Drilling for Good Governance: Key Issues for Auditing the Extractive Sector and Extractive Revenues

Andrew Bauer
Economic Analyst, NRGI

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The Natural Resource Governance Institute (NRGI)

Ideas

- Extractive Industry Transparency Initiative (EITI)
- Resource Governance Index
- Natural Resource Charter
- International disclosure standards
- Research: Contracts, fiscal regimes, local content, revenue management, transparency and accountability

Technical Assistance

- Fiscal regimes and contracts (e.g., Liberia, Iraq, Mongolia, Guinea, Sierra Leone)
- Revenue management (e.g., Ghana, Indonesia, Libya, Nigeria, Peru, Timor-Leste)

Capacity Building

- Parliamentary training program
- Training hubs (e.g., Oxford, CEU, regional)

EITI Extractive Industries Transparency Initiative

NATURAL RESOURCE CHARTER

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Why extractive governance matters

- In 27 countries, oil and gas contributes more than 50% of government revenues or 60% of exports
- In 10 more countries, minerals contribute more than 30% of government revenues or 40% of exports
- Oil-dependent countries are more secretive, less accountable and grow slower than similar natural resource poor countries
- Rents are extremely large and sector is susceptible to corruption and 'loss'

	EI rents in 2010 (USD)
Angola	$37.3 billion
Brazil	$104.9 billion
China	$451.8 billion
India	$102.6 billion
Nigeria	$72.4 billion
Zambia	$4.3 billion

Source: World Bank

Why extractive governance matters

- Relatively light interventions can generate millions or even billions of dollars for the government
  - Proper invoicing – Tanzania mining companies may over-invoice oil imports to save approx. $250 million in taxes annually
  - Contract renegotiation – Guinea iron ore royalty hike will generate $3 billion more annually starting in 2017
  - Addressing transfer pricing – Zambian Mopani Copper Mine sold copper to Glencore, its parent company, at far below market rates, avoiding millions of dollars in taxes

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Source: Global Financial Integrity; Africa Progress Report

Total sub-Saharan ODA and resource rents (billion USD)

The scale of the opportunity

	2000	2008
ODA	$12bn	$36bn
Resource Rents	$39bn	$240bn

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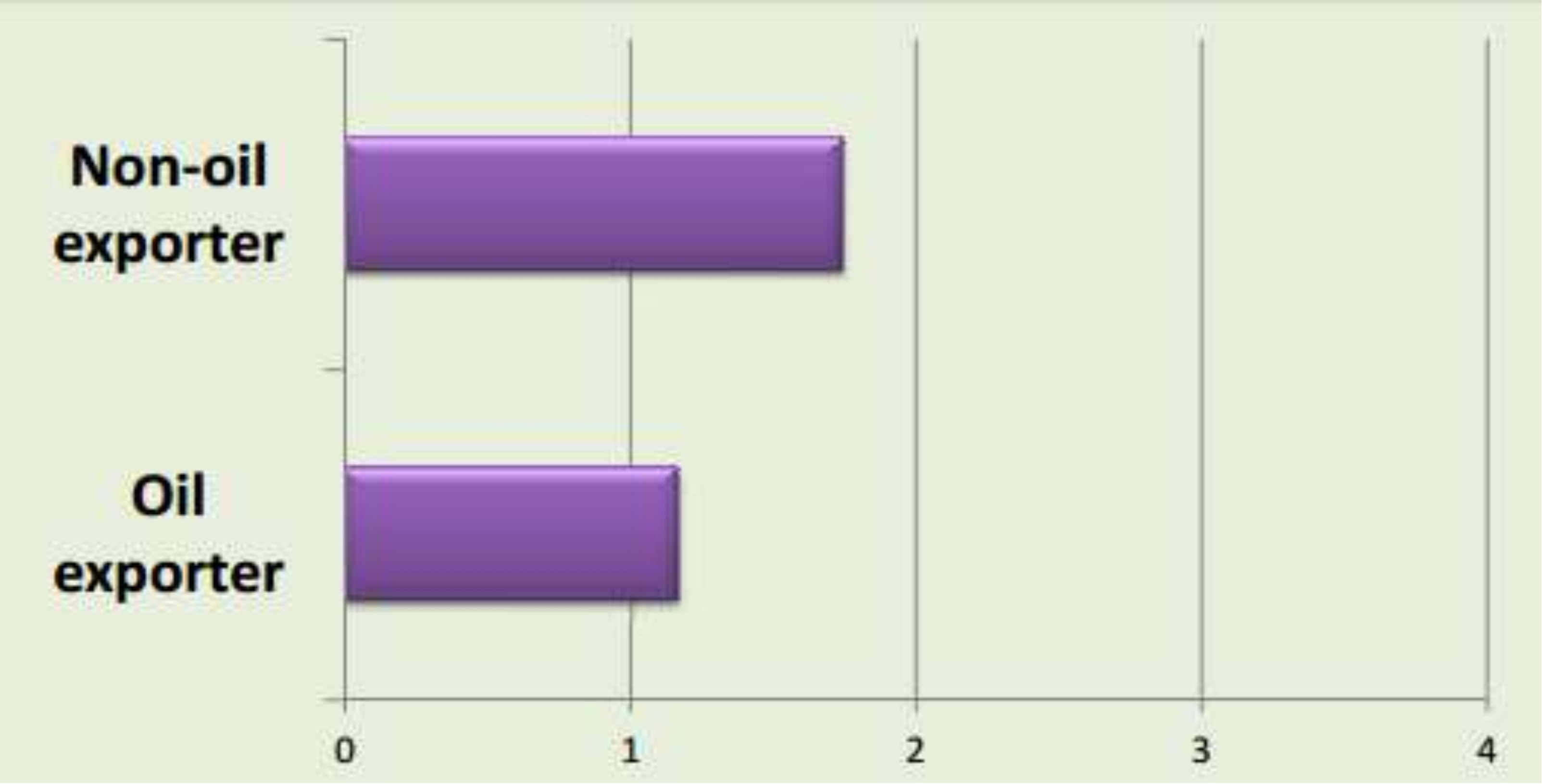
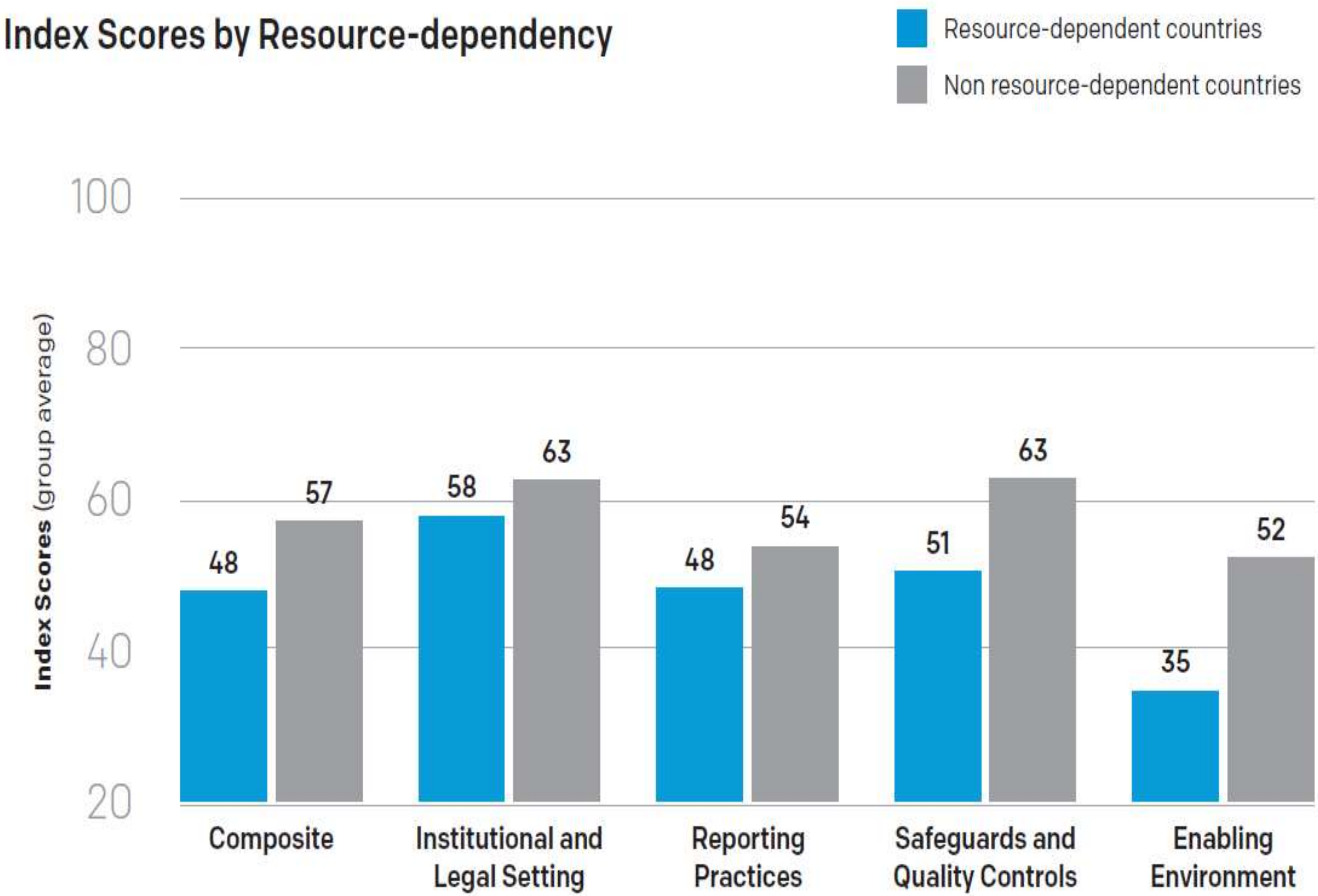
Source: World Bank, Changing Wealth of Nations & World Development Indicators

