



Extractive Industries Transparency Initiative

Founded on the belief that promoting revenue transparency in resource-rich countries is one of the fundamental building blocks for sustainable economic growth and poverty alleviation, the Extractive Industries Transparency Initiative (EITI) [1] was launched in Johannesburg at the World Summit on Sustainable Development in 2002. EITI aims to improve governance in oil, gas, and minerals-rich countries through the publication, verification, and reconciliation of payments made by extractive industry companies and revenues received by governments. This note describes the steps involved in implementing EITI.

“Companies that make legitimate, but undisclosed, payments to governments may be accused of contributing to the conditions under which corruption can thrive. This is a significant business risk,” said 72 institutional investors representing US\$12 trillion at the Third Plenary EITI Conference in October 2006 [2]. Petroleum Sector Briefing Notes No. 2 and 3 discussed the ways by which windfalls from extractive industries (oil, gas, and mining) can worsen corruption and slow down economic development [3, 4]. In developing countries, it is not unusual for revenues not to be reported, and national oil companies not to be audited. This lack of transparency can lead to discretionary exercise of power, corruption, and mismanagement. Peter Robertson, Vice Chairman of Chevron, echoed the sentiments of the 72 institutional investors when he said “governments, industry, civil society organizations [CSOs] and investors all recognized the benefits of transparency” at the same conference [5].

EITI is intended for countries where revenues from extractive industries constitute a large share of the total government revenue, total exports, or gross domestic product. To date, 27 countries have committed to EITI. While EITI implementation is led by the government, a very important feature of EITI is active participation of a wide range of stakeholders, including civil society. Among EITI supporters are 29 oil, gas, and mining companies; three industry associations; five international organizations including the World Bank; nine donor governments and G8; seven international non-governmental organizations (NGOs); and numerous global investment institutions.

What Is Required for Implementation

The EITI criteria, agreed in March 2005, set out what countries need to do to implement EITI successfully.

- ◆ Publish, on a regular basis, all “material” oil, gas, and mining payments by companies to governments—a payment is material if its omission can distort the total payments—and all material revenues received by governments from the same companies, to a wide audience in an understandable, comprehensive, and publicly accessible manner. For the published figures to be meaningful, all companies, including national oil companies, should participate.
- ◆ Conduct a credible, independent audit of payments and revenues if they are not already audited to international auditing standards.
- ◆ Reconcile payments and revenues through a credible, independent administrator (referred to as the administrator hereafter), and publish the administrator’s opinion regarding the reconciliation and discrepancies, should any be found.
- ◆ Engage civil society in the design, monitoring, and evaluation of this process and in the public debate.
- ◆ Develop a public, financially sustainable work plan including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.

Benefits of EITI

EITI offers benefits to all stakeholders—government, companies, and civil society.

- ◆ Governments that are seen to be working to enhance revenue transparency may see improving credit-worthiness and investment climate and associated economy-wide benefits. Providing better information on payments and revenues to the public also helps manage expectations. First, in the absence of information, civil society may assume the worst, suspecting that some revenues have gone “missing.” Second, the start of oil production brings with it an often false perception of instant wealth for all, when in practice it takes several years before substantial revenues are received. Information on revenues, if communicated properly, will ensure that the public understands what is and is not going to be received and when.

EITI has a strong international brand—it is recognized worldwide as a symbol of commitment to governance—and that international recognition alone benefits governments and companies alike.

- ◆ For companies, transparency on payments made reduces reputational risks by helping to avoid the perception that they are complicit in mismanagement or theft of resource revenues; that they are not giving enough back to the people; or that they have “something to hide.” Transparency improves relationships with local communities where they operate and with institutional investors, and helps lower the cost of doing business. Transparency covering all companies operating in the country also helps create a level playing field. If only some companies disclose payments but not others, there could be a concern that those that do not disclose could somehow gain a commercial advantage.
- ◆ For civil society, information on payments and revenues helps hold the government and companies accountable. If amounts received are lower than payments made, the public can ask where the difference went. If the total amount received is not fully reflected in the budget through combined spending and saving, the public can again ask what happened to the difference. A better understanding of resource wealth will help the public become involved in realistic decision-making on how the revenues should be managed.

