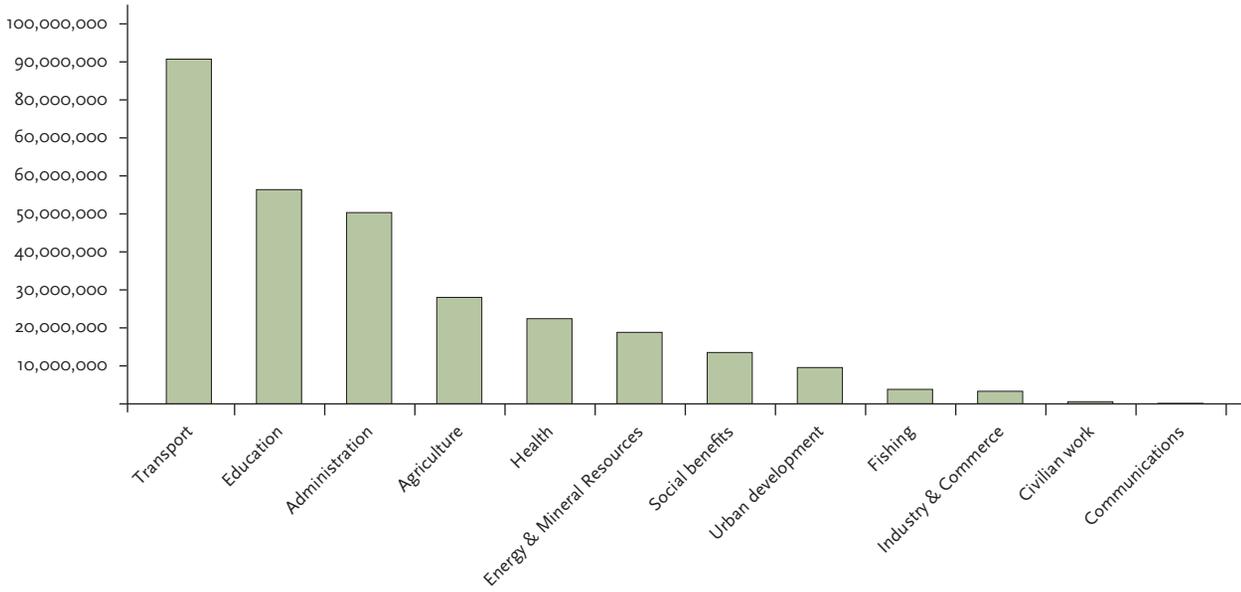
In Peru's case, the number of subregional actors is quite large. The required contribution of 50 percent of the mining tax under the Mining Canon<sup>60</sup> is as follows:

- District administrations of the mine producing areas: 10%
- Provincial municipality of the producing areas: 25%
- Districts and provinces of the region: 40%
- Regional governments: 25%

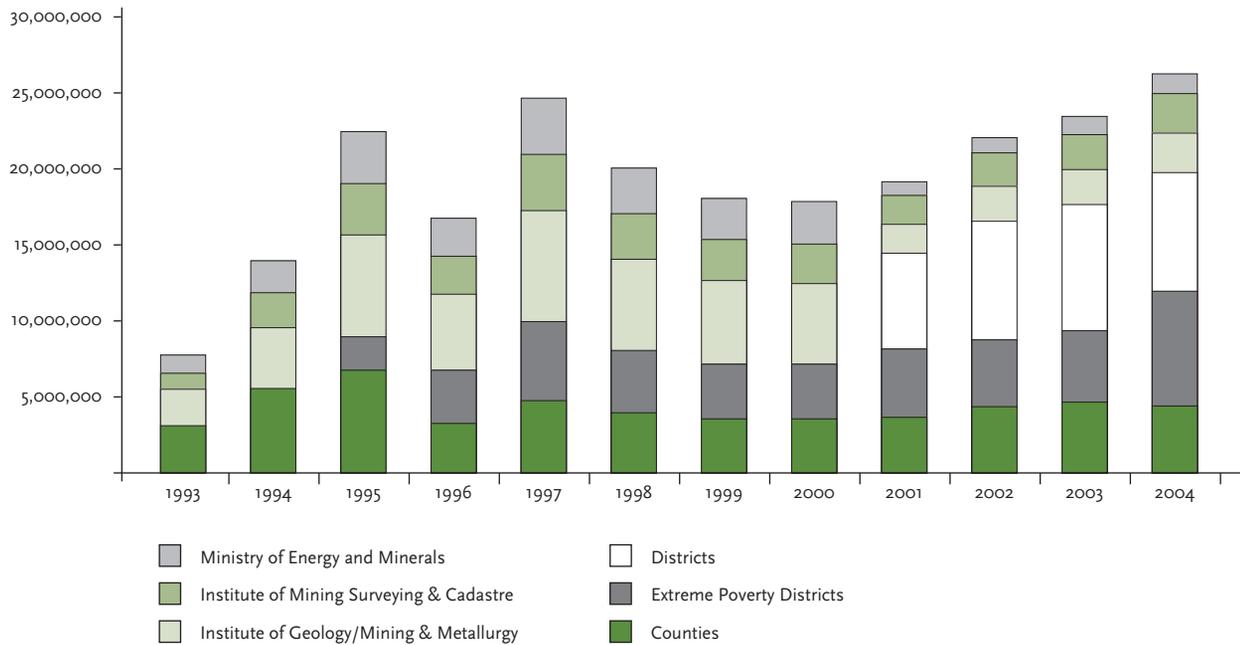
Other beneficiaries of the mining tax distribution (around US \$25 million per year) include:

- The Ministry of Energy and Minerals
- Institute of Mining Surveying and Cadastre
- Institute of Geology, Mining, and Metallurgy
- Related districts
- Districts with extreme poverty
- Related counties

**Figure 8.4: Peru Distribution of Payments to Departments in 2004**



**Figure 8.5: Peru Distribution of Mining Tax Payments to Government Entities**



Transparency at the subregional level in Peru is relevant because those communities that are concerned about the impact of mining on communities as well as the mechanisms and the distribution of a proportion of the mining tax, have a basis for discussing the changes they want under the EITI rubric.

*Quasi-Government Organizations.* It is common to find government organizations that are funded through contributions from the oil and gas industries, including training organizations and development corporations. It is necessary to evaluate such funded entities and determine whether they should be regarded as part of the government for the purpose of the EITI. This will depend significantly on how independent such entities are from the government. Typically, unless such entities are clearly private, they will be classified as a government entity, and therefore their accounts will be within the scope of the EITI review.



## CHAPTER 9

# *Key Areas of Vulnerability in Extractive Industry Accounting*

A key concern for governments and CSOs is whether the country is being paid what it should be for the resources extracted. Governments should want to ensure that they receive the full value of the country's resources as required by their laws and by the contracts under which the companies operate. CSOs should care because they too want to ensure their country gets full value for the resources extracted, but also because there is opportunity for fraud and corruption when no one verifies and publishes what prices are paid. One major limitation of the so-called EITI Basic, which is the minimal EITI implementation, is that there is little assurance about whether anyone is checking the receipts. This chapter describes what it takes to check the receipt of royalties and profit taxes to verify that the numbers are right. This chapter also describes what it takes to arm CSOs with the information necessary to determine whether these processes are being followed by governments or companies, or in cases where CSOs are asked to rely on existing audited accounts. While many ministries publish the amounts of minerals produced, or the tax and royalty rates, stakeholders will need to rely on the auditors or aggregators to give them current, accurate, and complete information on volumes and tax and royalty rates, in order to calculate these figures correctly. By knowing what must be done to calculate these figures, stakeholders can understand what auditor and aggregators are supposed to be doing and verify that the work is being done.

## 9.1 Checking the Receipt of Royalties

Royalty systems operate differently in every country. Because of this variation, each country requires a checking procedure that has been specifically designed to assess customized local systems. The types of systems vary depending on whether they charge the royalty based on:

- The chargeable value of crude oil or the mineral
- The profit of the concession holder
- A unit-based system (i.e., rate per barrel or per ton)
- Type of mineral or the API of the oil
- The characteristics of each concession (different rates taking account of the terrain or location)

In an extreme case, there could be individual royalty arrangements with each concession owner. This is the case, for example, in China.

The value-of-crude system is the most common type for oil. For minerals, there is a wide variety of methods. Older systems may set the royalty at a rate per ton and enshrine this in legislation. This gets outdated because of inflation and the difficulty making changes to commodity prices.

The agency responsible for checking the royalty is usually a specialized government agency, which may be the regulator of the sector. The skills required are very specific, and most countries find that a dedicated agency is more suited to doing this job than, say, a ministry of government, department, or tax collection agency that has other general duties.

**Text Box 9.1: One Country Can Have Multiple Contractual Systems and Different Royalty Rates**

Nigeria Concession Chart					
Joint Venture operator	NNPC	IOC Share	Tax Rate on petroleum profits	Tax Rate on gas profits	Royalty Rate
Chevron	60%	40%	85%	30%	0%–20% (See note, below)
Elf	60%	40%	85%	30%	
Mobil	60%	40%	85%	30%	
NAOC	60%	40%	85%	30%	
SPDC	55%	45%	85%	30%	
Topcon	60%	40%	85%	30%	
Panocean	60%	40%	85%	30%	

Royalty rates are defined by legislation and are:

- Onshore location 20%
- Offshore location
  - 0–100m water depth 18.5%
  - 101–200m water depth 16.5%
  - 201–500m water depth 12.5%
  - 501–800m water depth 8.0%
  - 801–1000m water depth 4.0%
  - 1,000 m water depth 0%

Nigeria producing PSC Chart		
Company	Government Production Entitlement	Company Production Entitlement
Addax Petroleum	Not known	Not known
Agip ENR	Variable	Variable
Shell N Exploration and Production Co	Not known	Not known

*Note: These entitlements apply subject to recovery of costs, through distribution of cost oil.*

*A Royalties Example in the Mining Sector.* Let us say that the royalty on salt production is \$0.05/ton produced. The main steps to monitor this system include:

- Find out the tonnage produced
- Check the calculation
- Confirm that the amount was received by the respective agency

For the first step, note that it can be difficult to check amounts produced. There are three main approaches to checking production:

- Review what is recorded as having been sold
- Check the records of what was produced from the mine
- Survey the mine

In any case, the agency should require the concession holder to submit their calculation of the royalty amount along with the payment.

In the mining sector, particularly in the fringes of the sector, there has been a tradition of producing minerals and not recording them, so records may not be wholly reliable. Sometimes, because mine inspectors know this, there can be corrupt payments to officials to overlook deficiencies in the records. In some cases, mine inspectors might organize a survey of trucks leaving a mine to assess the weight of material being produced. Sometimes, trucks might be required to cross a weighbridge to monitor how much they are carrying.

Because of these difficulties, the third methods of checking—a survey of the mine—is necessary from time to time. This involves a geological survey of the inside of the mine to determine the shape of the hole in the ground, from which the volume of material extracted can be deduced. Using the earlier records of mine surveys, the constituent parts of the material mined can be determined. (For a salt mine, this will be partially the mineral itself and partially waste material.) Then the tonnage can be determined from the volume, using the known density of the material. Clearly, this is an approximate method but over time it will provide a relatively strong correlation to actual production.

Checking the calculation of royalty for a single period requires the skills of a mine surveyor and an accountant. The period evaluated is usually a year, but depending on the nature of the material, it could be as short as a month.

Assuming the amount payable has been agreed upon, the mine concession owner should be able to provide a receipt as evidence that the payment was made. The final step is to check the amount against the financial records of the receiving organization. This can be the account of the monitoring agency, or the account of the government to which the agency will require access for checking purposes.

Agencies should maintain registries of producers and should operate a program of verification. This could be a cyclical program or a random inspection. Every concession holder should be checked at some time and the agency will probably stratify its checking procedures to ensure that the mines that are expected to yield the highest levels of royalty are checked frequently.

*Another Minerals Example.* If the royalty is based on the value of material produced, a further dimension of monitoring is required.

Let us say that the royalty on coal produced is set at the rate of 10 percent of the sales value. The monitoring agency will need to find out the sales value of production. Note that the royalty in this example is not based on what is sold but on what is produced. From an accounting point of view, this is a hard system to apply, but legislators often use it. There is a mismatch between production and sales: the two will differ routinely because of changes in stock levels and because of losses between production and the point of sale. (Some types of coal stocks are notoriously prone to fires, which can cause some of the coal produced to be lost. Depending on the wording of the royalty rule, the royalty may be payable on that production.)

Furthermore, it can be difficult to define the point of sale. Was it intended that the royalty should be different if the mine operator sells the coal at the mouth of the mine, or if he decides to turn it into briquettes (called “beneficiation”) and sell it retail (calculating the royalty at the point of that retail sale)?

Assuming that the agency has resolved these ambiguities, how can the figures be checked? It will be necessary to compute the value of sales per ton sold and apply that rate to the quantity produced in the period. Accountants are again required. For overall verification, the agency should obtain annual financial statements of the concession holder, preferably audited, and compare the total realizations with the data that has been provided along with the royalty payment. Over a longer period of time, the differences resulting from changes in the stock level will be less material to the calculation and there should be a good correlation between sales and production.

*A Crude Oil Example.* In this example, a royalty is due on crude oil produced at the rate of four percent of its sales value.

There are four main steps to monitor this system of royalty:

- Find out the amount produced (in some countries, stakeholders can obtain this information from government publications or through EITI templates)
- Determine the sales value
- Check the calculation
- See that the amount was received by the respective agency

Similar to the mining examples, there are challenges at each stage of the checking. First, the agency has to check what was produced. Although the term is commonly used, the precise definition of “produced” will have been set by the legislation. It might be the wellhead production, export volume, or something in between. Usually, crude oil flows are subject to close physical control and an accurate measurement (which may be known as “fiscalization”). This measurement will be made while representatives of the agency and the crude owners are both present.

Apart from the volume, the agency needs to know the value of the production. This is partly a function of the international market and partly a technical question. Pricing can be based on international benchmarks, adjusted for the location of the oil. If the legislation requires a price, usually the agency itself will determine the price and announce it to the producers. It is usually impractical to apply actual realized prices because of the extent of vertical integration within the oil sector—most producers will sell the crude to an affiliated company for refining, so the transfer price to the affiliate might not reflect the market.