PIMI Index

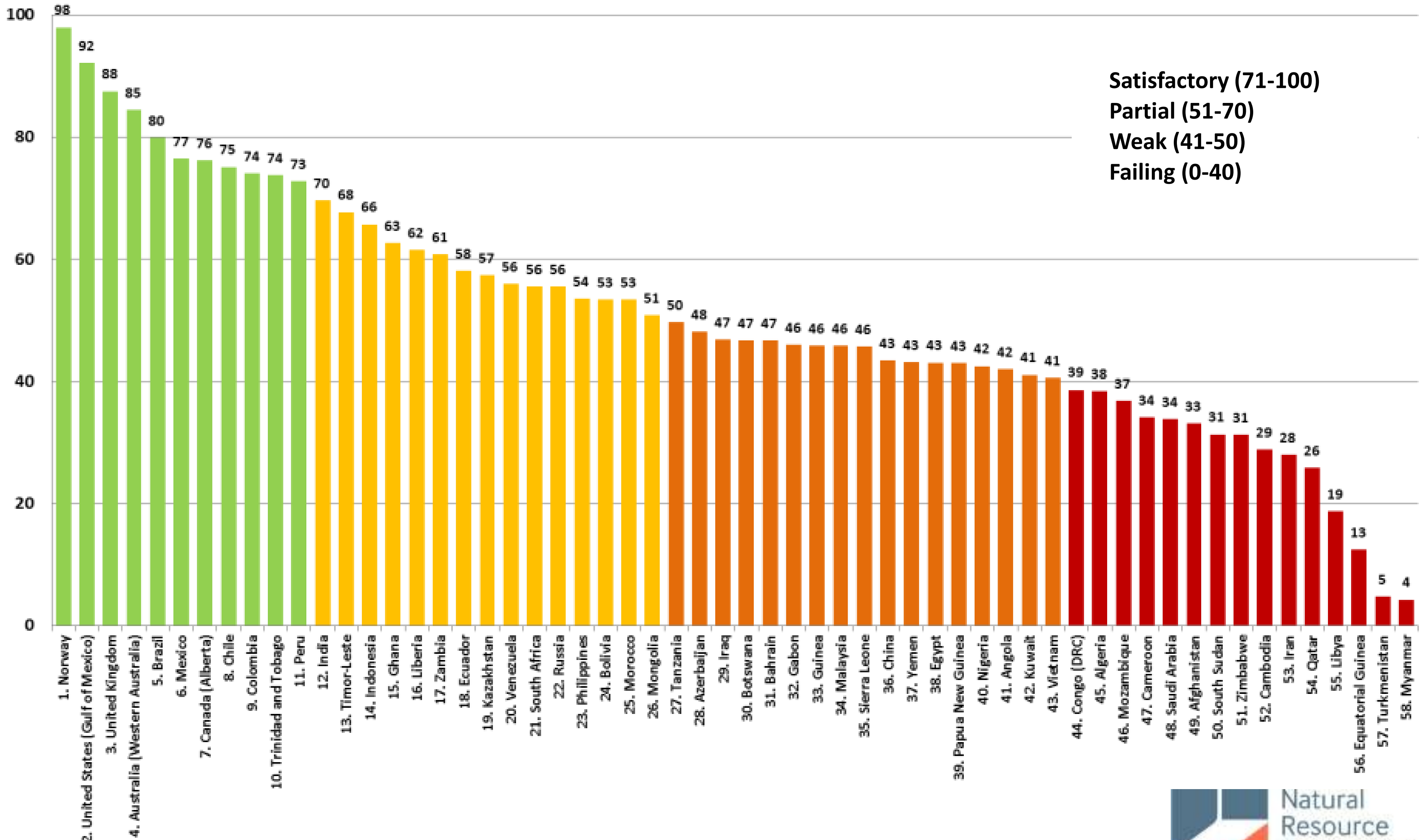


Source: IMF

Governance and transparency is missing where it is most needed



Resource Governance Index: 80% of countries do not meet satisfactory governance standards



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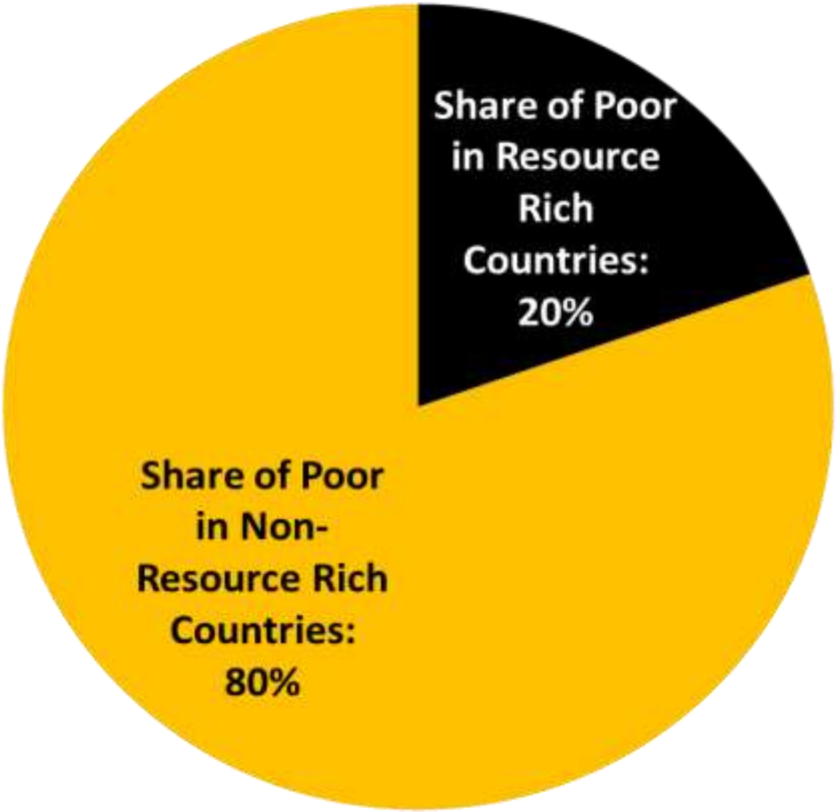

Share of the poor living under $2 a day in Non-Resource Rich Countries vs. Resource Rich Countries, 1990

