

WBG OIL GAS AND MINING POLICY AND OPERATIONS UNIT (COCPO)

BULGARIA: PILOT EITI PROCESS FOR GAS SECTOR AND TRANSIT REVENUES

DRAFT CONCEPT NOTE

(including possible elements of a EITI reporting template for gas sector and transit revenues)

I. Purpose of this Draft Concept Note

EITI, as a global standard for transparency of payments by companies and revenues received by governments is currently designed to cover oil, gas and mining upstream activities only, i.e. and exploration/development and production.

Bulgaria, as part of its overall policy reforms agenda for the gas sector and as part of the nation's broader framework for transparency and anti-corruption, is considering to adopt and implement a program of EITI for oil and gas transit and related revenues, and seek validation as an EITI-compliant country from the International EITI Board

Globally, since transit (and transport or other downstream activities) are not currently part of EITI policies and standards, the Bulgaria EITI could be implemented as a pilot activity but otherwise in line with EITI Criteria and Principles as outlined in this draft Concept Note. The Note presents an overview of an approach to implement the pilot EITI in Bulgaria in a way that enables Bulgaria to become an official EITI candidate and implement a pilot EITI process and become validated as an EITI-compliant country.

The purpose of this draft Concept Note is as an aide for Bulgaria (BEH and relevant agencies) to tailor an approach to EITI specific to Bulgaria's needs and sector circumstances - and to:

- **build a common understanding and political commitment** within Government of Bulgaria and among industry and civil society stakeholders on the approach to be taken to implement a pilot EITI process; and
- **Share with and obtain formal inputs from the International EITI Secretariat Oslo** for the proposed approach, given Bulgaria EITI would include transit revenues (the first country to do so) and to ensure conformity with EITI Criteria and Principles in Bulgaria's specific sector circumstances.

II. Summary Background to Bulgaria Gas Sector Structure and Transit Flows

Bulgaria is substantially energy import-dependent, and also a transit hub. Energy forms a significant part of Bulgaria's trade. Supplies from Russia (Gazprom) constitute the primary supply source and there are presently no alternative supplies because Bulgaria is connected only through its main gas transit and import routes via Ukraine (a source of past interruptions). Alternative routes (Nabuco line, Southern Stream, etc.) well as LNG imports (from Greece or Turkey) are being explored.

Bulgarian Energy Holding EAD (BEH), a wholly-state owned company, is at the apex of the energy sector activities in Bulgaria with Bulgargaz EAD and Bulgartransgaz EAD being the operating key companies in the gas sector, with operational autonomy in this holding structure.



Bulgargaz EAD is the main natural gas importer and supplier in Bulgaria, with approximately 3.7 billion cubic meters (bcm) supplied to various public suppliers and end-users (2007 data). Of this, 92% is imported from Russia with the remainder from domestic production; hence import prices play a key in domestic gas prices. The storage and national pipeline infrastructure relied on by Bulgargaz in this domestic gas activity is contracted from Bulgartransgaz EAD, as noted below.

Bulgartransgaz EAD owns and operates the Bulgarian gas transmission network for gas distribution companies in Bulgaria and for transit gas, and related underground gas storage, pursuant to EU requirements and Bulgarian law. The company's mandate includes natural gas market balancing and transmission system engineering and maintenance. Transit gas through Bulgaria goes to Turkey, Greece and Macedonia (approx. 17.2 bcm - 2007 data).

III. EITI in the institutional context of energy sector reform in Bulgaria

The new administration in Bulgaria has strongly articulated an agenda of transparency and good governance for the energy sector in general, and for gas distribution and transit revenues in particular. This agenda has been framed in the broader context issues of a national strategy for energy, diversification of energy source and supply for energy security, gas sector policy reform and gas infrastructure issues, as well overall context of accountability and anti-corruption goals in Bulgaria.

Regionally, gas sector and transit issues remain sensitive. This fact – and that EITI program around gas transit revenues would be a first - means ensuring a carefully-managed EITI process which focuses on transparency and consensus, and avoiding any perception of politicization or unrealistic goals. In particular, consensus around the EITI reporting template and modalities for and scope/depth of EITI will be important.