It is also necessary to know the API of the oil in order to adjust the price. This requires cargo inspection, understanding of field characteristics, and laboratory analysis. All cargo is inspected and analyzed on behalf of the producer, the vessel (which will have its own small laboratory), and the agency, so a corroborated API will be available for each lifting of crude.

Payment checks for crude royalty will be similar to those for mineral royalty, with one important difference: royalty on oil is usually payable in U.S. dollars. This transaction will therefore take place offshore, probably in New York, and the payment will appear as a SWIFT notification from the bank.

## 9.2 Checking Profits Taxes

Petroleum taxation is a highly sophisticated area, and the rules for computing<sup>61</sup> the tax payable are usually precisely described in legislation. This form of taxation is notionally based on profits.

Minerals taxation is very similar to taxation of any other industrial activity and is not discussed further here. Oil taxation, however, has some special features and varies between countries; differences can sometimes be fundamental. For example, in some countries a production sharing contract is exempt from taxation (because the profit is taxed within the PSA itself). In other countries, a tax is levied on the results after sharing production. It is not the purpose of this section to review the tax rules, but rather commentary is limited to the specific checking processes.

There are two essentially different types of tax systems:

- Those where the tax authority receives information on the basis of which they raise assessments on the taxpayer
- Those where the taxpayer self-assesses its tax liability and then submits its calculations to the tax authority

The first of these has been a traditional way of assessing tax. However, countries are increasingly moving toward self-assessment systems. This is because self-assessment

places a higher responsibility on the taxpayer to compute and pay the right amount of tax. Self-assessment systems rely on random, or profile-based, checking by the tax authority, so they are also more efficient to run. Self-assessment systems usually include hefty fines if the taxpayer's assessment is found to be wrong and tax has been underpaid.

The country's tax authority usually administers taxes, but because oil taxation is different from other industrial taxation, tax authorities usually designate a separate section within their department to manage this area and become specialists. Large amounts of money are at stake in the taxation of oil, so it is important that the oil taxation specialists in the tax authority are properly trained and can provide some kind of balance to the expertise available to the oil companies who, naturally, want to make sure they are not paying more tax than they are obligated.

Generally, oil companies make monthly payments on account of their tax liabilities. At the time tax payments are made, the tax authority has almost no data to check whether the amounts being paid are reasonable. The main checking takes place later and is based on annual returns and financial statements.

Key elements of the return require checking:

- Reconciliation with the audited financial statements
- Whether the gross income is correct
- What has been claimed for capital expenditures (e.g., construction work or expenditures on assets with a useful life of more than one year, such as platforms, buildings, and machinery)
- Whether key cost items are properly deductible

A desk review of the returns filed by the company is conducted. After this, the taxing authority may communicate with the company to submit specific documents and information that substantiate the returns. This additional information is further reviewed and could result in additional tax.

All tax returns submitted by the taxpayer should be accompanied by audited accounts, which should be the starting point for taxation. They should provide adequate explanations for any differences between the audited accounts and the tax returns.

*In Nigeria, the audit revealed that the tax calculations are not cross-checked to the audited accounts and the tax authority lacked the expertise to do this. The auditors recommended steps to be taken to strengthen the capacity of the tax authority. Consequently, a major capacity-building exercise was commissioned.*

Gross income for tax purposes might be different from the gross income in the financial statements. As in the case of royalties, the actual sale price of the oil for purposes

of profit tax calculations is not typically used. Instead, it is premised upon a price pre-established by the government. The tax authority will want to check that this has been properly done. There are three main elements:

- Confirmation of the prices used to value realizations
- Confirmation of production volume with the regulatory agency
- Confirmation of oil liftings with the NOC

The volume of oil sold that has been used in the financial statements and/or in the tax computations should be in agreement with, or reconcilable to, the figures used for royalty purposes. The regulatory agency that checks royalty calculations will have checked the volumes of oil that were produced, so the same volumes should form the basis for profits taxation. This means there should be communication between the tax authority and the regulator. Although this may sound simple, it is often a problem. Government agencies tend to act independently and not share data. Sometimes they are expressly prevented by legislation or confidentiality agreements that prevent data sharing. Therefore, these issues should be examined to determine whether they are putting revenue at risk and warrant remedies to permit intra-governmental sharing of data:

*In Nigeria, the audit revealed there was no process to ensure that the tax calculations were based on the data that the regulator had verified and was using for royalty purposes. As a result of the audit, the links between government institutions were reviewed.*

It is important to recognize that capital expenditures warrant special attention in all tax jurisdictions. The amounts are so large, and the opportunities to “massage” their treatment in order to affect the tax calculations typically means that legislation has been enacted which sets out precisely how allowances (often known as “capital allowances” or “investment allowances”) are treated for tax purposes. The tax authority will need to check the analysis of expenditures to make sure that some capital items, for example, have not been hidden in repair costs. They might also occasionally make a visit to the company’s field operations to check that the field is developing in the way it has been described.

*Relevance to the EITI.* Ask whether the tax authority has the necessary in-house skills and personnel to undertake this kind of check. If not, how are they confident that the right tax is being paid?

The tax authority might have powers to carry out a tax audit. Some countries (e.g., the United Kingdom) do not give this legal right of audit, but the authorities apply other techniques to obtain the information needed for checking assessments. Tax audits are not carried out on every company every year. When they take place, they generally

focus on the checking of documentation that is not available as part of the routine submission of tax returns and financial statements.

The amount of tax payable is highly dependent on the amount of costs. However, these are the most difficult element to check. Costs can only be properly validated in a Value-for-Money (VFM) review, which tests the economy, efficiency, and effectiveness of cost elements:

- *Economy* pertains to the practice of the thrift and general “good housekeeping” by the industry participants with regard to their management of expenditures. A VFM audit therefore checks that an operation acquires resources of appropriate quality and quantity at the lowest cost.
- *Efficiency* pertains to minimizing the ratio of inputs to designated outputs. For example, a VFM audit endeavors to reveal inefficiencies within operations, such as identifying activities that have no useful purpose, or those that result in the accumulation of an excess of materials, and so forth.
- *Effectiveness* pertains to ensuring that the output from any given activity meets expectations or achieves the desired operating objective or goal. In order to assess effectiveness, it is necessary to first determine and specify the objectives, and secondly, to assess performance against these objectives.



P A R T III

DRILLING DOWN

## Beyond EITI Basic

## CHAPTER 10

# *The Need for the EITI to Evolve*

### 10.1 Beyond EITI Basic

It is a significant step for a country to consider undertaking the EITI, first becoming a “candidate” country and moving on toward being a “compliant” country. It takes time, trust, and experience simply to launch the EITI Basic program. As stakeholders grow used to each other, and as they look at ways to deepen their understanding of the industry, overcome distrust, and root out corruption and mismanagement in the industry, they should look at moving beyond a basic implementation of the EITI to a more in-depth inquiry.

This chapter looks at three important issues for civil society to address:

- How to think about the evolution of your country’s EITI program
- Reasons why all stakeholders might want to adjust the EITI mandate within their own country, to meet their own unique objectives and local circumstances
- Other key areas to consider

## 10.2 How to Think about the Evolution of a Country's EITI Program

In many countries, the EITI will be just one element of a wider program of transparency and anticorruption measures.<sup>62</sup> It may be most useful as a multi-stakeholder forum. In other countries, the EITI may be the leading edge of efforts to begin to bring transparency to the extractive industries. It is important to keep the following principles in mind:

- *The EITI is a tool, not an end in itself.* The EITI provides a voluntary method of gathering stakeholders together (though we recommend that it be codified in national legislation where possible). It assures that citizens have basic but accurate information about the financial resources a country has available for its national budget, and helps people hold their government accountable for its actions.
- *The EITI is a voluntary program.* While the EITI Validation Guide provides the essential steps that must be taken for a country to use the EITI brand, your country's EITI program must be tailored to your particular situation, and to the goals civil society, companies, and governments agree should be achieved.
- *The EITI programs should evolve.* There is enormous benefit in just getting started. Having a multi-stakeholder group discuss an extractive industry's revenues and practices will be very new to nearly every country. Simply organizing the MSG is an achievement in itself. It takes time for such a group to get to know each other, build trust, and develop a common base of knowledge. Once the basics have been achieved, however, civil society (in concert with stakeholder representatives) should look at how to improve the program itself, improve the capacity of stakeholders, and enhance the communication of the results.
- *The EITI must be a "home-grown" effort.* Countries will differ widely in their reasons for adopting the EITI. For countries that are just beginning to publish information about revenues and payments, the EITI is a way to get started on transparency. Civil society groups should aim to take the essential steps first, including developing a work plan, hiring an aggregator, getting a report published, and communicating the results. For countries that already audit national and foreign companies and publish revenue and payment figures, the EITI focuses on deepening the public's education about where the monies go after the central bank receives them: Do they go to states and localities? If so, how much? How are these monies spent? The EITI may be a means for improving the country's investment framework, but it is also a shared exploration of whether a country is getting the best value for its resources in the way it licenses, regulates, or markets its resource wealth.

### 10.3 The EITI Must Be Mainstreamed

The EITI needs to engender an attitude change in the extractive sector. An explicit goal of the EITI, as articulated by the international multi-stakeholder board, is the mainstreaming of the EITI over the coming years as a new international standard of transparency and accountability for governments and companies doing business. This relies on EITI countries institutionalizing their practices and principles as a permanent feature of extractive sector governance. Countries' multi-stakeholder groups should emphasize the sustainability of the EITI process from the start and take steps to ensure that the EITI is not a once-off exercise, but that it will continue and progressively deepen. Azerbaijan is seeking a United Nations General Assembly endorsement of the EITI that would solidify its status as an international norm. Transparency will be mainstreamed into the way the sector operates—the regular publication of public interest data will become a normal feature. Apart from enshrining the EITI in legislation, the MSG needs to stress that the EITI will, step-by-step, enquire more into the processes of the extractive sector and expound to civil society how these processes operate and whether they are to the ultimate benefit of the country.

### 10.4 Reasons Why All Stakeholders Might Want to Adjust the EITI Mandate

In order to move beyond the elements required by the EITI Validation Guide, there must be a consensus among all stakeholders. There are many reasons why civil society, companies, and governments in some countries have moved beyond EITI Basic to EITI Plus, including:

- Reducing corruption
- Ensuring that the country is realizing value for money
- Building national trust
- Improving a country's reputation
- Creating a more competitive investment climate
- Maximizing tax and royalty collections
- Educating the public about state and local spending

*Reducing Corruption.* Conducting a financial reconciliation and involving civil society in a conversation about the extractive industries' conduct brings a tremendous amount of “sunshine” to a sector that has often seen little light. This is why the first priority of civil society should be simply to get the EITI process launched and the first report published. But once the initiative has progressed to such an extent that there are clear “lessons” that have been learned, stakeholders need to ask themselves if they have addressed the main concerns that brought them to the table in the first place. If the main concern was the potential for corruption, then it may be time to deepen the EITI process.

Reconciliation may produce some discrepancies, but it is unlikely to reveal the kind of major gaps or vulnerabilities that can invite corruption or mismanagement. Corruption can occur in many subtle ways. If there is too much discretion in the hands of one official, he or she may be subject to influence in terms of which companies are awarded projects. If there are no technical qualifications as to what companies or individuals can satisfy requirements to be a local content providers, operators, or even purchasers of crude oil or minerals, then an unqualified party (which may be connected to a government or company official), may “win” those rights and simply sell them to someone else. To address these vulnerabilities, the EITI in a specific country may want to look at how the extractive industries business is currently operating, how technical qualifications are set, or how EITI projects are designed to redress these vulnerabilities going forward.

*Building National Trust.* In some countries there is widespread distrust about all participants in the extractive industries. There is often a mismatch between public perceptions and the reality about how much money the government earns, how much companies pay the government, or how much companies spend locally. A deeper examination of the extractive industries can help build trust and make expectations more realistic.

For example, in Mauritania, launching the EITI was part of a broader transparency movement designed to show that an interim government was willing to be transparent and to institutionalize that transparency before elections were held. In Nigeria, President Obasanjo and his reform team saw the EITI as a way to build trust by subjecting both government agencies and companies to an extensive audit of the extractive industries—from the production of oil to its fiscalization to where the money went to benchmarking all the major industry processes (such as licensing) against international standards. Significant systemic weaknesses were revealed, but the companies and government benefited from their willingness to undertake this deep and independent examination of the sector.

*Improving a Country's Reputation.* Many countries have negative reputations, including scoring low on global development indices and/or high on corruption indices. A willingness to look at ways to improve how the country conducts its business, such as the utility of tendering acreage for exploitation rather than giving a minister wide discretion, can improve a country's reputation. A consensus can be built around companies (which would benefit from a level playing field to compete for acreage), governments (which may earn more from a competition than a bilateral deal), and civil society (which benefits from a transparent process).

*Creating a More Competitive Investment Climate.* In order to earn more revenue for development, countries may want to create a more competitive investment framework. The EITI process can incorporate in its work plan an assessment of the country's exist-

ing framework, and an evaluation as to whether more transparent rules might earn higher shares of government take or signature bonuses.

#### **Text Box 10.1: Transparent Bidding Maximizes Returns**

“Analysts say the Libyans have played their hand exceptionally well so far, providing reassuring transparency in the bidding process, in return for maximizing their potential gains from production increases.”

Wallis, William: “Libya: Hitting the jackpot as Gaddafi comes in from the cold”  
Financial Times February 28, 2006

*Maximizing Tax and Royalty Collections.* In countries with weak government institutions there may be perceptions that companies are not paying their fair share of taxes or royalties, or that the government is not fulfilling its obligation to regulate the sector. All stakeholders have an interest in proving that the law is being complied with and enforced. In such cases, there may be a consensus for having auditors test the accuracy of calculations of taxes and royalty payments by companies on a sampled basis. Random “test checks” can uncover ambiguities in regulations, reveal a lack of clarity to audit, or verify that taxes and royalties are indeed being collected and paid with accuracy.

*Educating the Public on Sub-National Income and Spending.* In some countries where government and company accounts are audited and published, the EITI is a vehicle for helping the public to understand where the money goes after it gets to the central government, or where it goes other than to the central government. In many countries, significant sums are paid to sub-national governments in both producing regions and non-producing regions.<sup>63</sup> Figure 8.5 illustrates this kind of distribution. Companies may also spend significant sums on local support. While this may not represent material flows of funds as a percentage of total revenue, communities may want these sums quantified and published. Companies may want the public to have a full and accurate picture of their contributions to the country. Civil society may want to know the full amount of sums paid and to whom. Citizens of states and localities will want to know the amounts local governments have received so they can hold them accountable. In these cases there may be a consensus to have the auditors or aggregators map and publish the flows of funds to all levels of governments.