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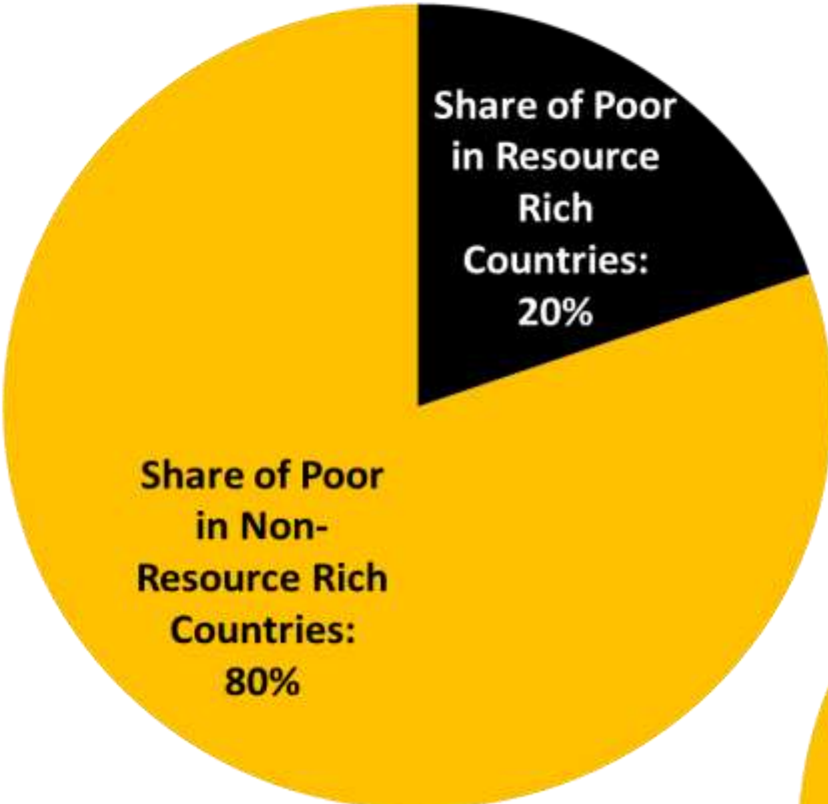
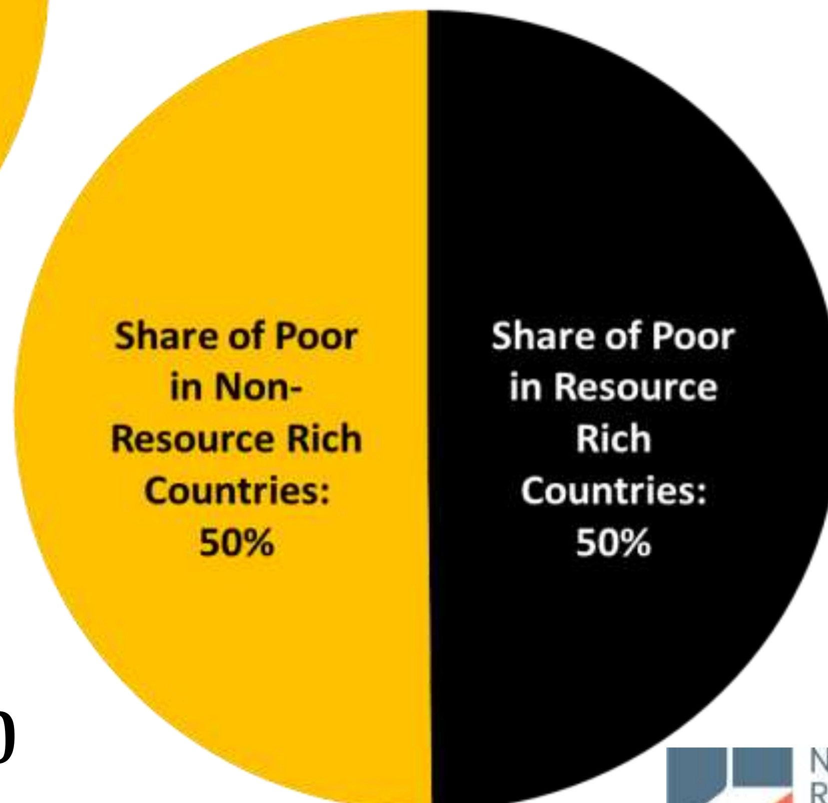
Share of the poor living under $2 a day in Non-Resource Rich Countries vs. Resource Rich Countries, 1990 & 2030



1990



2030

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The Natural Resource Charter

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Four key 'risk areas'

- Licensing
- Tax collection
- State owned-company governance
- Revenue distribution and management

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Risk 1: Licensing and contracts

- Top three 'risk areas'
  - Poor company selection leading to weak technical capacity to explore or produce, or conflict with communities
  - Poor fiscal terms leading to renegotiation
  - Tax incentives

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Common licensing in the petroleum sector

Agreement

Exploration/
Development

Production

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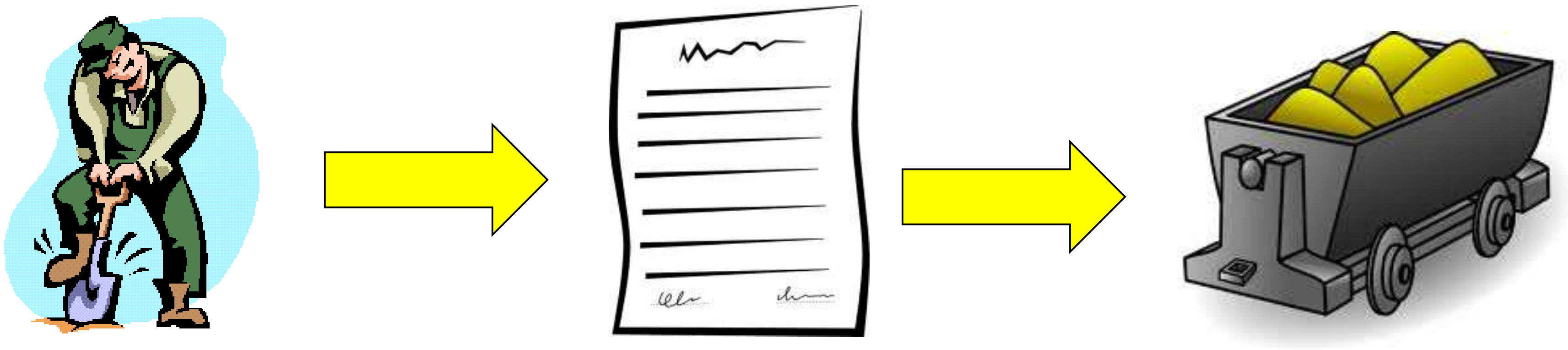
Common licensing in the mining sector



Exploration Agreement Production

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Company selection

- Competitive bidding (auctions or tenders)
  - Fixed vs. variable terms
  - Open vs. pre-qualification
- Direct negotiations

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Poor selection and conflict: Guinea

- BSGR paid $160 million for the license; sold 51% to Vale for $2.5 billion
- Former President Conté's family and entourage reportedly received millions of dollars in gifts and shares
- License revoked in April 2014
- Rio Tinto suing Vale and BSGR
- Beny Steinmetz under investigation in Guinea, France, Switzerland, the UK, and the US.

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Sources: Financial Times, New Yorker

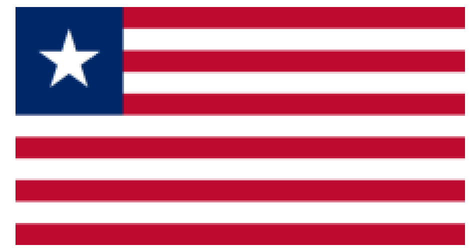
EITI audit in Liberia revealed deficiencies in the concession allocation process

LEITI Liberia Extractive Industries Transparency Initiative

We set out in the table below a summary of our findings with an indication of the contracts to which they relate:

Table 2 – Summary of findings

Finding n°	Title	Related contract ref. (*)	Priority (**)	Government Agency responsible
1	Cavalla Rubber Corporation and Golden Veroleum Agriculture Concessions awarded without going through competitive bidding process	1, 2	1	MOA and PPCC
2	Sime Darby Agriculture Concession awarded without going through the competitive bidding process	4	1	MOA and PPCC
3	Entity Concession Committees not appointed	1 to 5, 8 to 18 and 66 to 68	2	MOA, MLME, FDA and NOCAL
4	Certificate for Concession not sought or obtained	1 to 5, 8, 9 and 66 to 68	1	MOA, MLME and NOCAL
5	Lack of Concession Procurement Plans	1 to 5, 8 to 18 and 66 to 68	2	MOA, MLME, FDA, NOCAL, PPCC and IMCC
6	Lack of stakeholder forums	1 to 5, 8 to 18, 42 to 54, 56 to 59 and 66 to 68	2	MOA, MLME, FDA, NOCAL and IMCC
7	Agriculture Concession durations not compliant with the Public Lands Law	2, 4	3	MOA
8	Appointment of Inter-Ministerial Concession Committees not justified	3, 66, 67	2	IMCC, MOA and MLME
9	Concession Bid Evaluation Panels not constituted and works not substantiated	1, 2, 4 and 10 to 13	1	IMCC, MOA and FDA
10	Invitations to bid and bid documents not approved by the Inter-Ministerial Concessions Committee	3, 10 to 13 and 68	2	IMCC, MOA, ,FDA and MLME



http://www.leiti.org.lr/

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Philippines: Strong fiscal terms on paper… but generous tax incentives

- Standard royalty, income tax, VAT and withholding taxes, BUT…
- 6-8 year income tax holiday
- Deduction of all exploration and development costs from ALL taxable income
- In some cases 100% of infrastructure costs are tax deductible

Competitive bidding in Iraq

$2.80/barrel:

Difference between fee bid by Exxon & the winning bid of CNPC/BP for Rumaila oil field.