Identifying Stakeholders

The three key stakeholder groups are government, companies, and civil society. Civil society is broadly defined and could include community-based associations, NGOs, the media, trade unions, academic and research institutions, and faith-based organizations. Early identification and engagement of stakeholders is essential for effective implementation of EITI. Several countries have chosen to have representative stakeholders sign a memorandum of understanding for EITI.

There may be numerous interested parties in civil society, but it might not be practical to involve all of them directly. In many countries, CSOs have formed a coalition and developed regulations to govern themselves. Forging these coalitions helps achieve a consensus position and strengthen the role of CSOs in EITI. The selected stakeholders come together to form an EITI multi-stakeholder committee. A dedicated secretariat for EITI is typically needed to provide technical support and coordination.

What Is Reported

All material payments and revenues (referred to as benefit streams hereafter) in connection with exploration, development, and production of oil, gas, and minerals from all companies—international petroleum and mining companies, national oil companies, and domestic private companies—to all levels of government are reported. Most EITI programs exclude indirect benefits (value-added tax, social contributions such as setting up and operating a health clinic by companies) and intra-government transfers, although some governments are now beginning to include such payments and transfers as part of their EITI programs.

Benefit streams required to be reported include the following.

- ◆ Income tax, which is usually a percentage of net profits. Because companies are recovering costs in the first few years of production, sizable profits are not made until several years after the start of production.
- ◆ Royalty, which is a percentage of the gross revenue. Because royalties are collected on gross revenues and are not dependent on whether or not the company is making a profit, royalty revenues start flowing to the government from the start of production.

- ◆ Government's share of production, which occurs in a contractual system called production sharing. Production sharing is unique to the petroleum industry and has been the contractual system employed in Cambodia to date. Oil (or gas) production is split into so-called cost oil and profit oil (or gas). Cost oil is sold by the company to recover costs. Profit oil is shared between the company and the government, and hence the term "production sharing." As with income tax, profit oil is small while the company is recovering costs.
- ◆ Bonuses, which are one-off payments. One example is signature bonus, which is paid upon signing a contract. In some licensing rounds, all contractual terms are set except for the signature bonus, and the company that bids the highest signature bonus wins the contract. The size of the signature bonus is a function of the prospectivity of the block being tendered—if companies believe that there is a lot of oil or gas that can be produced profitably, they will be willing to pay large signature bonuses.
- ◆ Surface rental (rental fee for the contract area) and other fees, which are typically small.
- ◆ Dividends of national oil companies if they exist.
- ◆ Customs duties, fines, penalties, and other contributions in cash.

The multi-stakeholder committee develops reporting templates for private-sector companies, national oil companies, and the government. The reports are submitted to the administrator on a confidential basis. The administrator acts as an independent and neutral third party who is trusted by all stakeholders for impartiality and confidentiality. The multi-stakeholder committee agrees on the terms of reference for, and appoints, the administrator.

Dealing with Discrepancies

If discrepancies are found, the administrator investigates the submitted data to identify the sources of the discrepancies. If some data have not been audited to international standards, which is often the case with small companies and national oil companies in developing countries, the administrator either provides the audits or identifies the information required for the reconciliation process. There is a trade-off between the amount of detail gathered on payments and revenues

on the one hand and the amount of time, efforts, and resources spent on generating that level of detail on the other. The multi-stakeholder committee needs to decide both what would constitute a material payment (and revenue), and the margin of error the committee would be willing to accept for discrepancies, bearing in mind that the objective of EITI is not to account for every last cent, but rather to capture important revenues and payments accurately.

Some legitimate discrepancies do occur. For example, if oil prices and exchange rates on different dates are used by companies and the government, the payments and revenues may not match. The job of the administrator is to explain each discrepancy wherever possible. Addressing Concerns about Confidentiality

Addressing Concerns about Confidentiality

There is a need to balance transparency in public finance management including transactions in oil, gas, and mining, and companies' legitimate interests in protecting proprietary information. Current best practice distinguishes between *technical data*, which are typically property of the government and remain confidential; *contractual terms*, which are increasingly disclosed; and *financial data*, for which arrangements should be made for disclosure for the purpose of implementing EITI; companies often disclose the necessary financial data voluntarily. In general, gains to business confidence and investment from a policy of transparency greatly outweigh commercial disadvantages to the government's negotiating position through disclosure.