Depending on the stakeholder consensus and the issues important to your country, civil society groups may want to consider broadening and deepening their EITI implementation. The objective is to move beyond an implementation of the EITI in its basic form, to a more comprehensive, insightful, and reliable initiative that truly serves the core objective of improving the fiscal management of the proceeds from extractive industries wealth (i.e., EITI Plus).

Table 10.1: Nigeria Distribution to States

## Federal Ministry of Finance, Abuja

## Distribution of Revenue Allocation to State Governments by Federation Account Allocation Committee for the month of January, 2008 shared in February, 2008

1	2	3	4	5	6-4+5	7	8	9	10-6-(7+8+9)	11	12	13-6+11+12	14=10+11+12
S/n	Beneficiaries	No. of LGCs	Gross Statutory Allocation	13% Share of Derivation	Gross Total	External Debt	Deductions Contractual Obligation (ISPO)	Other Deductions (see Note)	Net Statutory Allocation	Distribution from Domestic Excess Crude Proceeds to Augment Budget	VAT Allocation	Gross Amount	Total Net Amount
1	Abia	17	1,513,135,352.94	304,474,767.00	1,817,610,119.94	25,257,104.66	—	44,583,483.33	1,747,759,531.95	—	359,091,652.22	2,176,701,772.16	2,106,851,184.17
2	Adamawa	21	1,687,918,434.14	—	1,687,918,434.14	27,519,435.69	—	111,562,500.00	1,548,836,498.45	—	336,330,639.19	2,024,249,073.32	1,885,167,137.63
3	Akwa Ibom	31	1,667,122,866.72	6,311,560,667.44	7,978,683,534.16	103,122,388.37	—	—	7,875,561,145.79	—	399,404,571.85	8,378,088,106.01	8,274,955,717.64
4	Anambra	21	1,690,094,025.30	—	1,690,094,025.30	44,364,368.98	10,000,000.00	16,308,000.00	1,619,421,656.32	—	385,830,356.09	2,075,924,381.39	2,005,252,012.41
5	Bauchi	20	1,904,489,618.88	—	1,904,489,618.88	77,325,489.24	56,879,023.19	83,152,575.00	1,687,132,153.45	—	381,198,302.56	2,285,687,921.44	2,068,330,834.01
6	Bayelsa	8	1,311,404,878.27	4,230,118,632.53	5,541,523,510.80	25,302,536.39	—	7,087,500.00	5,509,133,474.41	—	299,144,248.26	5,840,667,759.06	5,808,277,722.67
7	Benue	23	1,821,250,695.80	—	1,821,250,695.80	21,357,530.31	—	131,999,000.00	1,667,894,165.49	—	372,282,531.07	2,193,533,226.88	2,040,176,696.57
8	Borno	27	1,933,320,606.43	—	1,933,320,606.43	22,927,402.71	—	109,932,650.00	1,800,460,553.72	—	362,618,953.14	2,295,939,559.57	2,163,079,506.86
9	Cross River	18	1,580,900,793.25	552,840,092.69	2,133,740,885.94	173,055,810.86	258,954,275.11	15,700,000.00	1,686,030,799.97	—	335,440,606.74	2,469,181,492.68	2,021,471,406.71
10	Delta	25	1,688,517,126.84	37,973,313,993.77	5,485,831,120.61	96,507,348.26	—	6,120,000.00	5,383,203,773.35	—	446,127,557.10	5,931,958,677.71	5,829,331,329.45
11	Ebonyi	13	1,428,133,508.76	—	1,428,133,508.76	23,360,077.74	—	17,000,000.00	1,387,773,431.02	—	303,234,854.91	1,731,368,363.67	1,691,008,285.93
12	Edo	18	1,679,936,776.56	64,400,955.55	1,744,337,732.11	102,415,602.89	—	32,115,000.00	1,609,807,129.22	—	344,395,489.83	2,088,733,221.95	1,954,202,619.06
13	Ekiti	16	1,420,204,919.09	—	1,420,204,919.09	6,101,320.03	—	39,545,000.00	1,374,558,599.06	—	308,400,404.82	1,728,605,333.92	1,682,959,003.89
14	Enugu	17	1,571,410,761.06	—	1,571,410,761.06	58,312,768.82	—	42,789,412.50	1,470,308,579.74	—	419,351,151.79	1,990,761,912.85	1,889,659,731.53
15	Gombe	11	1,445,698,713.77	—	1,445,698,713.77	9,235,406.98	—	145,501,250.00	1,290,962,056.79	—	303,607,151.80	1,749,308,865.58	1,594,569,208.60
16	Imo	27	1,665,644,975.94	432,383,074.19	2,098,028,050.12	75,864,559.98	—	19,325,000.00	2,002,838,490.14	—	367,367,396.31	2,465,395,446.43	2,370,205,886.45
17	Jigawa	27	1,849,437,932.68	—	1,849,437,932.68	16,486,132.89	1,000,000.00	76,187,692.00	1,755,764,107.79	—	385,740,612.48	2,235,178,545.16	2,141,504,720.27
18	Kaduna	23	2,069,094,918.28	—	2,069,094,918.28	34,026,695.98	33,187,500.00	220,208,837.50	1,781,671,884.80	—	458,847,154.88	2,527,942,073.16	2,404,519,039.68
19	Kano	44	2,516,901,272.27	—	2,516,901,272.27	38,686,808.58	—	148,675,000.00	2,359,539,463.69	—	613,453,969.70	3,130,355,241.97	2,942,993,433.39
20	Katsina	34	1,973,507,250.61	—	1,973,507,250.61	18,533,397.02	—	—	1,954,973,853.59	—	425,185,933.24	2,398,693,183.84	2,380,159,766.82
21	Kebbi	21	1,641,179,185.03	—	1,641,179,185.03	28,049,632.75	119,621,704.15	16,200,000.00	1,477,307,848.13	—	333,548,867.00	1,974,728,052.03	1,810,856,715.13
22	Kogi	21	1,646,096,019.51	—	1,646,096,019.51	35,065,926.82	—	247,890,000.00	1,363,140,092.69	—	341,313,279.07	1,987,409,298.57	1,704,453,371.75
23	Kwara	16	1,498,639,987.20	—	1,498,639,987.20	13,601,813.03	—	—	1,485,038,174.17	—	304,792,168.42	1,803,432,155.62	1,789,830,342.59

24	Lagos	20	2,378,443,772.27	—	2,378,443,772.27	196,903,270.15	351,464,109.59	225,000,000.00	1,605,136,392.53	—	2,542,937,606.50	4,921,381,378.57	4,148,073,998.83
25	Nassarawa	13	1,417,880,943.73	—	1,417,880,943.73	105,162,120.33	—	101,662,937.50	1,211,055,886.10	—	342,614,763.47	1,760,495,707.19	1,553,670,649.56
26	Niger	25	1,906,720,094.12	—	1,906,720,094.12	112,529,284.72	—	250,247,550.00	1,543,943,259.40	—	352,598,630.76	2,259,318,724.88	1,896,541,890.16
27	Ogun	20	1,606,075,211.44	—	1,606,075,211.44	53,550,240.88	33,750,000.00	16,051,000.00	1,502,723,970.56	—	383,565,189.90	1,989,640,401.34	1,886,289,160.46
28	Ondo	18	1,578,481,817.37	1,585,161,083.61	3,163,642,900.98	66,507,533.99	—	—	3,097,135,366.99	—	351,887,489.47	3,515,530,390.45	3,449,022,856.46
29	Osun	30	1,543,567,150.23	—	1,543,567,150.23	54,001,466.80	—	24,844,659.00	1,464,721,024.43	—	343,677,232.79	1,887,244,383.02	1,808,398,257.22
30	Oyo	33	1,926,433,008.44	—	1,926,433,008.44	179,285,214.20	—	106,669,143.17	1,640,478,651.08	—	444,358,373.21	2,370,791,381.66	2,084,837,024.29
31	Plateau	17	1,642,844,397.80	—	1,642,844,397.80	66,919,883.94	—	133,720,275.00	1,442,204,238.86	—	337,557,607.68	1,980,402,005.48	1,779,761,846.54
32	Rivers	23	1,817,256,470.10	10,088,250,448.49	11,905,506,918.58	65,668,959.34	—	89,325,000.00	11,750,512,959.24	—	758,934,110.44	12,664,441,029.03	12,509,447,069.69
33	Sokoto	23	1,738,467,066.81	—	1,738,467,066.81	20,625,067.97	—	115,327,500.00	1,602,514,498.84	—	356,129,711.60	2,094,596,778.41	1,958,644,210.44
34	Taraba	16	1,624,769,944.85	—	1,624,769,944.85	17,463,405.51	—	160,145,000.00	1,447,161,539.34	—	353,387,596.22	1,978,157,541.07	1,800,549,135.56
35	Yobe	17	1,578,891,227.22	—	1,578,891,227.22	34,018,160.31	—	324,209,600.00	1,220,663,466.91	—	356,978,743.33	1,935,869,970.55	1,577,642,210.24
36	Zamfara	14	1,636,365,047.36	—	1,636,365,047.36	9,231,903.05	—	39,267,500.00	1,587,865,644.31	—	334,282,502.21	1,970,647,549.58	1,922,148,146.53
37	Soku Disputed Funds		—	—	—	—	—	—	—	—	—	—	—
38	Onn Asaboro Disputed Funds		—	—	—	—	—	—	—	—	—	—	—
	<b>Total (States/LCCs)</b>		<b>61,600,236,771.09</b>	<b>27,366,503,715.26</b>	<b>88,966,740,486.35</b>	<b>2,038,356,669.97</b>	<b>864,796,612.04</b>	<b>3,118,333,065.00</b>	<b>82,925,234,739.34</b>	<b>—</b>	<b>15,845,617,409.84</b>	<b>104,812,337,896.19</b>	<b>98,770,852,149.18</b>

Note: Other Deductions cover; National Water Rehabilitation Projects, National Agricultural Technology Support Programme, Payment for Fertilizer, State Water Supply Project, State Agricultural Project and National Fadama Project.

Source: Office of the Accountant-General of the Federation.



## CHAPTER 11

### *EITI Plus*

EITI Plus is characterized by additions to the scope of EITI implementation in one or more of the following ways:

- Moving from financial reconciliation to comprehensive audits
- Conducting physical audits
- Examining key processes in the extractive industries
  - Licensing
  - Portfolio management
  - Local content
- Benchmarking costs in the industry
- Moving beyond revenues to distribution

#### **11.1 Moving from Financial Reconciliation to Comprehensive Audits**

The EITI not only requires a reconciliation of government and company accounts. It also requires that the reconciliation meet either international auditing standards or the standards agreed to by the MSG. Companies will usually assert that they are audited at the national—and in many cases—international level, as well as by the host country's revenue and regulatory authorities. They will assert that yet another audit is redundant, expensive, and wasteful. National oil companies may also argue that they

already hire independent auditors and are audited both externally and by government regulators.

In many cases there is no reason to doubt the reliability of these underlying audited accounts, and a reconciliation will be sufficient. Indeed, rather than spending money on a full audit, monies may be better spent on improving communications or capacity building.

But in some countries there will be public doubt about the underlying numbers. National accounts may be audited, but auditors may not be in a position to certify that the audits are up to international standards. In these cases, it may be prudent to have government and company accounts audited rather than reconciled. Auditors will test the key revenue streams on a random basis, in order to ensure that taxes were calculated correctly, paid, and recorded by the government. Royalty calculations will be checked to ensure that royalty was paid on the correct volume of resource extracted. Audits will check to ensure that applicable laws and regulations are being enforced, such as those requiring the amount paid to vary if the price of the commodity changes. This process can be expensive, but it can do wonders to elicit gaps in legal interpretation, regulatory enforcement, and capacity.

## 11.2 Value for Money

In some countries, civil society and governments may want to be sure that the government is earning maximum financial value for the resources being exploited, while companies may want to prove publicly that they are acting in good faith. Countries can lose value in many ways. They can fail to accurately assess taxes or royalties. They can sell their assets for less than market value. They can fail to monitor the costs of joint venture companies and reduce the taxable income they produce. They can consume the resource they produce internally, by selling it for subsidized rates, and earn less than they would by importing a product or just subsidizing the poor. EITI reconciliation will not address these weaknesses unless these processes are examined independently, or unless the actual transactions they produce in the government and company books are audited and checked. But a consensus can be built among stakeholders to examine potential vulnerabilities and either correct them or prove that they are not present.

**Text Box 11.1: An EITI Obligation to Report Benefit Streams Received: Not to Assess the Spending of Such Receipts**

It is important to note that the EITI is concerned with financial flows to the government and not with how the government spends the money it receives.

Even regarding expenditures on the extractive industries, there is no EITI requirement to report government investment. Nevertheless, the MSG may elect to broaden the scope of the reporting to include investment or other transactions if it determines that they are important to understanding the financial inner workings of the country's extractive industries. Nigeria, for example, reported on the amounts that government invested into joint ventures.

### 11.3 Benchmarking Costs

One key question in many countries is whether the cost of producing the resource is appropriate or in line with international practice. With production costs rising dramatically in the 2002–2007 time period, there is often internal political concerns about the accuracy of cost deductions asserted by companies and the impact these decisions have on national income. One way to certify the integrity of these costs is to conduct a Value-for-Money audit.<sup>64</sup> A VFM audit requires an independent auditor or expert to look at the capital expenditures and operating costs of companies in selected projects and measure them against projects in other countries. These comparisons must account for differences in how similar materials are used in comparative projects, differences in the speed and stability of government decision-making, security risks, political risks, and labor costs.

### 11.4 Physical Audits

In the extractive industries, the amount the government earns is often tied to the amount of oil, gas, or mineral produced. Royalties are generally tied to volume and taxes are paid on the profit earned after the expenses incurred to produce the oil are deducted. But to ensure that these amounts are right, citizens need to be confident that the volume of the resource extracted is accurately reported, and that the volume recorded as produced by every company matches the government's number used to calculate the amount to which it is entitled. This verification can be obtained by a physical audit, in which the independent auditor checks the records of the government and companies to see if they match; if the records do not match, the auditor will determine why.