$750m:

Extra accruing to Iraq per year from 1m barrels per day (bpd) production of the Rumaila field.

But, need to look at details of deal and factor for risk of negotiations / renegotiations.

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Risk 2: Tax collection and contract compliance

- Tax avoidance: Transfer pricing and misinvoicing
- Production figures: Volume and quality of ore
- Legal loopholes: Tax deductible loans, tax holidays, no ring-fencing, and carry-forwards
- Capacity: Control, management and accounting systems
- Oil trading

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Tools for tax collection and compliance

- Extractive Industry Transparency Initiative (EITI)
- Mandatory disclosure of payments (US and EU)
- Ending tax havens
- Monitoring contract compliance

Contract transparency – growing, but still an exception

All or most contracts/licenses are available

Some contracts/licenses are available

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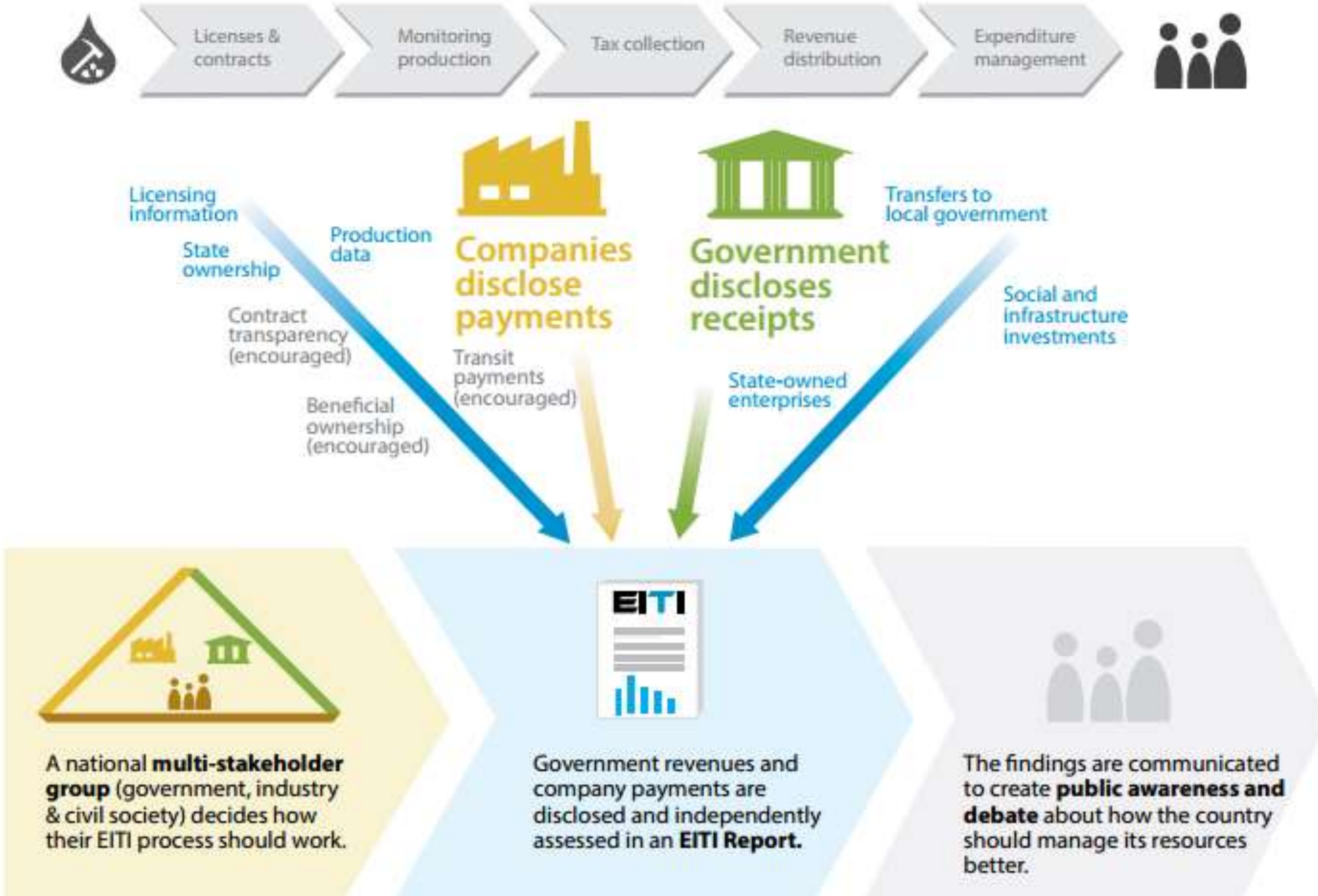
Source: Resource Governance Index, 2013

The EITI Standard

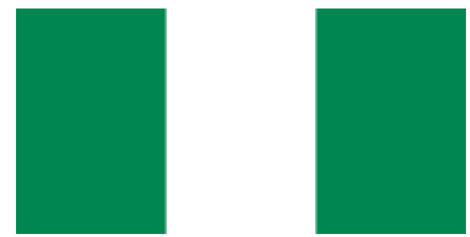


EITI in Nigeria revealed billion of dollars in unpaid taxes

NEITI Nigeria Extractive Industries Transparency Initiative

THE PRESIDENCY

- Over $800 million shortfall in company payments, more than annual Ministry of Education budget
- $443 million recovered
- $4.7 billion owed by the Nigerian National Petroleum Company (NNPC)



http://neiti.org.ng/

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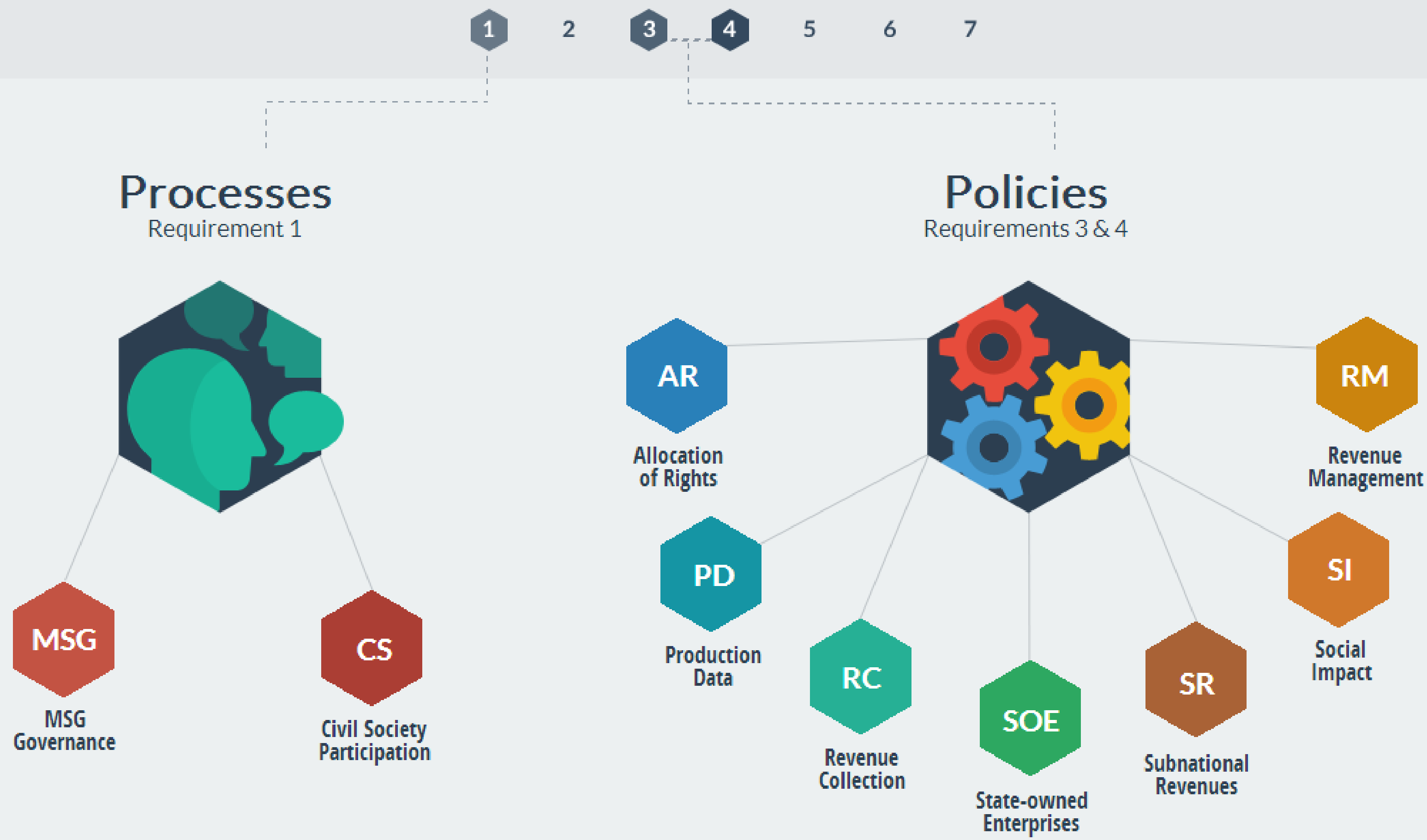
Using EITI for Policy Reform: Natural Resource Governance Institute Guide to the EITI Standard

This Guide advises on how the EITI can generate meaningful information that improves natural resource governance.