IV. Potential benefits of a pilot EITI for gas sector and transit revenues

At the global level, EITI is a now well-established mechanism for enhancing transparency and accountability by putting information on revenues and payments into the public domain. It is helping to improve risk perceptions and thus investments in many countries, ultimately for resources to be well-managed and revenues used to benefit the people. The EITI standard has tangibly helped EITI countries to signal their commitment to the market and their citizen about transparency and reform, and to good governance and anti-corruption efforts.

With Bulgaria being a key actor in the energy transit corridor in the sub-region and gas transit being a key source of income for Bulgarian gas sector, for Bulgaria EITI offers a way to both launch a path-breaking transparency process (first of its kind) tailored to Bulgaria's circumstances. As a participative process including civil society engagement, EITI can help in overall trust-building. EITI can be seen as a step towards broader reforms designed to gas sector remains well-managed, institutionally protected from corruption and opacity, with ultimate benefits of EITI as a solid platform for broader reforms in governance in Bulgaria, helping build a good investment climate for energy, and thus energy security.

V. Key implementation issues for a pilot EITI process for Bulgaria

Meeting EITI Criteria and Principles – but in a tailored way for transit revenues

The current EITI standards and Criteria/Principles may not fully apply to the current structure Bulgaria's oil and gas sector, since (Bulgaria is not a major energy producer. For this reason EITI would need to be tailored, while also ensuring all other aspects of EITI Criteria are followed.

Building on existing BEH audited financial statements and gas sector disclosures:

As an illustration, one option for the scope of a pilot EITI in Bulgaria could be to cover the following areas in the EITI Reports:

Revenues and payments:

- audited revenues earned by Bulgargaz from domestic gas sector supply (optionally, broken down by major customer group);
- audited payments made by Bulgargaz to the sole supplier, Gazprom, for gas imports for the domestic gas market;
- audited payments by Bulgargaz (or domestic production accrued) for the domestic gas market - in this case, matched and reconciled as part of EITI process;
- audited external gas transit fees revenues earned by Bulgartransgaz (optionally broken down by payer, though currently all transit fees are paid by the sole transit gas supplier);
- corporate taxes, license fees and all other gas-related payments – and dividends - paid to Government by BEH group and any non-BEH companies – also in this case matched and reconciled as part of EITI process; and
- Optionally, major inter-company transactions within the BEH group, covering both gas operations and financial transactions (like management fees and inter-company dividends).

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Gas volumes:

- Reconciliation of gas import (and domestic production); domestic use; transmission wastage and addition to / withdrawal from gas storage amounts.
- Reconciliation of gas transit flows to external destinations (currently Turkey, Greece and Macedonia) and changes in related gas storage amounts, if any.

Other potential disclosures:

Beyond this, at the outset or over time, Bulgaria could consider an expanded scope of EITI reporting for contractual topics beyond gas revenues and transit issues, such as disclosures on cost and tariff structure for gas imports, domestic-use and transit gas; treatment of gas storage costs and operating costs and/or of capital and pipeline maintenance costs (if paid by entities outside of BEH, if any); specifics of long-term buyer or transit contracts or transit treaty details (or their key terms); and electricity exports if significant to understanding the overall gas sector.

The goals of a high standard of EITI would be to achieve a degree of transparency where all companies disclose what each is paying to whom whether in cash or in kind, and for revenues recipients, who is receiving what payments – and whether this is on an arms-length basis. Further, as applicable, this data could be matched to national budget numbers for assurance on completeness. This standard could require disclosure of the key contractual relations between key actors in the gas import, sales and transit operations.

Buy-in from other Government agencies

Although all gas transit transactions, and their accounting and reporting, are centralized within BEH and MOEE, EITI will need to obtain their cooperation and support of other Government agencies involved (for example, Ministry of Finance for corporate taxes paid).

Active civil society (and oil industry) participation

EITI is a participative process, comprising government, companies and civil society, the latter being an integral part of the multi-stakeholder body which is created in each country to manage EITI process. Bulgaria will need to do the same to include both Government and gas industry representatives but also appropriate members of civil society and other organized groups, chosen as transparently as openly as possible.