## 11.5 Examining Key Processes

As noted above, the best way to root out corruption is to ensure that the systems your government uses to manage the extractive industry maximize value. If this is in doubt, the EITI may be an excellent platform for procuring an independent examination of these key processes and considering reforms. A consensus among stakeholder may be possible if reform is likely to create fair and competitive conditions and reduce ministerial discretion.

The key processes to examine are:

- How is mining, oil, and gas acreage sold (i.e., to whom, at what price, and with what technical or financial qualifications)?
- How are the country's resources marketed (i.e., to whom, with what financial qualifications, and at what price)?
- How is the country's interest in joint ventures (if applicable) managed (i.e., do they do a good job of monitoring costs, picking projects, etc.)?
- How does the country consume its own resource production (whether, for example, the process for supplying internal refineries is transparent, or the system for pricing petroleum products or natural gas adds to or destroys value to national income)?
- Is the system for promoting job creation and technology transfer sustainable, or is it vulnerable to corruption?

## 11.6 Sub-National Distribution and Expenditure

Some countries have developed their EITI implementation beyond the basic guidelines to include distribution and expenditure of oil, gas and mining revenues at the sub-national level. This focus extends the basic principle of understanding not only how much money is flowing in from the extractive industries, but also how and where that wealth is being spent.

Ghana is the first country to undertake sub-national reporting, in an attempt to use the EITI to capture not only all payments to the central government but also those made to regions, districts, or local governments. Ghana created and implemented "district level" reporting templates for data collection that capture the receipts and utilization of the extractive wealth sent to the mining communities. Ghana has taken the unique step of including District Assembly Representatives in its multi-stakeholder working group, which has helped to move EITI information and ownership of the process down to the grassroots level. Ghana has also introduced an EITI template for reporting corporate social payments made by companies at the sub-national and national levels.

In Nigeria, the Ministry of Finance instituted a process by which the distribution of funds from the Federal Government to the States was publicly reported through the national media, around the time when EITI implementation began. Although not strictly part of the NEITI scheme, this public information process has made it possible for citizens, civil society and others to ask more meaningful questions about revenue management and expenditure at both the state and the federal level.



## APPENDIX A

### *The EITI Validation Grid*

## 5. The Validation Grid

### EITI Criteria –

Implementation of EITI must be consistent with the criteria below.

**1. PUBLICATION:** Regular publication of all material oil, gas and mining payments to governments (“payments”) and all material revenues received by governments from oil, gas and mining companies (“revenues”) to a wide audience in a publicly accessible, comprehensive and comprehensible manner.

**2. AUDIT:** Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.

**3. RECONCILIATION:** Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards, and with publication of the administrator’s opinion regarding that reconciliation including any discrepancies, should be any be identified.

**4. SCOPE:** This approach is extended to all companies including state owned companies

**5. CIVIL SOCIETY:** Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process, and contributes towards public debate.

**6. WORKPLAN:** A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation and an assessment of potential capacity constraints.

### EITI Implementation

#### Sign up

1. Has the government issued an unequivocal public statement of its intention to implement EITI?

2. Has the government committed to work with civil society and companies on EITI implementation?

3. Has the government appointed a senior individual to lead on EITI implementation?

4. Has a fully costed workplan been published and made widely available, containing measurable targets, a timetable for implementation and an assessment of capacity constraints (gov., private sector and civil society)?

See Indicator Assessment Tool (IAT)

#### Preparation

5. Has the government established a multi-stakeholder group to oversee EITI implementation?

See IAT

6. Is civil society engaged in the process?

See IAT

7. Are companies engaged in the process?

See IAT

8. Did the government remove any obstacles to EITI implementation?

See IAT

9. Have reporting templates been agreed?

See IAT

	Disclosure	Dissemination
<p>10. Is the multistakeholder committee content with the organisation appointed to reconcile figures? See IAT <input type="checkbox"/></p>	<p>14. Were all material oil, gas and mining payments by companies to government ("payments") disclosed to the organisation contracted to reconcile figures and produce the EITI report? <input type="checkbox"/></p>	<p>18. Was the EITI report made publicly available in a way that was: – publicly accessible, – comprehensive, and – comprehensive? See IAT <input type="checkbox"/></p>
<p>11. Has the government ensured all companies will report? See IAT <input type="checkbox"/></p>	<p>15. Were all material oil, gas and mining revenues received by the government ("revenues") disclosed to the organisation contracted to reconcile figures and produce the EITI report? <input type="checkbox"/></p>	
<p>12. Has the government ensured that company reports are based on audited accounts to international standards? See IAT <input type="checkbox"/></p>	<p>16. Was the multistakeholder group content that the organisation contracted to reconcile the company and government figures did so satisfactorily? <input type="checkbox"/></p>	
<p>13. Has the government ensured that gov. reports are based on audited accounts to international standards? See IAT <input type="checkbox"/></p>	<p>17. Did the EITI report identify discrepancies and make recommendations for actions to be taken? <input type="checkbox"/></p>	
	<p>How have oil, gas and mining companies supported EITI implementation? See IAT <input type="checkbox"/></p>	<p>What steps have been taken to act on lessons learnt, address discrepancies and ensure EITI implementation is sustainable? See IAT <input type="checkbox"/></p>



## APPENDIX B

# *Indicator Assessment Tools*

## 6. Indicator Assessment Tools

### Grid indicator 4: Indicator Assessment Tool

**Indicator:** Has a fully costed Country Work Plan been published and made widely available, containing measurable targets, a timetable for implementation and an assessment of capacity constraints (government, private sector and civil society)?

**Purpose:** The Country Work Plan is the foundation of the country validation process. The sixth EITI Criteria requires that a work plan is produced that is agreed with key EITI stakeholders and is publicly available.

**Evidence:** To give this indicator a tick, the Validator is expected to see evidence that the workplan has been agreed with key stakeholders and that it contains:

- Measurable targets.
- A timetable for implementation.
- An assessment of potential capacity constraints.
- How the government will ensure the multi-stakeholder nature of EITI, particularly in terms of the involvement of civil society.
- A timetable for validation during the stage at which a country is a 'Candidate'. This should reflect country needs, but should take place at least once every two years.
- The Work Plan should also elaborate on how the government will pay for validation.

The Validator will need to assess progress on the implementation of EITI against these targets and timetables, and assess whether a country has acted on the identified capacity constraints.

A key element in the country validation process will be whether the timetable for implementation is being followed. If the timetable is not being met, the Validator – based on evidence from key stakeholders and others – will need to determine whether delays in meeting the timetable are reasonable. If unreasonable, the Validator will need to consider whether to recommend that the country be de-listed from the list of Candidate countries.

## Grid indicator 5: Indicator Assessment Tool

### Indicator: Has the government established a multi-stakeholder group to oversee EITI implementation?

**Purpose:** Implementation of EITI should be overseen by a group comprising all appropriate stakeholders, including – but not limited to – the private sector, civil society (including independent civil society groups and other civil society, such as the media and parliamentarians) and relevant government ministries (including government leads). The group should agree clear, public terms of reference (TOR). These TORs should at least include: endorsement of the Country Work Plan – following revisions where necessary; choosing an auditor to undertake audits where data submitted for reconciliation by companies or the government are not already based on data audited to international standards; choosing an organisation to undertake the reconciliation; and, other areas as noted in the Validation Grid.

**Evidence:** To give this indicator a tick, the Validator is expected to see evidence that a multi-stakeholder group has been formed, that it comprises the appropriate stakeholders and that its terms of reference fit the purpose.

Evidence should include:

- Stakeholder assessments where these have been carried out.
- Information on the membership of the multi-stakeholder group:
  - Was the invitation to participate in the group open and transparent?
  - Are stakeholders adequately represented (this does not mean stakeholders have to be equally represented)?
  - Do stakeholders feel that they are adequately represented?
  - Do stakeholders feel they can operate as part of the committee – including by liaising with their constituency groups and other stakeholders – free of undue influence or coercion?
  - Are civil society members of the group operationally, and in policy terms, independent of government and/or the private sector?
  - Where group members have changed, has there been any suggestion of coercion or an attempt to include members that will not challenge the status quo?
  - Do group members have sufficient capacity to carry out duties?

Report of the EITI International Advisory Group

- Do the TORs give the committee a say over the implementation of EITI? These TORs should at least include: endorsement of the Country Work Plan – following revisions where necessary; choosing an auditor to undertake audits where data submitted for reconciliation by companies or the government are not already based on data audited to international standards; choosing an organisation to undertake the reconciliation; and, other areas as noted in the Validation Grid.
- Are senior government officials represented on the committee?

## Grid indicator 6: Indicator Assessment Tool

### Indicator: Is civil society engaged in the process?

**Purpose:** This indicator reinforces indicator 5. The EITI criteria require that civil society is actively engaged as a participant in the design, monitoring and evaluation of the process, and that it contributes to public debate. To achieve this, EITI implementation will need to engage widely with civil society. This can be through the multi-stakeholder group, or in addition to the multi-stakeholder group.

**Evidence:** To give this indicator a tick, the Validator will need to see evidence that the government, and the EITI multi-stakeholder group where appropriate, have sought to engage civil society stakeholders in the process of implementation of EITI. This should include the following evidence:

- Outreach by the multi-stakeholder group to wider civil society groups, including communications (media, website, letters) with civil society groups and/or coalitions (e.g. a local Publish What You Pay coalition), informing them of the government's commitment to implement EITI, and the central role of companies and civil society.
- Actions to address capacity constraints affecting civil society participation, whether undertaken by government, civil society or companies.
- Civil society groups involved in EITI should be operationally, and in policy terms, independent of government and/or the private sector.
- Civil society groups involved in EITI are free to express opinions on EITI without undue restraint or coercion.

Extractive Industries Transparency Initiative

## Grid indicator 7: Indicator Assessment Tool

### Indicator: Are companies engaged in the process?

**Purpose:** This indicator reinforces indicator 5. EITI implementation requires that companies are actively engaged in implementation and that all companies report under EITI. To achieve this, EITI implementation will need to engage widely with oil, gas and mining companies. This can be through the multi-stakeholder group, or in addition to the multi-stakeholder group.

**Evidence:** To give this indicator a tick, the Validator will need to see evidence that the government, and the EITI multi-stakeholder group where appropriate, have sought to engage companies (oil, gas and mining) in the implementation of EITI. This should include the following evidence:

- Outreach by the multi-stakeholder group to oil, gas and mining companies, including communications (media, website, letters) informing them of the government's commitment to implement EITI, and the central role of companies.
- Actions to address capacity constraints affecting companies, whether undertaken by government, civil society or companies.

Report of the EITI International Advisory Group

## Grid indicator 8: Indicator Assessment Tool

### Indicator: Did the government remove any obstacles to EITI implementation?

**Purpose:** Where legal, regulatory or other obstacles to EITI implementation exist, it will be necessary for the government to remove these. Common obstacles include confidentiality clauses in government and company contracts and conflicting government departmental remits.

**Evidence:** To give this indicator a tick, the Validator should see evidence that the government has removed any obstacles. This might be following a proactive assessment of obstacles, or through reactive action to remove obstacles as they arise. There is no one way of dealing with this issue – countries will have various legal frameworks and other agreements that may affect implementation, and will have to respond to these in different ways.

The sort of evidence the Validator will want to see could include:

- A review of the legal framework.
- A review of the regulatory framework.
- An assessment of obstacles in the legal and regulatory framework that may affect implementation of EITI.
- Proposed or enacted legal or regulatory changes designed to enable transparency.
- Waiver of confidentiality clauses in contracts between the government and companies to permit the disclosure of revenues.
- Direct communications with e.g. companies, allowing greater transparency.
- Memoranda of Understanding setting out agreed transparency standards and expectations between government and companies.

Extractive Industries Transparency Initiative

## Grid indicator 9: Indicator Assessment Tool

### Indicator: Have reporting templates been agreed?

**Purpose:** Reporting templates are central to the process of disclosure and reconciliation, and the production of the final EITI Report. The template will define which revenue streams are included in company and government disclosures. The templates will need to be agreed by the multi-stakeholder group.

The EITI criteria require that “all material oil, gas and mining payments to government” and “all material revenues received by governments from oil gas and mining companies” are published. EITI templates will need, therefore, to define by agreement of the multistakeholder group what these material payments and revenues comprise, and what constitutes ‘material’. It will also be necessary for the multistakeholder group to define the time periods covered by reporting. A revenue stream is material if its omission or misstatement could materially affect the final EITI Report.

It is commonly recognised that the following revenue streams should be included:

- Host government’s production entitlement.
- National state owned company production entitlement.
- Profits taxes.
- Royalties.
- Dividends.
- Bonuses (such as signature, discovery, production).
- Licence fees, rental fees, entry fees and other considerations for licences and/or concessions.
- Profit oil.
- Other significant benefits to government as agreed by the multistakeholder group.

**Evidence:** To give this indicator a tick, the Validator will need to see evidence that the multi-stakeholder group was consulted in the development of the templates, that wider constituencies had the opportunity to comment, and that the multi-stakeholder group agreed the final templates. This could include the following evidence:

- Draft templates provided to the multi-stakeholder group.
- Multi-stakeholder group minutes of template discussions.
- Communications to wider stakeholders (e.g. companies) regarding the design of the templates.
- Arrangement to enable stakeholders to understand the issues involved.
- Agreement by the multi-stakeholder group that they agreed the templates, including all revenue streams to be included.

## Grid indicator 10: Indicator Assessment Tool

### Indicator: Is the multi-stakeholder group content with the organisation appointed to reconcile figures?

**Purpose:** An organisation will need to be appointed to receive the disclosed company and government figures, reconcile these figures, and to produce the final EITI Report. This organisation is variously known as an administrator, reconciler, or auditor. It is vital that this role is performed by an organisation that is perceived by stakeholders to be credible, trustworthy, and technically capable.

**Evidence:** To give this indicator a tick, the Validator will need to see evidence that the multi-stakeholder group were content with the organisation appointed to reconcile figures. This could include the following evidence:

- TORs agreed by the multi-stakeholder group.
- Transparent liaison with the EITI Secretariat and Board to identify potential Validators.
- Agreement by the multi-stakeholder group of the final choice of organisation.