The EITI Standard has 7 Requirements



www.resourcegovernance.org/eitiguide

Risk 3: State-owned company governance

- Top three 'risk areas'
  - Inefficient project development and revenue collection
  - Extra-budgetary expenditures leading to parallel budget
  - Financial risk for taxpayers

Benefits and risks of SOE participation

Benefits and Success Stories

- Development of national skills
- Long-term economic control and financial returns
- More effective state control over the pace and development of the industry
- Stimulator of local content and positive economic spillovers

Statoil

CNPC

ارامكو السعودية
Saudi Aramco

PETRONAS

PETROBRAS

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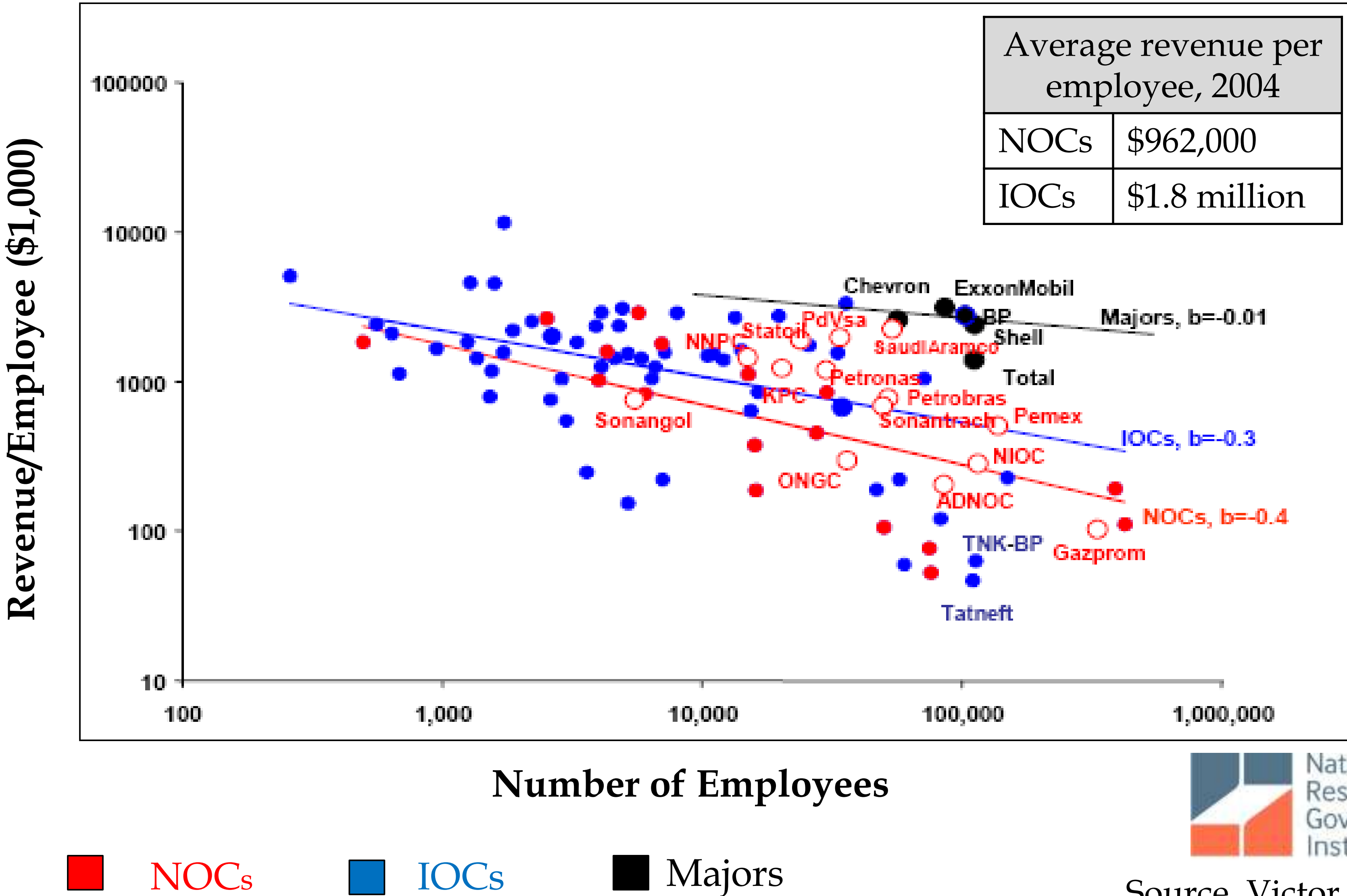
Are taxpayers getting value for money?: Project development and revenue collection



Average revenue per employee, 2004	
NOCs	$962,000
IOCs	$1.8 million

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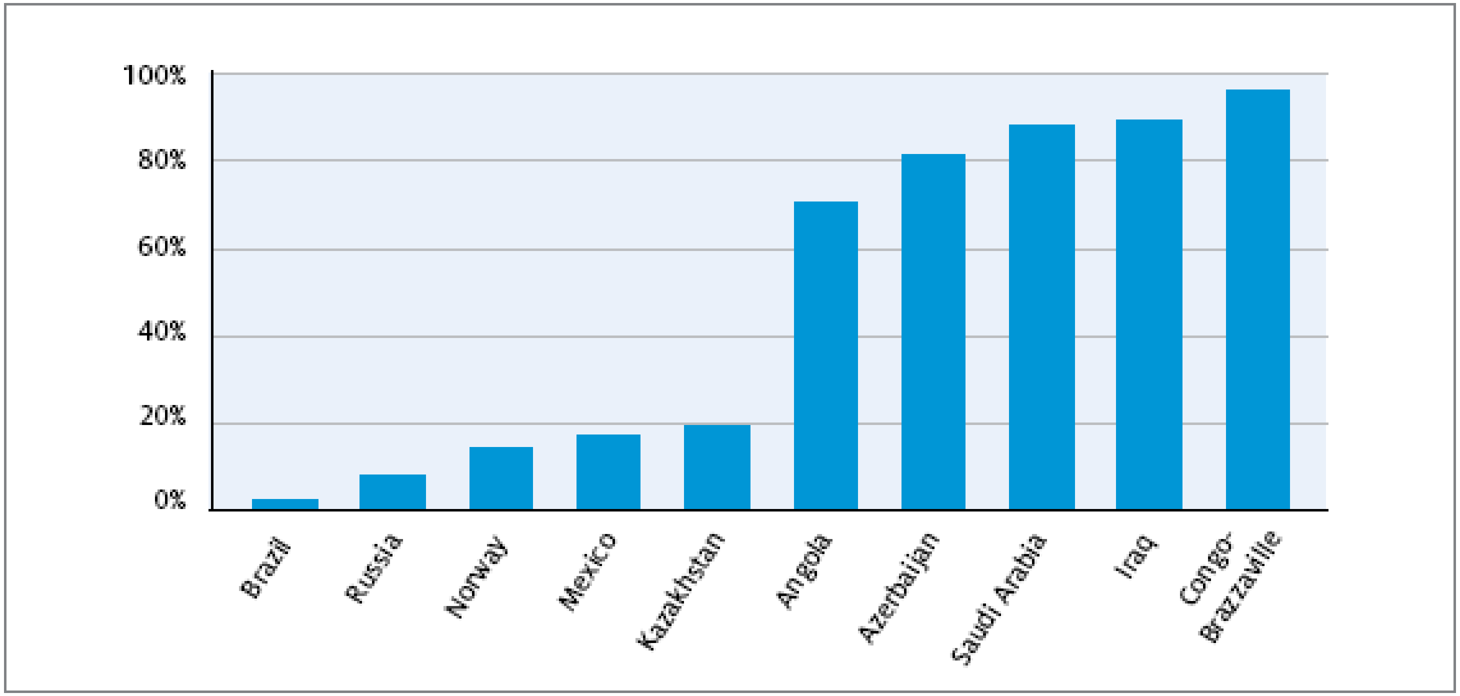
Source, Victor 2007

Should certain SOEs be audited as parallel treasuries?