VI. Step-by-step outline of a pilot EITI approach for Bulgaria

Step 1: Sign-up - achieving EITI candidate status (work plan and possible launch event)

When the political commitment to EITI is made, this will need a public announcement of Bulgaria's adoption of EITI principles for transit revenues (including commitment to work with all stakeholders in the process). If possible the appointment of the EITI Coordinator should also be announced. The (remaining) step to fulfill all the "sign-up" steps in the EITI process is to complete a draft costed work

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plan for Bulgaria pilot EITI and to get stakeholder input into that work plan – in order to apply for candidate status from the International EITI Board.

The proposed approach to the EITI pilot; the EITI work plan and the modalities (and membership) of the multi-stakeholder body which will manage EITI in Bulgaria is best debated and endorsed with wide stakeholder inputs at some kind of public “launch event”. This event can publicize and debate the draft work plan; obtain inputs from stakeholders including on the draft membership and terms of reference (Charter) of the multi-stakeholder body.

Step 2a: Preparation (in parallel) - establish EITI Secretariat and needed administrative decrees

In parallel, BEH/Ministry will need to establish a small team (EITI Secretariat) to execute the national EITI work plan and ensure that EITI is implemented, under the oversight of the Bulgaria multi-stakeholder body. Also during this stage, all the needed decrees (and laws if needed) to formalize the EITI process and give authority to the EITI Secretariat will be needed. This step will also ensure that there is no contradiction between pilot EITI proposals and Work Plan and applicable laws and contractual obligations (e.g. on release and disclosure of gas transit revenue and flow information)

Step 2b: Preparation – formalizing Bulgaria multi-stakeholder body

Once Bulgaria achieves EITI candidate status, among the first tasks is to fully establish (membership, terms of reference and authority) the Bulgaria multi-stakeholder body including government, civil society and companies. It will be important to ensure broad and representative participation from companies and civil society (such as NGOs, anti-corruption agency members, professional bodies, academic bodies etc.). Among the first steps this Bulgaria multi-stakeholder body will need to do take (helped by Bulgaria EITI Secretariat) will be to (i) finalize the EITI Work Plan and (ii) finalize the scope and depth of the proposed EITI Report for gas/transit revenues, and the period to be covered and (iii) select the reconciliation/audit firm to prepare the EITI Report. See below.

Step 2c: Preparation – Setting scope of Bulgaria EITI Report for Gas/Transit Revenues

In setting the scope of the EITI Report and in selecting the reconciliation/audit firm, the matrix further below summarizes the considerations. As noted, beyond the initial scope of EITI agreed by Bulgaria, there is the option to consider a yet more comprehensive scope of EITI for the energy sector as whole.

Step 3: Finalizing and publishing EITI Report

The reconciliation/audit work for EITI will result in an EITI Report, aligned to EITI Criteria (as extended to transit revenues by this pilot), per the scope of EITI agreed as above.

Step 4: Communicating the EITI Report and its findings widely to the public

This will involve an extensive effort to publicize EITI Reports and findings to all parts of the country, using websites as well as media.

Matrix comparing EITI Criteria to current Gas Sector financial disclosures:

EITI Criteria	Extent met by existing Bulgaria publication of gas sector data	Next Steps - to prepare for and seek EITI candidacy
#1 - Regular publication of payments by companies and revenue by government to a wide audience	<p>Comprehensive audited financial statements (done under international audited standards by KPMG and/or TP Howarth) of BEH as a consolidated entity and of Bulgargaz and Bulgartransgaz are publicly available on the respective websites – and are referenced by various economic journals in Bulgaria and outside</p> <p>The audited financial statements, produced on the IFRS basis, provide detailed financial information (income statements, balance sheets and cash flows statements as well as supplementary information, e.g. on related party transactions)</p> <p>Additional information on the web sites contains information on volume e.g. of transit flows</p>	<p>- Government to take lead on four “sign up” steps:</p> <ul style="list-style-type: none"> i) Public announcement ii) Commit to work with CSOs and all companies / NOCs iii) Appoint EITI “champion” iv) Do EITI work plan (#6 below) <p>- One approach to EITI could be to include (i) gas transit revenues (with specific payer details) and related taxes etc. and (ii) sales and imports for domestic use gas (volume and value) and (iii) reconciliation of gas volumes</p> <p>- Beyond that potentially, the EITI could also cover other disclosures and reconciliation of gas sector proceeds to the national budget etc. for a more comprehensive EITI coverage.</p>
#2. – Payments and revenues be subject to credible audits	<p>As noted, BEH audited data is audited to international audit standards.</p> <p>Information on audit status government data (e.g. taxes paid) not obtained in this exercise</p>	<p>- EITI will build on <u>existing</u> audited information in BEH/companies and in Govt.</p> <p>- If none, other ways to be found to achieve audit assurance of government EITI data</p>
#3 - Payments and revenues reconciled by an independent Administrator	N/A	After candidacy, scope of EITI to be agreed – and TORs prepared for vendor bid for reconciliation/audit firm
#4 –Include all companies in EITI including NOCs	N/A	As #1 above – BEH and smaller companies to take part in EITI
#5 – Civil Society is actively engaged	N/A	CSO participation to be publicly accepted and included as part of Bulgaria EITI multi-stakeholder body (with companies)
#6 - A costed EITI work plan and timetable to be done with public/ stakeholder inputs – and publicized	N/A	Costed Bulgaria EITI Work Plan to be devised as part of EITI candidacy process (EITI sign-up step #4)

Step 5. Launching validation process to attain EITI-compliant status

The EITI process is completed only when a country undergoes an external validation of the process for the Bulgaria pilot EITI, which if successfully completed, would result in Bulgaria being declared as EITI-compliant by the International EITI Board.

V. Timetable and implementation costs

There is currently a 2-year time limit to accomplish validation after becoming a candidate country. Experience shows that for Bulgaria, this could mean setting up and pilot EITI process and issuing the first EITI Report by end-2010, and undertaking validation by mid 2011. The indicative implementation costs are shown below (as an illustration only):

<i>Secretariat staff and Facilities - BEH / Ministry of Economy, Energy and Tourism</i>	0.5
Consultants, technical expertise, events	0.15 – 0.20
Training and engagement with CSOs	0.10 – 0.20
Bulgaria EITI Secretariat / multi-stakeholder body events	0.10 – 0.20
Reconcile and issue EITI Report (in 2010)	0.25 – 0.30
Communication and outreach of EITI Reports	0.10 - 0.20
Validation (in 2011)	0.10 – 0.10
TOTAL (US\$ million equivalent, for two years)	0.80 – 1.20

EITI implementation in many countries is supported by World Bank (in terms of advisory work) and by various bilateral development partners (in terms of transitional funding support). Although Bulgaria will need to commit the staff and financial resources needed to implement EITI and undergo validation, development partner resources may be available to Bulgaria.

Annex:

Sample format of EITI reporting templates including for gas transit revenues

Sample format of EITI reporting template including for gas transit revenue

(Bulgaria sample/ indicative reporting template as modified for gas transit revenues - original extracted from EITI Source Book 2005 Annex pages 49-53 -- see website: www.eiti.org)

A Input template for Host Government Reporting Entity

(To be completed by Ministry of Economy and Energy or Ministry of Finance as applicable for Bulgaria, based as far as possible on financial data audited by the State Auditor-General or similar State body)

Host Country reporting on: _____

Reporting Period: _____

Scope 1 Benefit Streams

Line ref		Guidelines section 6 ref	Volume	Value
1	Benefit Stream from International Companies only			
1a)	Host Government Production Entitlement from International Companies i) Production Stream - in kind	i		
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) Production Stream - in cash			
2	Benefit Stream from National State-Owned Companies			
2a)	Host Government Production Entitlement from National State-Owned Company i) Production Stream - in kind	i		
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) Production Stream - in cash			
3	Benefit Streams from International and National State-Owned Company			
3a)	Profit taxes	iii		
3b)	Royalties	iv		
	- in cash			
	- in kind			
3c)	Dividends	v		
3d)	Signing bonuses and production bonuses	vi		
3e)	License fees, rental fee, entry fees and other considerations for licenses/concessions	vii		