## Grid indicator 11: Indicator Assessment Tool

### Indicator: Has the government ensured all companies will report?

**Purpose:** The EITI criteria require that all companies – public (state owned), private, foreign and domestic – report payments to the government, according to agreed templates, to the organisation appointed to reconcile disclosed figures. The government will need to take all reasonable steps to ensure all companies do report. This might include the use of voluntary agreements, regulation or legislation. It is recognised that there might be good (albeit exceptional) reasons why some companies cannot be made to report in the short term. In this situation, government must demonstrate that they have taken appropriate steps to bring these companies in to the reporting process in the medium term, and that these steps are acceptable to other companies.

## Validation Guide: Indicator Assessment Tool

**Evidence:** To give this indicator a tick, the Validator will need to see evidence that the government has done one of the following:

- Introduced/amended legislation making it mandatory that companies report as per the EITI Criteria and the agreed reporting templates.
- Introduced/amended relevant regulations making it mandatory that companies report as per the EITI Criteria and the agreed reporting templates.
- Negotiated agreements (such as memoranda of understanding and waiver of confidentiality clauses under production sharing agreements) with all companies to ensure reporting as per the EITI Criteria and the agreed reporting templates.
- Where companies are not participating, the government is taking generally recognised (by other stakeholders) steps to ensure these companies report by an agreed (with stakeholders) date.

## Grid indicator 12: Indicator Assessment Tool

**Indicator:** Has the government ensured that company reports are based on audited accounts to international standards?

**Purpose:** The EITI criteria require that all data disclosed by companies is based on data drawn from accounts which have been audited to international standards. This is a vital component of EITI implementation.

**Evidence:** To give this indicator a tick, the Validator will need to see evidence that the government has taken steps to ensure data submitted by companies is audited to international standards. This could include the following:

- Government passes legislation requiring figures to be submitted to international standards.
- Government amends existing audit standards to ensure they are to international standards, and requires companies to operate to these.
- Government agrees an MoU with all companies whereby companies agree to ensure submitted figures are to international standards.
- Companies voluntarily commit to submit figures audited to international standards.
- Where companies are not submitting figures audited to international standards, the government has agreed a plan with the company (including SOE) to achieve international standards against a fixed timeline.
- Where figures submitted for reconciliation are not to audited standards, the multi-stakeholder group is content with the agreed way of addressing this.

Report of the EITI International Advisory Group

## Grid indicator 13: Indicator Assessment Tool

**Indicator:** Has the government ensured that government reports are based on audited accounts to international standards?

**Purpose:** EITI criteria require that all data disclosed by the government is audited to international standards.

**Evidence:** To give this indicator a tick, the Validator will need to see evidence that the government has taken steps to ensure data submitted is audited to international standards. This could include the following:

- Government passes legislation requiring figures to be submitted to international standards.
- Government amends existing audit standards to ensure they are to international standards, and ensures compliance with these.
- Where figures submitted for reconciliation are not to audited standards, the multi-stakeholder group is content with the agreed way of addressing this.

Extractive Industries Transparency Initiative

## Grid indicator 18: Indicator Assessment Tool

**Indicator:** Was the EITI Report made publicly available in a way that was:

- publicly accessible,
- comprehensive, and
- comprehensible?

**Purpose:** EITI is ultimately fully implemented when the EITI Report is made public, and it is widely disseminated and openly discussed by a broad range of stakeholders. The EITI Criteria require that the Report is publicly available in a way that is publicly accessible, comprehensive and comprehensible.

**Evidence:** To give this indicator a tick, the Validator will need to see evidence that the government ensured the Report was made publicly available in ways that are consistent with the EITI Criteria, including by:

- Producing paper copies of the Report, which are distributed to a wide range of key stakeholders, including civil society, companies, the media and others.
- Making the Report available on-line, and publicising its web location to key stakeholders.
- Ensuring the Report is comprehensive, including all information gathered as part of the validation process and all recommendations for improvement.
- Ensuring the Report is comprehensible, including by ensuring it is written in a clear, accessible style and in appropriate languages.
- Ensuring that outreach events – whether organised by government, civil society or companies – are undertaken to spread awareness of the Report.



APPENDIX C  
*Ghana Work Plan*



**B. Aggregation Phase**

Activities	2006												2007												2008												
	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	
<b>Collection of Data from MDA's—Thread</b> – Revenues to Government – Payments from Mines – Technical Data from Mines Operations – Technical Data from MC/MD																																					
<b>Collection of Data from Mining Companies</b> – Payments made to Government (with supporting documents) – Technical Details of Operations – Financial Statements																																					

Activities	2006												2007												2008												
	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	
<b>Collection and Analysis of MDA's and Mines Data</b>																																					
– Reconciliation of Details from Mining Sector and Revenue Agencies																																					
– Ascertain the Correctness of Computations on Payments																																					
– Comparison of Payments by Mining Companies and Receipts of Revenue Agencies																																					
– Reconcile OASL Figures Head/Regions																																					
– Reconciliation of Technical Details of Mines and Minerals Commission																																					
– Recording Data on Templates (Aggregation) ETC																																					
<b>Discussion and Review of Draft Templates with MDA'S and Mining Companies. Feedback for Framework on Transparency</b>																																					
<b>Collection of Data from District Assemblies/ Traditional Councils and Stools</b>																																					





## APPENDIX D

### *Kazakhstan Work Plan*

**Work Plan on Realization of Extractive Industry Transparency Initiative in the Republic of Kazakhstan for the Period of 2007–2009**  
(Based on MOU between Government of Kazakhstan and World Bank dated December 1, 2006)

No.	Objective	Outputs/Results/Indicator		Funding Plan [KZT thousands]			
		Short Term—2007	Medium Term 2008–2009	2007	2008	2009	Government of Kazakhstan Funding
1.	<b>Establish Secretariat (MOU step A)</b>						
	Establish a dedicated EITI Secretariat, for the coordination of all EITI work in Kazakhstan and provide support to the National Stakeholder Council for EITI.	Three-person Secretariat was established based in the Ministry of Energy and Mineral Resources, with Ministry of Finance participation, and is headed by a Vice-minister of the Ministry of Energy and Mineral Resources.		Not required			
	<b>Time of performance—December 2006</b>						
	<b>Purpose:</b>						
	Serve as focal point for entire EITI process in Kazakhstan and all follow-up activities			Not required			
	<b>Required Activities/Inputs—and timetable:</b>						
1.1	In the course of time build-up EITI fulltime department at the Ministry of Energy and Mineral Resources, which will implement the Secretariat functions, and provide additional funding to effectively manage the EITI work plan and work load.		Comprehensive EITI process becomes smoothly functional, managed and coordinated by the Secretariat	Not required			
	<b>Time of execution—September 2007</b>						
1.2	Given higher scope of EITI participation, re-define work content, roles and responsibilities etc of the EITI Secretariat (ToR)		Comprehensive EITI process becomes smoothly functional, managed and coordinated by the Secretariat	Not required			
	<b>Time of execution—2007–2008</b>						

Full participation by companies (MOU step B.a)						
2.	<p>Ensure the full participation of all extractive industry (oil, gas, and mining) companies operating in Kazakhstan (EI companies) in the EITI initiative</p> <p><b>Time of execution—2007–2008</b></p> <p><b>Purpose:</b></p> <p>To achieve a comprehensive EITI process in Kazakhstan consistent with global EITI's Criteria #1 (publication of all payments) and global EITI's Criteria #4 (involvement of all companies).</p> <p><b>Required Activities/Inputs—and timetable:</b></p>	Carrying out negotiations with extractive oil & gas, and mining companies concerning their joining to the Extractive Industries Transparency Initiative in Kazakhstan.			Not required	
2.1	<p>Ensure coverage of EITI extends to all international, local, and state-owned EI Companies and their production subsidiaries in Kazakhstan (through the Government Decree #1166 of December 4, 2006).</p> <p><b>Time of execution—2007–2008</b></p>				Not required	
2.2	<p>Both Oil &amp; Gas, and Mining sectors: Commence discussions with all new EI oil/gas company entrants into the EITI process to make them familiar with EITI, their role and expectations of them, and discussions of the next steps with participation of NGOs.</p> <p><b>Time of execution—2007–2008</b></p>	Clear sense of understanding by EI mining companies of their roles and responsibilities—and cost/benefit—of EITI participation.			Not required	

No.	Objective	Outputs/Results/Indicator		Funding Plan [KZT thousands]			
		Short Term—2007	Medium Term 2008–2009	2007	2008	2009	Government of Kazakhstan Funding
2.3	<p>Get consensus on and modify the existing MOU between GoK, oil and gas companies and NGOs to accommodate the higher number of participants in EITI.</p> <p><b>Time of execution—end of 2007—1st quarter 2008</b></p>	<p>Agreement among all EI companies of their part in EITI governance and decision-making through the NSC (together with GoK and NGOs), including representation of all company segments and active participation in NSC work.</p>		Not required			
2.4	<p>Get agreement on rules for the larger size of NSC, composition mix, charter for voting rules etc. to take into account the larger membership of EI companies —See further steps at No. 8. below</p> <p><b>Time of execution—2007–2008</b></p>			Not required			
2.5	<p>Consider whether a “stratification” of EI companies is needed by size of production, amount of company revenues etc. to identify very small companies.</p> <p><b>Time of execution—1st quarter 2008</b></p> <p><b>Assessment of potential capacity constraints</b></p>	<p>Decision on whether very small EI companies can be excluded in each year’s EITI cycle—and if so to agree cut-off criteria/amount.</p>		Not required			
2.6	<p>According to the RoK Law of the Subsurface Use all new and existing extractive companies are obliged to sign the EITI MOU before they conclude any further production contracts. However in accordance with the EITI voluntary nature, the companies who had already signed the contracts or Product Sharing Agreements have a right not to sign the EITI MOU referring to the confidentiality terms of their contracts.</p>	<p>RoK Government and the members of the National Stakeholders Council recognize the importance of involving the extractive companies into the EITI, and therefore will make maximum efforts to get large and medium size Oil, Gas, and Mining companies involved into the EITI during 2007 and 2008 years.</p>					

EITI data integrity (MOU step B.b)						
3.	Ensure integrity of reported data appearing in Kazakhstan's and EI Companies' EITI statements consistent with EITI Criteria # 2 (data is based on audited accounts).					Not required
	<b>Purpose:</b>					
	To provide additional assurance to users of EITI information on the reliability—completeness and accuracy—of the data reported by EI companies and government.					Not required
	<b>Required Activities/Inputs—and timetable:</b>					
3.1	Implement a cost-effective mechanism for requiring each EI entity's existing auditors to provide a certification (i.e. statement under “agreed upon procedures”) which certify that such entity's EITI data reported are based on that companies existing audited accounts and/or audited accounting records.					Not required
	<b>Time of execution—to the end of 2007</b>					
3.2	Only for 2007, for companies which provide EITI data before Jan 1 2008 (when the above decree comes into force), (i) encourage all companies to voluntarily obtain such certification from their existing auditors, else (ii) require companies to self-certify (by a company senior official on the reporting template) that the data reported agrees to and is extracted from the company's existing audited accounts and/or audited accounting records.					Not required
	<b>Time of execution—to the end of 2007</b>					

No.	Objective	Outputs/Results/Indicator		Funding Plan [KZT thousands]			
		Short Term—2007	Medium Term 2008–2009	2007	2008	2009	Government of Kazakhstan Funding
4.	<b>Ensure sustainable financing for EITI (MOU step B.d)</b>						
	<b>Purpose:</b> To achieve a financially sustainable and cost-efficient EITI process in Kazakhstan.						
	<b>Required Activities/Inputs—and timetable:</b> Ensure the assigned working group (a working group to analyze and report required expenditures to ensure such financing) establishes the budgetary requirement..		GoK funding clearly established as a budget line item in relevant Ministry budget, to cover all EITI recurrent costs including data reconciliation and reporting.				
4.1	<b>Time of execution—August 2007</b>						
5.	<b>Appoint a reconciliation firm (MOU step B.e)</b>						
	Appoint and manage an appropriate consulting or auditing firm to carry out reconciliation work and issue reports in connection with the EITI program.						
	<b>Purpose:</b> To appoint a firm that will aggregate, reconcile and report on the data provided by companies and government.			13,000	13,000		26,000
	<b>Time of execution—May–August 2007</b>						
	<b>Required Activities/Inputs—and timetable:</b> Determine the period of coverage and number of companies in the initial reconciliation and reporting exercise (i.e. 2005 data alone) and develop ToRs for the work together with NSC						
5.1	<b>Time of execution—August 2007</b>						

5-2	For 2005 and/or 2006 EITI reports, Government to provide funding for, and launch competitive process to select, using an international consulting, auditing or specialist firm (or a joint venture of such firms and a Kazakhstan national firm) for reconciliation and reporting of EITI data. <b>Time of execution—August 2007</b>	Issue the initial EITI report for 2005.					
5-3	For 2006 and 2007 EITI reports, Government plans to provide funding for reconciliation firm in 2008. <b>Time of execution—June 2007</b>		Subsequent EITI reports				
5-4	For all EITI reconciliation work, Government to manage and supervise the reconciliation contracts with the selected firm, with inputs from a specialist working group of the NSC. <b>Time of execution—2007–2009 years</b>						
5-5	NSC to conduct follow-up work on the initial EITI report findings and agree next steps together with the Government. <b>Time of execution—till the end of 2007</b>			Long-term follow-up work on EITI as well as other sector reform and transparency issues.			
5-6	To publish EITI report for 2005 in accordance with the EITI criteria <b>Time of execution—till the end of 2007</b>						

No.	Objective	Outputs/Results/Indicator		Funding Plan [KZT thousands]			
		Short Term—2007	Medium Term 2008–2009	2007	2008	2009	Government of Kazakhstan Funding
6.	<p><b>Public outreach on EITI (MOU B.f)</b></p> <p>Conduct a series of national and regional workshops, starting with the first workshop by end of September 2007 to promote and discuss EITI throughout Kazakhstan in conjunction with the EITI data reporting.</p> <p><b>Time of execution—2007–2008 years</b></p> <p><b>Purpose:</b></p> <p>To make the EITI process in Kazakhstan consistent with EITI Criteria # 1 (making EITI reports widely available in an understandable manner) and EITI Criteria # 5 (involving civil society in EITI discussions).</p> <p><b>Required Activities/Inputs—and timetable:</b></p>						
6.1	<p>Devise a communications strategy to achieve broad outreach of EITI information to the public.</p> <p><b>Time of execution—to the end of 2007</b></p>						
6.2	<p>Launch communications and outreach to media, public, civil society and opinion leaders, conduct a series of national EITI conferences.</p> <p><b>Time of execution—2007–2008 years</b></p>	Outreach to areas with low literacy; poor access to media.	Measurable improvement in public understanding of the EITI sector and financial flows.				