NOC Exports as a share of total government revenue, 2010



Source: http://www.resourcegovernance.org/sites/default/files/OilSales-Transparency.pdf

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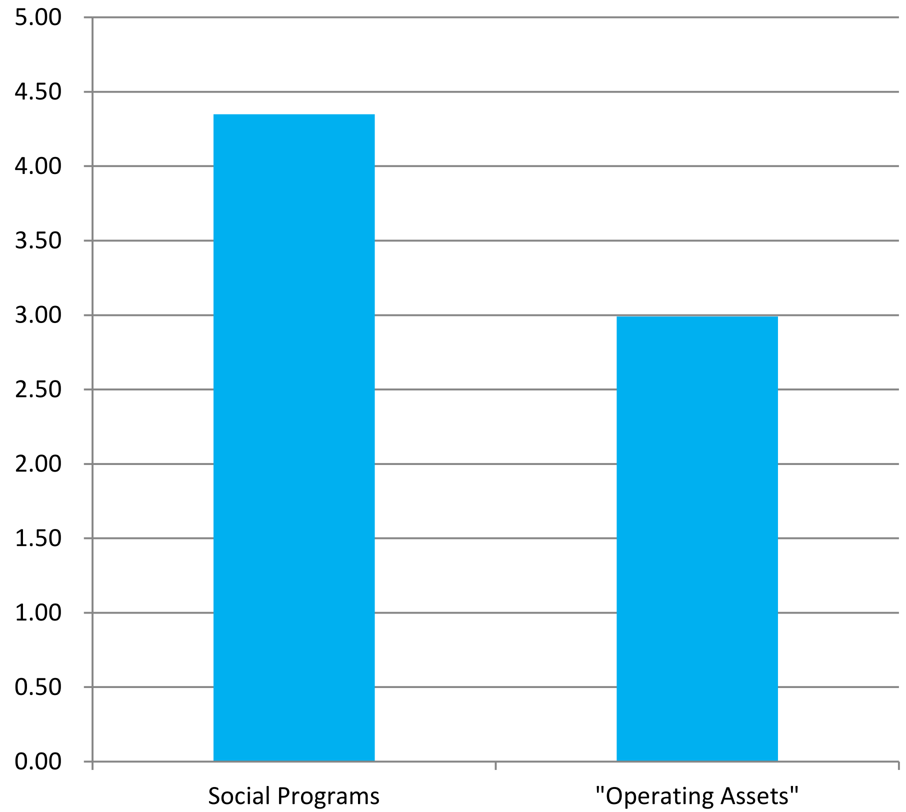
Angola: Extra-budgetary expenditures

$32 Billion

SONANGOL

Venezuela: Extra-budgetary expenditures

PDVSA (Venezuela) Spending, $ billions, 2012



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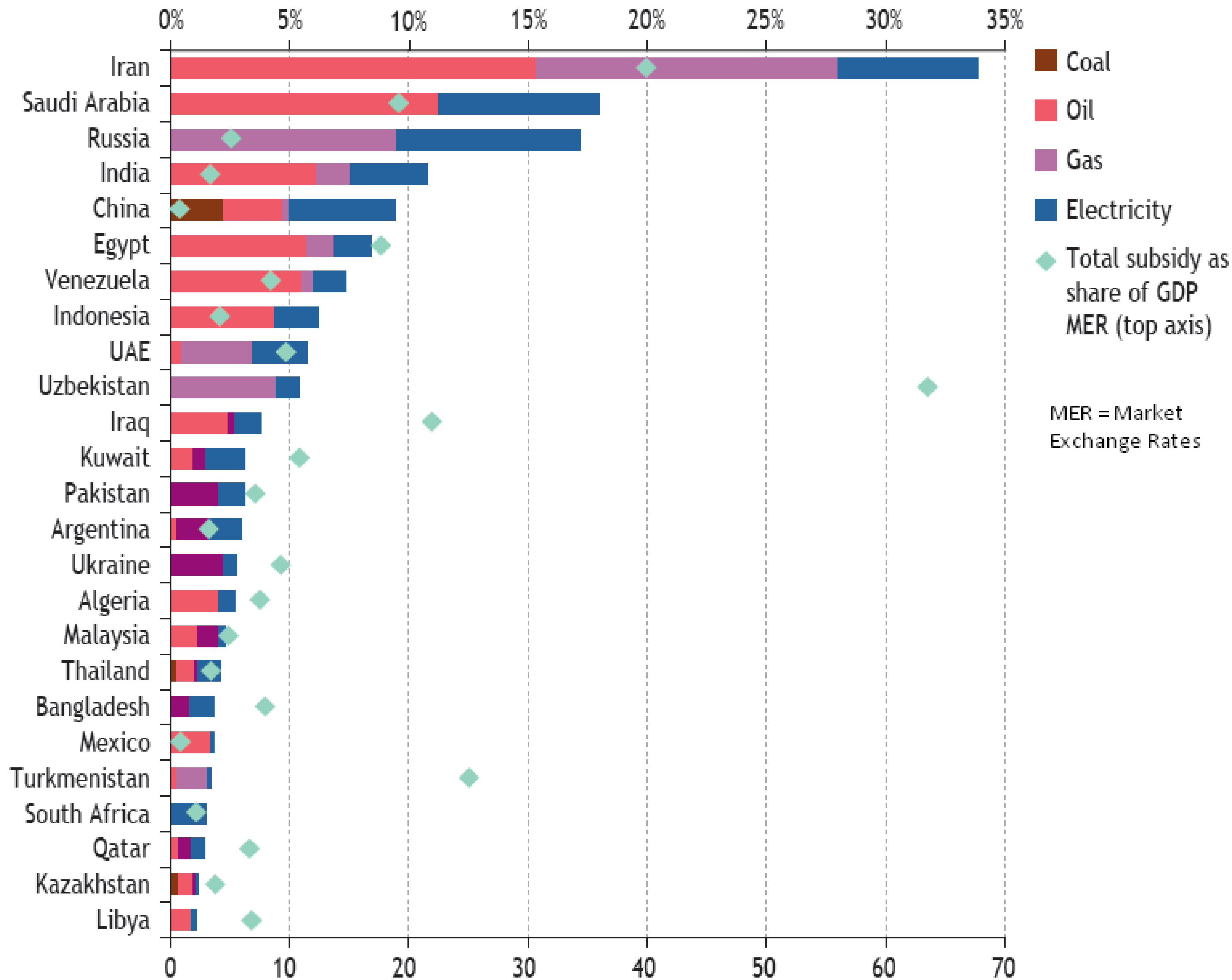
Source: Latin American Herald Tribune