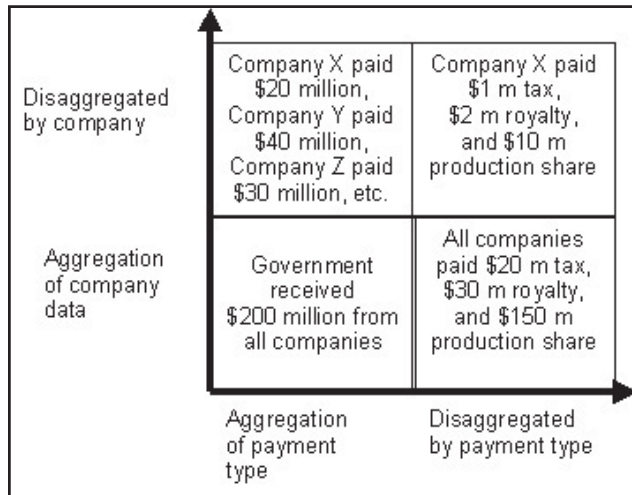
Publishing an EITI Report

The multi-stakeholder committee needs to decide the level of detail in the EITI report that will be published and widely disseminated. The reporting format should be agreed to by all stakeholders. Broadly, there are four levels of detail, as illustrated in Figure 1.

The collected data may be summed or disclosed separately for each benefit stream: income tax, royalties, and so on. Benefit streams, summed or disaggregated, may also be reported by company. The most disaggregated form of reporting is the upper right-hand quadrant in Figure 1, whereby benefit streams are disaggregated by company and by payment type. Nigeria and Ghana have chosen this approach. The most aggre-

gated is the lower left-hand quadrant, whereby one number will be disclosed for payments made and another for revenues received. No EITI-implementing country has chosen to aggregate all the data into a single number.

Figure 1: Level of Detail in EITI Report



Communicating and Reviewing

The results need to be communicated in a way that makes it easy for people to understand the process behind the numbers and what they mean. Because large sums such as billions of dollars are difficult to relate to, it would be helpful to cast them in concrete terms: the number of schools the oil revenue can build or the number of additional households that can be connected to electricity. The results should be communicated in local languages throughout the country and in various media, such as newspapers, radio, television, pamphlets, workshops, and round-table discussions.

EITI rarely works perfectly from the outset. The only way to find out what kinds of problems may be encountered is to run a first round of reporting. It is important that the administrator provide a report on lessons learned, and that a full review of the process take place after the first round that involves all stakeholders.

The value of EITI would be greatly diminished if it is a one-off process. For EITI to bring tangible benefits, it should become an integral part of public financial management. That would require sustainable funding. Regular publication of benefit streams sustains public confidence and helps establish a baseline. Comparison of data from one year to the next makes it easier to detect anomalies, and such comparison is possible only if reasonably accurate data are available over a number of years.

EITI in Context

EITI takes transparency in revenue accounting as a manageable first step toward governance in oil, gas, and mining. However, as mentioned at the beginning of this note, EITI is only one of many building blocks. EITI criteria do not specifically cover the following:

- ✓ Asking if granting of production rights (licensing) was conducted in a transparent manner, and whether the terms and conditions negotiated were “fair”
- ✓ Investigating what the companies should have paid in addition to what the companies paid
- ✓ Verifying the volumes of oil and gas sold against what the companies said they sold
- ✓ Covering proceeds from refining and sales of refined products
- ✓ Investigating what happens to the revenues once they are received by the government. After properly accounting for receipts, the revenues can still be squandered.

What this suggests is that strict adherence to EITI criteria is indeed a first step and will benefit the participating countries, but only if undertaken in a broader context of reform, transparency throughout the extractive industries, and sound public finance management. Indeed, several countries have built upon EITI criteria and are addressing one or more of the above issues in their EITI programs.

References

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