6.3	Consider upgraded web-site platform and content for ease of access and links. <b>Time of execution—August 2007</b>							
6.4	Create EITI information kit to ensure all citizens receive EITI information. <b>Time of execution—2007–2009 years</b>	Simple accessible information on EITI report findings on the website <a href="http://www.eiti.kz">www.eiti.kz</a> .						
6.5	Maintain Website <a href="http://www.eiti.kz">www.eiti.kz</a> <b>Time of execution—2007–2009 years</b>		437.5					—
<b>7. Other civil society collaboration (MOU B.g)</b>								
	Consider other measures for EITI implementation through active collaboration with non-governmental organizations. <b>Purpose:</b>							
	To help Kazakhstan to attain best practice level of EITI implementation, through wide level of national collaboration and outreach. <b>Required Activities/Inputs—and timetable:</b>							
7.1	Consider holding workshops with a special focus on mining transparency and social issues at the local level. <b>Time of execution—2007–2008 years</b>	Expanded outreach to NGOs with a special interest in the mining sector.						



EITI Validation						
9.	<p>Appoint a Validation company to go through the EITI validation process in 2008.</p> <p><b>Time of execution—2008</b></p> <p><b>Purpose:</b></p> <p>To make the EITI process in Kazakhstan consistent with requirements of the International EITI Board, and to become EITI Compliant.</p> <p><b>Required Activities/Inputs—and timetable:</b></p>	Select the validation company		8,750	—	8,750
9.1	<p>Send Application for funds for the validation to the State Budget Committee.</p> <p><b>Time of execution—June 2007</b></p>					
9.2	<p>Select a validation company through a tender among the candidates companies provided by the International EITI Board.</p> <p><b>Time of execution—I–II quarters 2008</b></p>					
9.3	<p>Go through the EITI validation process.</p> <p><b>Time of execution—I–II quarters 2008</b></p>					
<b>GRAND TOTAL (KZ tenge thousands)</b>				13,438	21,751	34,751
<b>GRAND TOTAL (US\$ equiv. 117 KT/US\$)</b>				107.5	174	278



## APPENDIX E

# *Calculating Costs and Cost Oil under a PSC*

Under a PSC, the management committee agrees to a work program and budget on an annualized basis. Money expended by the contractor (or the operator) within the budget is then agreed on for cost recovery purposes. This means that the contractor can recover these costs by being allocated a share of the production. For example, if the contractor spent \$20,000 on a piece of equipment that had been approved for purchase under the annual work program and budget, and production was currently being sold for \$20 per barrel, then the contractor would be entitled to 1,000 barrels of oil. This allocation of oil is called “cost oil.” The contractor could then sell this oil in the market in order to recover its costs.

In the original PSCs, there was no limit on how much cost oil could be claimed to recover costs. Most current PSCs now place a cap on the amount of cost oil that can be used in any one year, typically defined as a percentage of the annual production. In countries with low production costs, such as Middle Eastern countries with onshore production, the cost oil percentage might be as low as 20 percent. In higher cost areas, such as deep offshore areas, cost oil percentages can range up to 90 percent. These percentages are generally negotiated before the PSCs are finalized and will depend on the expected sizes of the fields that might be discovered, the quality of oil or gas, the costs of the development, and the distance from the marketplace or refinery. In some PSCs, the cost oil may be high to start with but decrease over time or upon the occurrence of some triggering event (e.g., when the first excess cost oil arises, as described below).

When costs are high, such as at or before the start of production, there may be more costs to recover than there is available cost oil. Under these circumstances the unrecovered costs are carried forward each year until they have been recovered from the available cost oil. Carrying capital costs forward has a similar effect as applying depreciation to the capital expenditure in a concession agreement. For example, if \$20,000 in costs are to be recovered but there are only 500 barrels of cost oil available ( $500 \text{ bbl} \times \$20/\text{bbl} = \$10,000$ ), then the other \$10,000 in unrecovered costs would be carried forward until there is sufficient cost oil available. In some PSCs, when the costs are carried forward, those unrecovered costs are uplifted by a percentage to compensate for inflation and the time cost of money.

There comes a time when the value of available cost oil exceeds the costs that have been incurred. The difference between the available cost oil and the cost oil required for recovering actual costs (including any “uplift”) is then called excess cost oil. In some PSCs the excess cost oil is treated the same way as profit oil (see below) while in other PSCs it is treated differently. In some PSCs (e.g., Egypt and Syria) the excess cost oil reverts wholly to the government. This arrangement does not encourage the contractor to save costs, because under these circumstances the contractor would not benefit. In other PSCs, excess cost oil is treated similarly to the profit oil split, but with a different percentage share.

For cost recovery purposes, operating and capital costs are generally treated the same way, with operating costs recovered out of the available cost oil first. In some PSCs, the capital costs are fiscally depreciated before they can be recovered out of cost oil.

## APPENDIX F

# *Calculating Profit Oil under a PSC*

Profit oil is allocated between the government and the commercial operator following the allocation of cost oil, to the extent that any such oil is available for distribution. The distribution of profit oil under a PSC operates to a significant degree in the same manner as a petroleum tax under a concession agreement.

PSCs are not recognized as tax exempt by some countries, such as the United States, which taxes the contractor on its share of the profit oil. This can result in double taxation. Therefore, to make the venture economically viable for the contractor, it is possible to increase the contractor's share of profit oil in the contract and then tax it. For example, if the profit oil share was originally 30 percent to the contractor and 70 percent to the government, and the corporate tax rate in the oil producing country was 50 percent, the contractor's profit oil share could be doubled to 60 percent, but then taxed at 50 percent. This still gives the contractor an effective 30 percent share of the profit oil after tax. Although strictly unnecessary in a PSC, tax is often one of the parameters included in a production sharing contract.

Most countries like to negotiate a cap on an oil company's profitability in a particular venture by reducing the contractor's share of profit oil when certain criteria have been reached. These caps might be related to the project's profitability (through its internal rate of return, or IRR), earning power, the cumulative contractor reward divided by its cumulative costs, the size of the project through a daily production rate, or cumulative volume of oil produced. Changing the contractor's profit oil percentage with oil price

is another possibility, as is the case in some contracts in Angola. In some contracts there can be up to three of these differently calculated caps—with the one giving the contractor the lowest profit oil share being applied (e.g., in Kazakhstan).

Some of the criteria above do not relate to the profitability of the venture. Such terms create a risk that the oil company will be penalized before the project has made a reasonable return on its investment. If these terms are included in a PSC it can make the country less attractive to other companies, and in the long run may slow development.

## APPENDIX G

# Calculating Equity Oil Share in a PSC

Under a PSC, when its utilization of cost oil and profit oil to account for project costs incurred and profits realized, the oil company's share of equity oil is its share of cost oil, *plus* its equity share of profit oil.

To illustrate, if cost oil is 40 percent and the contractor's share of profit oil is 30 percent, then the contractor's equity oil share will be:

$$\begin{aligned}
 & (Total\ Oil\ Production \times Price\ of\ Oil) \times 40\% \text{ Cost Oil} = Contractor's\ Cost\ Oil\ (40\%) \\
 & + \text{Remainder of Oil Unallocated (60\%)} \times 30\% \text{ Profit Oil} = Contractor's\ Profit\ Oil\ (18\%) \\
 & \qquad \qquad \qquad = Contractor's\ Total\ Equity\ Oil\ (58\%) \\
 & \qquad \qquad \qquad = Government's\ Total\ Equity\ Share\ (42\%)
 \end{aligned}$$

These allocations between the government and contractor may adjust over the term of the PSC, thereby altering the shares of equity oil to each party. For example, over time, the major capital costs will be recovered from cost oil and there may be a point when excess cost oil becomes available. Changes in the price of the oil produced may also have an impact on the actual allocations of oil between the government and the contractor.

For example, utilizing the prior scenario, in which the cost oil (40 percent) was fully utilized, assume that the oil price has increased from \$20/barrel to \$40/barrel. Again, assume that 1,000 barrels have been produced and that \$8,000 in costs has been

approved for recovery from cost oil. The total revenue from the project is \$40,000, of which \$16,000 (40 percent) is available to recover costs. If the \$8,000 is recovered by the allocation of cost oil to the contractor, \$8,000 in excess cost oil will remain, which is available for allocation under the specific terms of the PSC. Assume in this example that excess cost oil is treated the same way as profit oil. The contractor's total equity oil will then be 20 percent in cost oil plus  $(80\% \times 30\% =) 24$  percent in profit oil, or 44 percent in total. This contrasts with the contractor's share of total equity oil of 58 percent when the oil was half this price at only \$20/bbl. This relationship of contractor's equity oil increasing with decreasing oil prices is only effective when the available cost oil is not fully utilized.

In net effect, these examples also illustrate another key point. The government benefits under a PSC when the price of oil increases, not only through more valuable profit oil, but also through its realization of a greater share of the profit oil. Because of this effect, the PSC realizes a measure of stability despite fluctuating oil prices and without having to rely upon the imposition of extra taxes, such as a windfall profits tax, to generate revenues.

## APPENDIX H

# *Government–Private Company Partnerships*

Special issues arise when the government is a partner in a concession or a PSC. The three primary issues are:

1. Can the government pay its share?
2. Does the government's role pose a conflict of interest for the joint company?
3. Are the joint company's audited accounts adequate for EITI purposes?

### **What Is a Joint Venture?**

A joint venture is a project in which one or more private companies partner together, often including the national oil company as a partner. The relationship between the joint venture partners is usually governed by a joint operating agreement (JOA). The partnership can exist in a concession, production sharing, margin, or technical service agreement.

Examples of some joint ventures:

- In Nigeria, under a margin arrangement, there is a joint venture between NNPC (the Nigerian NOC) (55%), Shell (30%), Elf (10%), and AGIP (5%).
- In the United Kingdom, under a concession arrangement, there is a joint venture between Shell and Esso (Exxon) (50% each).

- In Kazakhstan, under the North Caspian Sea PSA, there is a joint venture between Agip, Exxon, Shell, and Total (18.52% each), KazMunayGas (representing the Kazakh government) and Inpex (8.33% each), and ConocoPhillips (9.26%).

## Can the Government Pay Its Share? Utilizing Carry Agreements

In some cases where the government, or its NOC, is a joint venture partner and it does not have the capital to pay its share of the capital or operating costs required by the joint company, the nongovernmental companies may pay for all of the costs of the exploration phase, or even the appraisal phase, and obtain reimbursement with or without interest from the NOC's share of production revenues. This arrangement is called a carry agreement. As development costs are so much greater, it is unlikely that the companies will carry the NOC through the development phase of the project, but it does happen in some instances. Generally, the NOC will have to find outside funding if it cannot provide the development costs. It may even sell part of its share in the venture to help pay for its remaining share of the development costs. This was the case in the North Caspian Sea venture in Kazakhstan. In other cases, the failure of the government to pay its share may slow the development of the country's resources. Countries like Nigeria, which traditionally have had trouble accessing funds for capital contributions to its joint ventures due to competing fiscal needs, have now switched to PSCs, which move all capital costs and risk to private companies.

### Text Box H.1: NOC as JV Partner

The key issue is whether the government paid its contribution on time.

## Is NOC Participation in a Joint Venture Partner a Conflict?

State participation can have a large detrimental effect on the economics of a venture and needs to be properly addressed in the contract. Where an NOC is a joint venture partner, there is often a conflict of interest. For example, the government may wish to employ as many local staff as possible and to award contracts to all local companies, whereas as a joint venture partner it would wish to get the venture on stream as quickly as possible and for the lowest lifetime cost. These goals may not all be compatible with each other.

An NOC as a joint venture partner will also have obligations to make capital and operating cost contributions to the partnership and have an entitlement to earn oil or money from the project. However, as noted above, if the NOC fails to make the contri-

butions on time, this can lead to delays in development and wasted management time trying to address the issue.

## Are Joint Venture Audited Accounts Adequate for the EITI?

The joint venture partners will appoint an operator, who will manage the venture and be accountable to the other partners. The operator's role will be to operate the venture on behalf of the equity holders, to make cash calls to cover the operating expenditures, and to allocate cost oil and profit oil to the venture partners and the government. Any taxes and royalty payments will be the responsibility of the individual equity partners.

Under joint venture arrangements, it is customary for joint venture partners to conduct audits of the operator's accounts to ensure that the money they have contributed is being spent properly, in accordance with the joint operating agreement. The partners would also be interested in whether the operator procured supplies in a cost-effective manner and secured adequate value on behalf of the venture.

*Significance for the EITI.* If extensive audits of the joint venture have been carried out, there may be grounds for reducing the scope of an EITI audit, or for using the audited accounts for EITI reconciliation. Questions to ask are whether the audit was published, if the auditors were independent, and whether international standards were utilized for the audit.



## APPENDIX I

# *Other Types of Cash Flow to the Government*

There may be other cash flows from the commercial operator to the government that are more difficult to classify as clearly being a “benefit” to the government. For example, consider a situation in which the government lends money to finance the construction of a major plant in the oil and gas sector. This occurred in Nigeria, where the government financed a share of a liquefied natural gas plant. As the plant began to generate positive cash flow, the loans began to be repaid. The issue then becomes whether such repayment on the loans extended by the government should be regarded as a benefit stream to the government.

This is not an easy question to answer. Because the government is only getting back what it previously lent, it can be said that this is not technically a “benefit.” On the other hand, the underlying purpose of the EITI is to ensure that there is due accountability associated with financial transactions between the government and its commercial partners in the extractive industries. Under this line of argument, it is appropriate to require reporting under the EITI on the repayment of a loan by the government to the commercial party managing the project. Under these circumstances, Nigeria decided to publish the amounts of the loan repayments, although not combined with the core-benefit streams received by the government.

To extend the EITI inquiry as it pertains to a lending situation, consider the requisite disclosures if the government received interest on its loans. Now, it is reasonably clear that interest paid and received on that original loan should be regarded as a benefit.