Cost of fuel subsidies



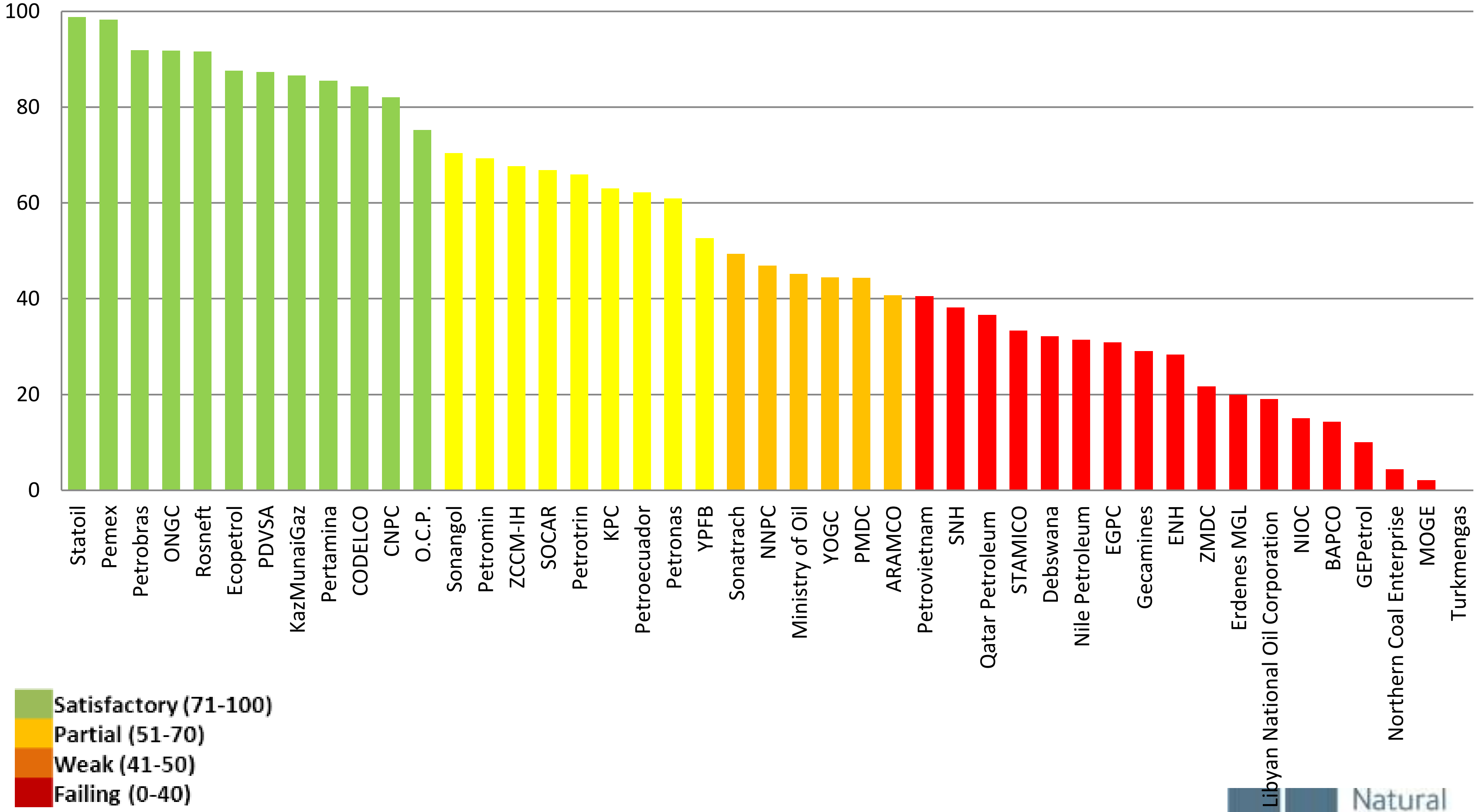
Source IEA, World Energy Outlook 2010, Figure 19.3

Financial risk to taxpayers

- Mexico
  - PEMEX's $127 billion in unfunded pension liabilities; one third to be taken over by Mexican government
- Nigeria
  - "Cash calls" are a major drain on taxpayers ($7 billion in 2010)
  - Petrol subsidies cost $11 billion in 2008-09
  - Refineries lose hundreds of millions of dollars per year

Sources: The Economist

Resource Governance Index – SOE scores



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Risk 4: Revenue distribution and management

- Top three 'risk areas'
  - Extra-budgetary oil or mineral funds
  - Weak financial management at the national and subnational levels
  - Weak budget processes leading to poor public investment decisions

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Sovereign wealth funds

Some have helped countries escape the "resource curse."

- Chile
- Norway
- Some Persian Gulf states
- Several U.S. states

Others have been mismanaged, not met objectives or become slush funds.

Some in :

- Central Asia (e.g., Russia)
- Latin America (e.g., Venezuela)
- MENA (e.g., Libya)
- SE Asia (e.g., Brunei)
- Africa (e.g., Equatorial Guinea)

What has made the difference are the rules, institutions and oversight.

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Subnational revenue distribution

- Lack of transparency in subnational transfers of oil, gas and mineral revenues
- Examples
  - DR Congo
  - Kazakhstan
  - Philippines

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Weak budgetary controls (examples)

- Fiscal rules
  - Azerbaijan
  - Trinidad and Tobago
- Project appraisal and selection
- Procurement
  - Timor-Leste electricity project

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Conclusions: Progress on public information

- Extractive Industries Transparency Initiative (EITI)
- Dodd-Frank (USA) & EU Transparency Directives
- Budget plans

Often unavailable or difficult to access

- Project level social or financial cost-benefit analysis
- Contracts / fiscal terms
- Project level costs and profits
- Licenses (national and subnational)
- State-owned company payments
- Extra-budgetary revenues and expenditures
- Budget execution audit

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Questions auditors can ask

Financial audits

- Are licensing processes being followed?
- Are contracts being complied with?
- Are correct taxes being collected?
- Are national oil / mining companies following their mandates and accurately reporting revenues and expenditures?
- Are sovereign wealth funds meeting their objectives?
- Are correct resource revenues being transferred to subnational governments?
- Are project appraisal, selection and procurement processes followed?

Performance audits

- Is the national oil / mining company providing value for money?
- Is the government getting a fair deal?
- How can tax loopholes be closed?

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Thank you

Questions and Discussion

abauer@resourcegovernance.org

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Data example – Royalty payments in Burkina Faso, Société d’Exploitation Minière d’Afrique de l’Ouest, 2010

SEMAFO

INTERNATIONAL EXPERTISE®
HUMAN ADVOCACY

EITI Report:
SEMAFO paid fCFA 3,244,267,363 in royalties

How do we estimate the royalty owed?
Convention Minière Burkina Faso-SEMAFO, 2007, Art. 18.2

B- REGIME FISCAL

Le régime fiscal global applicable à l'Investisseur, à ses Sociétés affiliées et sous-traitants, dans le cadre des Opérations Minières liées au permis d'exploitation objet de la présente Convention se compose:

1 - De taxes et redevances minières définies par le Code Minier et sa réglementation;

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The Code and its regulations: 2010 = « a year of evolution »

Décret 2005-048, Art. 12

Royalties for gold = 3% of the FOB value

Décret 2010-075/PRES/MEF

Royalties for gold =

- 3% of the FOB value if gold price ≤ $1,000/oz;
- 4% of the FOB value if $1,000 < gold price ≤ $1,300/oz
- 5% of the FOB value if gold price > $1,300/oz

This decree was promulgated on December 1, 2010.

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First issue: does the new decree apply to this project?

- Contract signed in2007
- Stabilization clause

Assumption for our estimate:

The new royalty rate applied to this project as of December 1, 2010

- New decree: « applies the results of a dialogue between the Government and the private sector »
- Perspective from colleagues and sources

But hold onto the question!

Where do we find the necessary information?

Necessary information

Production

Price

Sources of information

Production: EITI Report (Ministry reports, company reports)

2010: 5,095 kg (EITI report, p. 36)

Price: International indexes (London Fixing)

2010:
Average annual gold price = $1,225.52/oz (London Fixing, www.kitco.com)

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The first 11 months: Production

Production, whole year (kg) (EITI report, p. 36)	5,095
Conversion oz/kg	* 35.274
= production, whole year (oz)	179,721

We estimate the production for the first 11 months in a very simplified manner.

Production, whole year (oz)	179,721
	*11
	/12
= production, estimated, Jan - Nov (oz)	164,744

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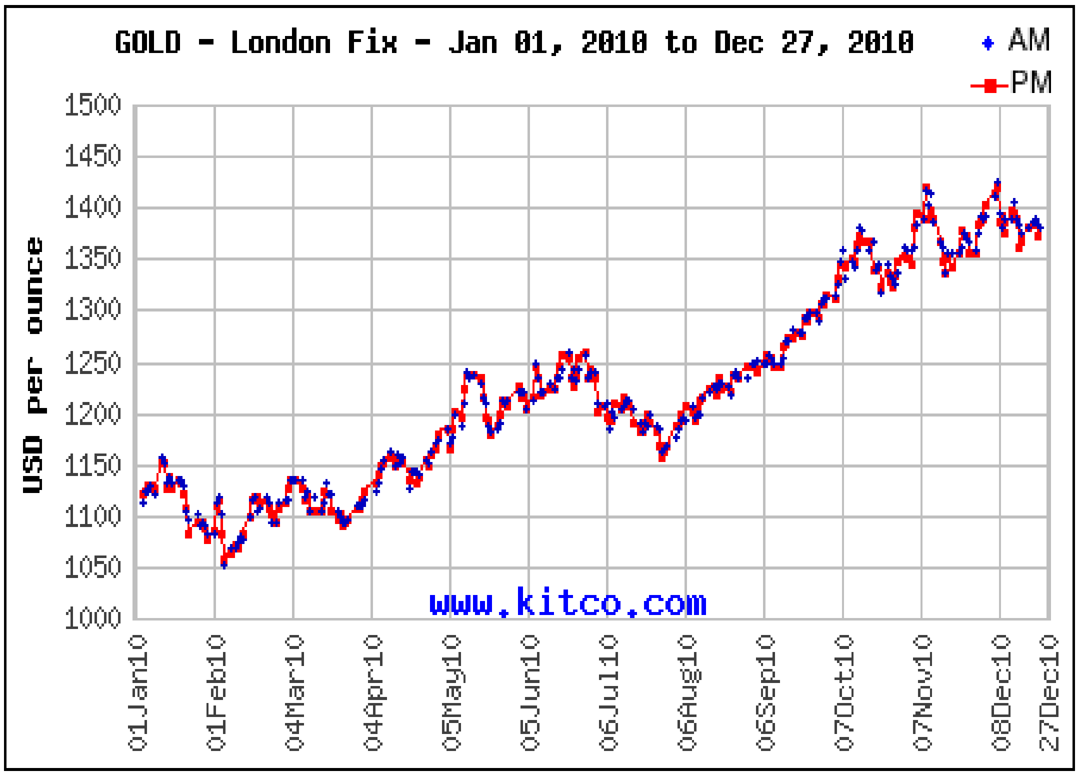
First 11 months: price