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3f)	Other payments to Host Governments, specified as:	viii		

Scope 2 Benefit Streams

Line ref		Volume	Value
4	Scope 2 Benefit Streams (voluntary disclosure):		

Government Agency sign off

We acknowledge our responsibility for the fair presentation of the Reporting Template in accordance with the Reporting Guidelines, with the exception of:

- _____;
- _____;
- _____;
- _____.

(Also – to add confirmation / sign-off if needed by State Auditor or equivalent attesting to the fact that the reported data is in line with audited financial statements or extracted from audited financial records of Govt.)

B. Input template for Company Reporting Entities (Oil & Gas)

To be completed by BEH Group – or other gas sector operators/companies as applicable to Bulgaria – based on respective audited financial statements and records)

Name of Company: _____

Host Country reporting on: _____

Reporting Period: _____

Scope 1 Benefit Streams				
Line ref		Guidelines section 6 ref	Volume	Value
1	Benefit Stream to be reported by International Companies only			
1a)	Host Government Production Entitlement to Host Government i) Production Stream - in kind	i		
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) Production Stream - in cash			
1b)	Host Government Production Entitlement to National State-Owned Company i) Production Stream - in kind			
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) Production Stream - in cash			
2	Benefit Stream to be reported by National State-Owned Companies only			
2a)	i) National State-Owned Companies equity share of Host Government production entitlement - in kind	i		
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) National State-Owned Companies equity share of Host Government production entitlement - in cash	i		
2b)	Production received by National State-Owned Company i) Production Stream - in kind	i		

Scope 1 Benefit Streams (continued)				
Line Ref		Guidelines section 6 ref	Volumes	Values
2c)	National State-Owned Company production entitlement			
	i) Production entitlement - in kind	ii		
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) Production entitlements - in cash	ii		
2d)	Production entitlement received on behalf of the host Government	i		
	i) Production stream - in kind			
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) Production entitlement received on behalf of the Host Government - in cash			
3	Payments to Host Government/National State-Owned Company			
3a)	Profit taxes	iii		
3b)	Royalties	iv		
	- in cash			
	- in kind			
3c)	Dividends	v		
3d)	Signing bonuses and production bonuses	vi		
3e)	License fees, rental fee, entry fees and other considerations for licenses/concessions	vii		
3f)	Other payments to Host Governments (specified as:	viii		

Scope 2 Benefit Streams			
Line ref		Volume	Value
4	Scope 2 Benefit Streams (voluntary disclosure <i>e.g. social payments</i>):		

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Scope 3 – Gas Transit Benefit Streams			
Line ref		Volume	Value
5	Scope 3 – Gas Transit / Transfer Benefit Streams:		
	Transit tariffs and all related fees (transit gas) Paid by: "show the name of payer" _____		
	Gas transfer (use of network within B Bulgaria) Paid by: "show the name of payer" _____		

Scope 4 – Domestic Gas Imports and Sales			
Line ref		Volume	Value
6	Scope 4 – Domestic Gas Operations		
	Total Gas Sales within Bulgaria <i>Optional</i> - Paid by: "show the name of major gas users / buyers" _____		
	Total Gas Imports – for sales within Bulgaria <i>Optional</i> - Paid to: "show the names of major suppliers" _____		
	Change in Gas Stored (movements in /out of stored gas for use within Bulgaria) _____		

Company Management sign off:

We acknowledge [or On behalf of the Board of Directors (or similar body) we acknowledge] our responsibility for the fair presentation of the Reporting Template in accordance with the Reporting Guidelines, with the exception of:

- _____;
- _____;
- _____;

(Also – to add confirmation / sign-off by the Company’s auditors attesting to the fact that the reported data is in line with audited financial statements or extracted from company’s audited financial records)