Therefore, interest paid and received should be disclosed. The more nettlesome issue then turns to the appropriate accounting for such interest paid and received by the government. Questions arise such as whether the interest should be accounted for at the time it is earned, or the time it is paid. If the cash basis of accounting is utilized, then the payment date is arguably more relevant than the date on which the interest was earned. However, if the payments to the government were composite payments of capital and interest,<sup>65</sup> then such payments would need to be disaggregated, as the interest is a benefit warranting disclosure, and the principal, conversely, warrants disclosure, but not as a benefit realized by the government.

APPENDIX J  
*Mongolia's Accounting  
Templates*

Endorsed by Joint Resolution No. 49/96 of  
Chairman of National Statistical Office and  
Minister of Finance, from 2007

EITI TEMPLATE 1

### THE REPORT

of year \_\_\_\_\_ on quantity of sold production and on corporate taxes and fees paid to  
state and local budget by the Company (daughter company) \_\_\_\_\_  
operating in extractive industries

Registration No.						Code	1. The report shall be done in this template and disclosed publicly before March 30 of the following year, and submitted to Mongolian Regulatory Authorities of Minerals and Petroleum (MRAMP), along with report on disclosure.
Aimag, Capital city							
Soum, District							
Name of business entity							2. MRAMP shall submit to EITI Mongolia Secretariat, established as independent body, not later than May 31.
Type of business entity							

Indicators	Relevant part of instruction	Unit of Measurement	Quantity	Total amount '000 MNT
<b>Scope 1: Revenue and profit flow</b>				
<b>1. Production and sales products</b>				
<b>1.a) Production</b>	1.1			
License No. ____ Product		Ton		
License No. ____ Product				
License No. ____ Product				
License No. ____ Product				
Total sales		'000 MNT		
<b>1.b) Sales of Product</b>	1.2			
License No. ____ Product		Ton		
License No. ____ Product		Ton		
License No. ____ Product		Ton		
License No. ____ Product				
Total production		'000 MNT		
<b>1.c) Sales under Production sharing agreement by company</b>	1.3	Ton		
<b>2. Taxes and fees paid by foreign and domestic companies to state and local budget</b>				
<b>2.a) Paid taxes</b>	1.4			
Corporate income tax		'000 MNT		
Value added tax deducted from paid back		'000 MNT		
Customs tax		'000 MNT		
Windfall tax		'000 MNT		
Real estate tax		'000 MNT		
Excise tax (on imported fuel and lubricants)		'000 MNT		
Tax on petrol and diesel fuel		'000 MNT		
Tax on automobile and self-moving vehicle		'000 MNT		
Other taxes in monetary amount		'000 MNT		

<b>2.b) Fee</b>	1.5			
Fee for exploitation of mineral resources		'000 MNT		
License fee for exploitation and exploration of mineral resources		'000 MNT		
Reimbursement of deposit, exploration of which is carried by the budget fund		'000 MNT		
Land rent		'000 MNT		
Fee for water use		'000 MNT		
Fee for forestry use and fire wood		'000 MNT		
Fee for recruiting foreign experts and workers		'000 MNT		
Fee for use of mineral resources of wide spread deposit		'000 MNT		
<b>2.c) Charge and service charges</b>	1.6			
Stamp and other charge for state registration paid to state and local administrative organizations in accordance with relevant legislation		'000 MNT		
Service charges paid to state and local administrative organizations in accordance with relevant legislation		'000 MNT		
<b>2.d) Dividends on state and local property</b>	1.7			
Dividends on state property		'000 MNT		
Dividends on local property		'000 MNT		
<b>2.e) Other payments to recipient Government</b>	1.8			
Entitlement under Production Sharing Contract to Government		'000 MNT		
<b>2.f) Donation to Governmental organizations</b>	1.9			
Monetary donation from company to Ministries and agencies		'000 MNT		
Monetary donation from company to aimag		'000 MNT		
Monetary donation from company to soum		'000 MNT		
Monetary donation from company to local organizations		'000 MNT		
Fund disbursed by company in sustainable development and community relations		'000 MNT		
<b>Scope 2. Revenues and profits flow (voluntary basis)</b>				
<b>3. Profit and revenue transactions</b>	1.10	'000 MNT		
A. Sum of discounted and lifted taxes as per agreement and specific conditions		'000 MNT		
B. Capital expenditure		'000 MNT		
C. Expenditure for staff training and development		'000 MNT		
D. Expenditure for geology and exploration		'000 MNT		
E. In-kind contribution at rate of 50% to Environmental protection special account		'000 MNT		
F. Expenses for disaster prevention (Law on Disaster Prevention, article 27)		'000 MNT		

We state that we will bear all responsibility for correctness of this report in accordance with reporting regulations except in below mentioned cases:

Report prepared by

STAMP

\_\_\_\_\_  
Executive Director

\_\_\_\_\_  
General Accountant

Date: \_\_\_\_\_

Endorsed by Joint Resolution No. 49/96 of  
Chairman of National Statistical Office and  
Minister of Finance, from 2007

EITI TEMPLATE 2

### THE REPORT

of year \_\_\_\_\_ on corporate taxes and fees paid to state and local budget by the  
Company (daughter company) \_\_\_\_\_ operating in extractive industries

Registration No.						<p>1. The report shall be done in this template by all state administrative organizations and taxation authorities not later than March 30 of the following year, and submitted to General Department of national taxation of Mongolia (GDNTM). The report shall be done per each company engaged in extractive industries.</p> <p>2. GDNTM shall incorporate all data and submit to Ministry of Finance not later than May 15.</p> <p>3. The Ministry of Finance shall overview each by company, produce Government Report and after audit approval submit to EITI Mongolia Secretariat, established as independent, not later than May 31.</p>
Code						
Aimag, Capital city						
Soum, District						
Name of business entity						
Type of business entity						

Indicators	Relevant part of instruction	Total amount '000 MNT
<b>Scope 1: Revenue and profit flow</b>		
<b>1. Taxes and fees paid by foreign and domestic companies to state and local budget</b>		
<b>1.a) Paid taxes</b>	1.1	
Corporate income tax		
Value added tax deducted from paid back		
Customs tax		
Windfall tax		
Real estate tax		
Excise tax (on imported fuel and oil materials)		
Tax on petrol and diesel fuel		
Tax on automobile and self-moving vehicle		
Other taxes in money amount		
<b>1.b) Fee</b>	1.2	
Fee for exploitation of mineral resources		
License fee for exploitation and exploration of mineral resources		
Reimbursement of deposit, exploration of which is carried by the budget fund		
Land rent		
Fee for water use		
Fee for forestry use and fire wood		
Fee for recruiting foreign experts and workers		
Fee for use of mineral resources of wide spread deposit		
<b>1.c) Charge and service charges</b>	1.3	

Stamp and other charge for state registration paid to state and local administrative organizations in accordance with relevant legislation		
Service charges paid to state and local administrative organizations in accordance with relevant legislation		
<b>1.d) Dividends on state and local property</b>	1.4	
Dividends on state property		
Dividends on local property		
<b>1.e) Other payments to recipient Government</b>	1.5	
Entitlement under Production Sharing Contract to Government		
<b>1.f) Donation to Governmental organizations</b>	1.6	
Monetary donation from company to Ministries and agencies		
Monetary donation from company to aimag		
Monetary donation from company to soum		
Monetary donation from company to local organizations		
Fund disbursed by company in sustainable development and community relations		
<b>Scope 2. Revenues and profits flow (voluntary basis)</b>		
<b>2. Profit and revenue transactions</b>	1.7	
Sum of discounted and lifted taxes as per agreement and specific conditions		

We state that we will bear all responsibility for correctness of this report in accordance with reporting regulations except in below mentioned cases:

\_\_\_\_\_  
Prepared by

\_\_\_\_\_  
Overviewed by

\_\_\_\_\_  
Responsible Officer

\_\_\_\_\_  
State Secretary

Date: \_\_\_\_\_

Endorsed by Joint Resolution No. 49/96 of  
Chairman of National Statistical Office and  
Minister of Finance, from 2007

EITI TEMPLATE 3

**THE CONSOLIDATED REPORT**  
of year \_\_\_\_\_ on corporate taxes and fees paid to state and local budget  
by the Company operating in extractive industries

1. The General Department of national taxation of Mongolia (GDNTM) shall consolidate own data and data from aimag, capital city relevant state organizations on each company engaged in extractive industries and taxation authorities, and make a national level report as per Template 3, and submit to Ministry of Finance before May 15 of following year.
2. The Ministry of Finance shall overview data on each company and national level, and shall disclosure the Government Report within May of the following year.
3. The Ministry of Finance shall submit report done on each company, in form of Template 3, to EITI Mongolia Secretariat, established as independent.

Indicators	Relevant part of instruction	Total amount '000 MNT
<b>Scope 1: Revenue and profit flow</b>		
<b>1. Taxes and fees paid by foreign and domestic companies to state and local budget</b>		
<b>1.a) Paid taxes</b>	1.1	
Corporate income tax		
Value added tax deducted from paid back		
Customs tax		
Windfall tax		
Real estate tax		
Excise tax (on imported fuel and oil materials)		
Tax on petrol and diesel fuel		
Tax on automobile and self-moving vehicle		
Other taxes in money amount		
<b>1.b) Fee</b>	1.2	
Fee for exploitation of mineral resources		
License fee for exploitation and exploration of mineral resources		
Reimbursement of deposit, exploration of which is carried by the budget fund		
Land rent		
Fee for water use		
Fee for forestry use and fire wood		
Fee for recruiting foreign experts and workers		
Fee for use of mineral resources of wide spread deposit		
<b>1.c) Charge and service charges</b>	1.3	
Stamp and other charge for state registration paid to state and local administrative organizations in accordance with relevant legislation		
Service charges paid to state and local administrative organizations in accordance with relevant legislation		

<b>1.d) Dividends on state and local property</b>	1.4	
Dividends on state property		
Dividends on local property		
<b>1.e) Other payments to recipient Government</b>	1.5	
Entitlement under Production Sharing Contract to Government		
<b>1.f) Donation to Governmental organizations</b>	1.6	
Monetary donation from company to Ministries and agencies		
Monetary donation from company to aimag		
Monetary donation from company to soum		
Monetary donation from company to local organizations		
Fund disbursed by company in sustainable development and community relations		
<b>Scope 2. Revenues and profits flow (voluntary basis)</b>		
<b>2. Profit and revenue transactions</b>	1.7	
Sum of discounted and lifted taxes as per agreement and specific conditions		

We state that we will bear all responsibility for correctness of this report in accordance with reporting regulations except in below mentioned cases:

Prepared by

Ministry of Finance

Responsible Officer

State Secretary

Date: \_\_\_\_\_

Endorsed by Joint Resolution No. 49/96 of  
Chairman of National Statistical Office and  
Minister of Finance, from 2007

EITI TEMPLATE 4

### THE CONSOLIDATED REPORT

of year \_\_\_\_\_ on quantity of produced and sold production by the Companies  
operating in extractive industries

MRAMP shall receive from companies report in this format and submit consolidated report to EITI Mongolia Secretariat, established as independent, not later than May 31.

Indicators	Relevant part of instruction	Unit of Measurement	Quantity	Total amount '000 MNT
<b>Scope 1: Revenue and profit flow</b>				
<b>1. Production and sales products</b>				
<b>1.a) Production</b>	1.1			
License No. Product		Ton		
License No. Product				
License No. Product				
License No. Product				
Total production		'000 MNT		
<b>1.b) Sales of Product</b>	3.2			
License No. Product		Ton		
License No. Product		Ton		
License No. Product		Ton		
License No. Product				
Total sales		'000 MNT		
<b>1.c) Sales under Production sharing agreement by company</b>	3.3	Ton		

We state that we will bear all responsibility for correctness of this report in accordance with reporting regulations except in below mentioned cases:

Report prepared by

Mongolian Regulatory Authorities of Minerals and Petroleum

\_\_\_\_\_  
Chairman

\_\_\_\_\_  
Responsible department Chief

Date: \_\_\_\_\_

## APPENDIX K

### *Reference Sources*

#### **EITI Secretariat**

[www.eitransparency.org](http://www.eitransparency.org)

#### **EITI Country Websites through the International EITI Secretariat**

Azerbaijan	<a href="http://www.eitransparency.org/Azerbaijan">www.eitransparency.org/Azerbaijan</a>
Bolivia	<a href="http://www.eitransparency.org/Bolivia">www.eitransparency.org/Bolivia</a>
Cameroon	<a href="http://www.eitransparency.org/Cameroon">www.eitransparency.org/Cameroon</a>
Chad	<a href="http://www.eitransparency.org/Chad">www.eitransparency.org/Chad</a>
Congo, Democratic Republic of	<a href="http://www.eitransparency.org/DRCongo">www.eitransparency.org/DRCongo</a>
Congo, Republic of	<a href="http://www.eitransparency.org/Congo">www.eitransparency.org/Congo</a>
Equatorial Guinea	<a href="http://www.eitransparency.org/EquatorialGuinea">www.eitransparency.org/EquatorialGuinea</a>
Gabon	<a href="http://www.eitransparency.org/Gabon">www.eitransparency.org/Gabon</a>
Ghana	<a href="http://www.eitransparency.org/Ghana">www.eitransparency.org/Ghana</a>
Guinea	<a href="http://www.eitransparency.org/Guinea">www.eitransparency.org/Guinea</a>
Kazakhstan	<a href="http://www.eitransparency.org/Kazakhstan">www.eitransparency.org/Kazakhstan</a>
Kyrgyz Republic	<a href="http://www.eitransparency.org/Kyrgyzstan">www.eitransparency.org/Kyrgyzstan</a>
Mali	<a href="http://www.eitransparency.org/Mali">www.eitransparency.org/Mali</a>
Mauritania	<a href="http://www.eitransparency.org/Mauritania">www.eitransparency.org/Mauritania</a>
Mongolia	<a href="http://www.eitransparency.org/Mongolia">www.eitransparency.org/Mongolia</a>
Niger	<a href="http://www.eitransparency.org/Niger">www.eitransparency.org/Niger</a>
Nigeria	<a href="http://www.eitransparency.org/Nigeria">www.eitransparency.org/Nigeria</a>