Live Gold Price | Daily Market Report | Gold IRA | Charts Stats Essays
Gold Primer Q&A | USAGOLD Blog | Mobile Gold Price | Gold Coin Catalog

2010 Gold Price History

London Afternoon (PM) Gold Price Fixings

complete gold price history

2010	Price
01/04/10	$1121.50
01/05/10	$1123.25
01/06/10	$1130.00
01/07/10	$1130.25
01/08/10	$1126.75
01/11/10	$1153.00
01/12/10	$1151.25
01/13/10	$1127.25
01/14/10	$1138.25
01/15/10	$1128.00
01/18/10	$1134.50
01/19/10	$1133.00
01/20/10	$1120.25
01/21/10	$1108.25
01/22/10	$1084.00
01/25/10	$1095.25
01/26/10	$1093.25
01/27/10	$1094.75
01/28/10	$1088.00

USAGOLD Bulletin Board

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http://www.usagold.com/reference/prices/2010.html

First 11 months: estimated royalty owed

Avg price, Jan - Nov ($/oz)	1,290.93
Estimated production, Jan - Nov (oz)	* 164,744
= Estimated gross revenue, Jan - Nov ($)	199,493,071
Royalty @ 3% of value	*0.03
= Estimated royalty owed, Jan - Nov ($)	**5,984,792**

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December: production

Production, whole year (oz) (previous slide)	179,721

We estimate December production in the same simplified manner.

Production, whole year (oz)	179,721
	/12
= estimated production, Dec (oz)	14,976

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December: royalty rate and price

12/01/10	$1385.50
12/02/10	$1389.00
12/03/10	$1403.50
12/06/10	$1415.25
12/07/10	$1420.00
12/08/10	$1385.50
12/09/10	$1391.25
12/10/10	$1375.25
12/13/10	$1399.00
12/14/10	$1394.50
12/15/10	$1388.75
12/16/10	$1363.00
12/17/10	$1368.50
12/20/10	$1380.00
12/21/10	$1383.00
12/22/10	$1387.00
12/23/10	$1373.50
12/29/10	$1412.50
12/30/10	$1405.50
MM/DD/YY	$

http://www.usagold.com/reference/prices/2010.html

Royalties for gold =

- 3% of the FOB value if gold price ≤ $1,000/oz;
- 4% of the FOB value if $1,000 < gold price ≤ $1,300/oz
- 5% of the FOB value if gold price > $1,300/oz

So what rate do we apply here?

5%

Average price: $1,390.55

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December: estimated royalty owed

Avg price, Dec ($/oz)	1,390.50
Estimated production, Dec (oz)	* 14,976
= Estimated gross revenue, Dec ($)	20,825,962
Royalty @ 5% of value	*0.05
= Estimated royalty owed, Dec ($)	**1,041,291**

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Total estimate

Estimated royalty owed, Jan - Nov ($)	5,984,792
Estimated royalty owed, Dec ($)	+ 1,041,291
= Estimated royalty owed, 2010	$7,026,090.25
In the EITI report, revenues are cited in fCFA, so we must multiply by the exchange rate: 486.18 fCFA/$ (average annual rate)	*486.18
= Estimated royalty owed, total (fCFA)	**3,415,944,599**

Exchange rate source: http://www.oanda.com/currency/average

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Compare it with the actual revenues

A. Actual revenues (ITIE)	B. Estimated revenues owed	C. Difference (A – B)
3,244,267,363	3,415,267,363	– 171,677,196

Preliminary observation:

The gap is not enormous. (5% of total)

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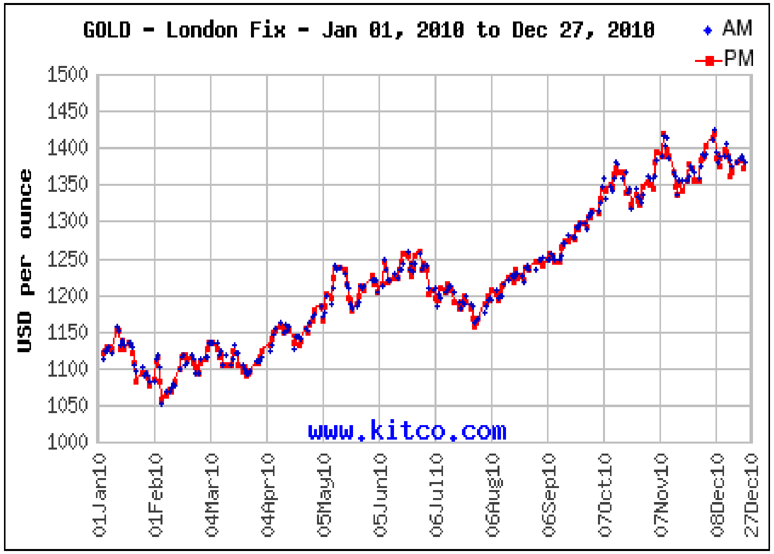
What could explain the gap?

1. We used non-precise estimates for monthly production and price, but in reality gold prices fluctuate over the course of the year.



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What could explain the gap?

2. We also used an average annual exchange rate. In reality, the exchange rate varied over the course of the year, and that could influence the $/fCFA conversion.

XOF	bid
January	451.93081
February	471.38086
March	474.35255
April	479.76970
May	509.94697
June	526.46767
July	504.68774
August	498.13032
September	494.66700
October	463.45881
November	471.01113
December	487.75403

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What could explain the gap?

3. Global gold price ≠ the sale price of Burkina Faso gold.

2009 example	
Cours de l'or SEMAFO (Rapport ITIE, p. 17)	Prix moyen global d'or (London Fixing)
$936/oz	$972/oz

This could be because of a lack of good control of transfer prices.

But not necessarily.

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What we can and can't do with the data

What can citizens do with open revenue data on extractives?

Compare extractive payments to government budget aggregates

Follow the change in extractive revenues over time

Compare different information sources on extractive payments

Compare government revenues from extractives with their total value ?

Monitor if resource contracts are being adhered/enforced

Evaluate if the country is getting a good deal

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Calculations

Production just started. Most of the payment is one-off upfront payment.

Estimate based on spot reference price. In practice mostly sold in long-term contracts.

Data source	Year	Country	Project	Sector	Government revenue, m$	Production value (estimate), m$	Government revenue/value (illustrative only)
Rio Tinto	2013	Namibia	Rössing mine	Uranium	12	176	7%
Rio Tinto	2013	Mongolia	Oyu Tolgoi	Copper, gold, silver	220	61	362%
Rio Tinto	2013	Chile	Escondida	Copper, gold, silver	380	6,727	6%
Tullow	2013	Ghana	Jubilee	Oil	300	1,245	24%
Tullow	2013	Equatorial Guinea	Multiple field	Oil	214	311	69%
Tullow	2013	Gabon	Ceiba, Okume Complex	Oil	227	494	46%
EITI	2009	Ghana	National	Mining	83	1,290	6%
EITI	2010	Ghana	National	Mining, oil, gas	212	1,763	12%
EITI	2011	Ghana	National	Mining, oil, gas	943	6,099	15%

Estimate based on reference price, but excludes shipping cost, marketing cost, quality adjustments for each commodity.

Lower revenue as still in cost recovery phase

Different fields with each varying costs and risk profiles

Different commodities yield different rents

Some more mature fields but also some new drillings undertaken

There is no meaningful interpretation of this column without additional contextual information