Peru	<a href="http://www.eitransparency.org/Peru">www.eitransparency.org/Peru</a>
Sao Tome and Principe	<a href="http://www.eitransparency.org/SaoTomeAndPrincipe">www.eitransparency.org/SaoTomeAndPrincipe</a>
Sierra Leone	<a href="http://www.eitransparency.org/SierraLeone">www.eitransparency.org/SierraLeone</a>
Timor-Leste	<a href="http://www.eitransparency.org/Timor-Leste">www.eitransparency.org/Timor-Leste</a>

## EITI Country Websites

### Azerbaijan

State Oil Fund EITI	<a href="http://www.oilfund.az">www.oilfund.az</a>
EITI NGO Coalition	<a href="http://www.eiti-az.org">www.eiti-az.org</a>

### Congo, Republic of

Country EITI	<a href="http://www.mefb-cg.org/eiti.htm">www.mefb-cg.org/eiti.htm</a>
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### Gabon

Country EITI website	<a href="http://www.finances.gouv.ga/eiti2.htm">www.finances.gouv.ga/eiti2.htm</a>
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### Ghana

Country EITI website	<a href="http://www.geiti.gov.gh/index.asp">www.geiti.gov.gh/index.asp</a>
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### Kazakhstan

Government of Kazakhstan's EITI Website	<a href="http://www.eiti.kz">www.eiti.kz</a>
NGO Coalition Oil Revenues Under Public Oversight	<a href="http://www.publicoversight.kz">www.publicoversight.kz</a>

### Mauritania

Mauritania National EITI Secretariat	<a href="http://www.mauritania.mr/itie/">www.mauritania.mr/itie/</a>
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### Nigeria

[www.neiti.org](http://www.neiti.org)

### Peru

[www.minem.gob.pe/eiti/default.asp](http://www.minem.gob.pe/eiti/default.asp)

## Supporting Country Government Agencies

### Australia

Overseas Aid (AusAID)	<a href="http://www.ausaid.gov.au">www.ausaid.gov.au</a>
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### Belgium

Foreign Affairs, Foreign Trade and Development Cooperation	<a href="http://www.diplomatie.be/EN/igfc/scope/default.asp">www.diplomatie.be/EN/igfc/scope/default.asp</a>
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### Canada

Department of Finance	<a href="http://www.fin.gc.ca/news07/07-012e.html">www.fin.gc.ca/news07/07-012e.html</a>
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### France

<https://pastel.diplomatie.gouv.fr>

### Germany

Federal Ministry for Economic Cooperation and Development	<a href="http://www.bmz.de/en/index.html">www.bmz.de/en/index.html</a>
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### Netherlands

Ministry of Foreign Affairs	<a href="http://www.minbuza.nl/en/home">www.minbuza.nl/en/home</a>
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**Norway**

Norway Agency for Development (NORAD)  
[www.norad.no](http://www.norad.no)

**United Kingdom**

Department for International Development (DFID)  
[www.dfid.gov.uk/news/files/extractiveindustries.asp](http://www.dfid.gov.uk/news/files/extractiveindustries.asp)

**United States**

US Agency for International Development (USAID)  
[www.usaid.gov/index.html](http://www.usaid.gov/index.html)

**International Organizations**

World Bank Group

[www.worldbank.org](http://www.worldbank.org)

European Bank of Reconstruction and Development (EBRD)

[www.ebrd.com](http://www.ebrd.com)

International Monetary Fund

[www.imf.org](http://www.imf.org)

Organization for Economic Co-operation and Development (OECD)

[www.oecd.org](http://www.oecd.org)

**International NGOs**

Revenue Watch Institute (RWI)

[www.revenuewatch.org](http://www.revenuewatch.org)

Publish What You Pay Coalition

[www.publishwhatyoupay.org/english/index.shtml](http://www.publishwhatyoupay.org/english/index.shtml)

Transparency International

[www.transparency.org](http://www.transparency.org)

Global Witness

[www.globalwitness.org](http://www.globalwitness.org)

Catholic Agency for Overseas Development (CAFOD)

[www.cafod.org.uk](http://www.cafod.org.uk)

Georgia Revenue Watch and NGO Coalition “For Transparency of Public Finance”

[www.publicfinance.ge](http://www.publicfinance.ge)

Open Society Institute

[www.soros.org/resources/articles\\_publications/articles/transparency\\_20050317](http://www.soros.org/resources/articles_publications/articles/transparency_20050317)

American Petroleum Institute (API)

[api-ec.api.org](http://api-ec.api.org)

International Council on Mining and Metals (ICMM)

[www.icmm.com](http://www.icmm.com)

International Organization of Oil and Gas Producers (OGP)

[www.ogp.org.uk](http://www.ogp.org.uk)



## Glossary

### **Administrator**

An organization appointed to reconcile payments and revenue data provided by companies and government agencies involved in the extractive industries. The administrator is charged with comparing different sets of data and trying to investigate and explain any discrepancies identified, but does not carrying out an actual audit of such transactions.

### **Aggregation**

The process of gathering financial information under the EITI for public reporting, but without delineating such information on the basis of the individual identity of payors (i.e., individual company names) and/or on the basis of individual payment types (e.g., by category of payment or expense obligation).

### **Aggregator**

An organization, typically an independent third party, designated to fulfill the task of aggregation under the EITI. This term is used interchangeably with the term “administrator.”

### **API Gravity**

The field unit established by the American Petroleum Institute (API) for the measurement of the specific gravity of oil.

**Associated Gas**

When crude oil is produced from a reservoir and comes to the surface, the pressure drops and lighter hydrocarbons become gaseous. These associated gases are described as “associated gas.”

**Audit**

A process of obtaining, verifying, potentially reconciling, and reporting upon information, including in the context of the EITI, concerning financial or physical information of relevance to the extractive industries.

**Auditor**

An organization, typically an independent audit firm that is licensed or otherwise certified to provide financial audits and related services by a professional standards or chartering authority for auditors within a designated legal jurisdiction. In the context of the EITI, the auditor is typically charged with the responsibility of inspecting the financial accounts and other information held by those companies and/or government agencies involved in the extractive industries, for purposes of ascertaining whether such accounts and information are accurately recorded and reported.

**Civil Society Organization (CSO)**

Civil society organizations are nongovernmental organizations such as trade unions, issue-based coalitions, faith-based organizations, indigenous peoples movements, and foundations.

**Contractor**

A term usually given to an oil company or a group of oil companies that are partners with technical competence, professional skills, and/or financial ability, and that are willing to explore and exploit a contract area at their own risk in a venture governed by a production sharing contract (PSC). This term differentiates the private oil companies (the contractor(s)) from the state oil company, which is usually the other party (concession holder) to the contract. The term can also apply to a company providing services to an oil company or venture.

**Costs**

Costs are expenditures incurred by an entity in pursuance of its business. The meaning of “costs” for the purpose of financial reporting may differ from the meaning for fiscal purposes. Capital expenditure is made on behalf of a project for capital items (i.e., assets which will serve for a number of years). Operating expenses are made on behalf of the project for non-capital items (e.g., services, salaries, perishable goods, and short-lived assets). Classifications of fiscal costs are defined by the tax or fiscal rules and regulations of a country. Cost classifications for accounting purposes are governed by relevant accounting standards and/or by the terms of a license or joint operating agreement applicable to the operation.

**Cost Oil**

Oil (or gas) produced that is shared with the contractor at a defined valuation, in accordance with a formula specified in the relevant production sharing contract, enabling the contractor to recover the costs spent on a project by the contractor.

**Cost Recovery**

The process of having accumulating and approving costs to ensure equitable recovery as cost oil or gas under a PSC or contributed as cash call by the respective partners to a joint venture.

**Depletion Allowances**

An allowance that is deductible when calculating tax liabilities or when reporting financial profits (depending on the context). It relates to the exhaustion of an asset in the ground. The costs of producing wells and facilities and the costs of leases are gradually written off over the life of an oil field or mineral deposit. The annual depletion allowance is calculated by relating the production for the year to the total producible reserves at the beginning of the year.

**Dividend**

A payment to a partner or shareholder out of the profit of a company as a return on the investment made.

**Downstream**

The activities in the oil and gas industry taking place after production—including transportation, refining, and marketing.

**EITI Plus**

A reference to a particular type of implementation of the EITI, which can be instituted by an individual country that exceeds the core standards and requirements of the EITI, as defined by the *EITI Sourcebook*, the EITI Validation Guide, and other applicable resources.

**EITI Secretariat**

The EITI is supported by an International Secretariat presently based in Oslo. The Secretariat works closely with the World Bank and the IMF to manage the EITI on the global level. Some implementing countries have an independent Secretariat with a full-time staff to help manage the administrative aspects of EITI implementation.

**EITI Sourcebook**

The *EITI Sourcebook*<sup>66</sup> provides guidance about how to become involved in the EITI. The sourcebook was produced by the International EITI Secretariat. It is intended to assist countries wishing to implement the EITI and stakeholders wishing to support implementation.

**Export/Import Duties**

Duty applied to the export or import of products. Oil and gas are usually exempt from export duties.

**Financial Flows**

Payment streams between extractive companies and any government entity at any level of government.

**Fiscalization**

The conversion of a unit of production (e.g., a barrel of oil) into monetary terms. For example, when oil is measured at the wellhead the measured quantity is then priced for purposes of calculating the government's tax or royalty.

**Flow Rate**

A term usually applied to the volume or quantity of oil or gas coming out of a well or flowing through a pipeline. The flow rate is often measured in oil field units, such as "barrels per day" or "millions of cubic feet per day."

**In-Kind Payments**

Payments made to a government (e.g., royalty) in the form of the actual commodity (e.g., oil, gas, or minerals) instead of cash.

**International Accounting Standards**

The internationally accepted standards for financial reporting as issued by the International Accounting Standards Board. The applicability of these standards in each country is a matter for the relevant regulatory organization of that country.

**International Auditing Standards**

The internationally accepted standards applicable to the way professional auditors conduct audits, as issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The applicability of these standards in each country is a matter for the relevant regulatory organization of that country.

**Joint Venture**

A group of companies, which can include a state company, that have joined together to conduct explorations and prospectively exploit minerals or hydrocarbons under a specified area under the terms of an agreed contract.

**Liquefied Natural Gas (LNG)**

Natural gas consisting of nearly pure methane that has been cooled to  $-162^{\circ}\text{C}$  to become a liquid. LNG occupies about 1/600 of its volume as a gas.

**Mapping of Financial Flows**

A mapping of financial flows is a simplified illustration that traces payments to show which entity makes the payments and which entity receives them. It is a helpful tool for understanding how money is exchanged between companies and government agencies in the extractive industry of a country.

**Material**

Material is used to describe revenue streams that are important or relevant. The EITI requires that all material benefit streams be published. According to the EITI, a benefit stream is “material if its omission or misstatement could materially affect the final EITI report.”<sup>67</sup> It is typically the responsibility of the stakeholders to decide how to define material in quantitative terms based on the EITI program objectives in that country.

**Multi-Stakeholder Group (MSG)**

A group made up of private sector, independent civil society representatives, and relevant senior government leaders that oversee the EITI effort in a country.

**Non-Associated Gas**

The designation for gas derived from a reservoir containing little to no crude oil.

**Oil Mining Lease (OML)**

A legal right to develop and produce hydrocarbons discovered in a specified area for a specified period of time.

**Oil Prospecting Lease (OPL)**

A legal right to explore for hydrocarbons over a particular area for a specified time period.

**Operator**

An entity, which may be an oil company or group of oil companies, that operates an asset on behalf of others. The asset could be an oil field or a number of oil fields. The agreement between the operator and the shareholders is usually governed by a joint operating agreement (JOA).

**Probability of Success (POS)**

In the oil and gas industry this is the term usually given to the chance of discovering hydrocarbons during exploration operations. If, for example, the POS is 10 percent, then the chance of failure, or the probability of not finding any hydrocarbons, is 90 percent.

**Production Sharing Agreement**

See “Production Sharing Contract.”

**Production Sharing Contract**

A petroleum production arrangement in which the contractor bears all costs of exploration and production without such costs being reimbursable if no find is made in the contract area (OPL or OML) and in which the government and contractor are both paid in the resource produced.

**Profit**

Profit is the net excess of income over expenses, according to the appropriate accounting rules. Profit may be defined either before and/or after deducting applicable taxes owed.

**Profit Oil**

A quantity of crude oil/gas which remains to be split between the government and contractor after the recovery of costs, through cost oil/gas, and payment of royalty and other taxes (if applicable) under a production sharing contract.

**Reconciliation**

A sufficient explanation of the difference between two figures.

**Refinery Margin**

The difference between the wholesale cost of gasoline (estimated by prices at which it is sold in large quantities to retailers or sellers) and the cost of crude oil.

**Refinery Net-Back Valuation**

The value of a crude oil based on the products it yields in a refinery.

**Regulator**

The government official or organization lawfully specified as having the responsibility to administer rules and regulations. A regulator might have authority to develop and issue rules.

**Return on Investment**

The income that an investment produces for each unit (e.g., dollar) of capital invested. If \$1 million invested produces \$100,000 per year that is a 10 percent return on investment.

**Ring Fencing**

Costs expended in one area can often be allowed against taxable profits earned in another area. For example, exploration costs may be allowed to be deducted against profits in a producing field. However, there are sometimes restrictions on what costs are allowed against profits generated elsewhere. These restrictions are called “ring fences.” For example, exploration costs onshore in the United Kingdom cannot be offset against profits generated from offshore producing fields. So onshore and offshore operations in the United Kingdom are ring fenced, even though it is the same company undertaking these operations.

**Royalty**

A payment for the extraction of mineral resources made to the host government (which may include a regional, provincial, and/or local administration).

**Service Contract**

A petroleum production arrangement under which the OPL title is held by one party, and the operator is designated the service contractor and provides funds required for exploration and production work over a period of time (e.g., five years for which the contractor is paid by installment as agreed in the contract irrespective of the result of the exploitation).

**Stakeholders**

Members of the government, civil society, and private sector affected by the extractive industry in a country.

**Tax**

A payment made to the host government in proportion to the taxable income resulting from the project, including for example, corporate tax and profits tax.

**Upstream**

The exploration and production phases of the oil and gas industry.

**Value Added Tax (VAT)**

A tax applied to each stage of the manufacture and sale of a product or service. The rules for a VAT system are specified at country level and differ between countries. Typically, the VAT that the company pays on goods can be offset against any VAT it charges on the sale of goods or the provision of services. The difference is paid to (or received from) the government. Export of oil and gas is usually exempt from VAT.



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