



BRIEFING NOTE

THE ROLE OF SUPREME AUDIT INSTITUTIONS IN THE GOOD GOVERNANCE OF THE EXTRACTIVE INDUSTRY

2019







Quality Assurance Certificate

Chair of the Goal 3: Knowledge Sharing and Knowledge Services Committee

Based on the assurance provided by the Chair of the *Working group on Audit of Extractive Industries (WGEI)* and the assessment by the Goal Chair, it is certified that the document "*Briefing note: The Role of Supreme Audit Institutions in the Good Governance of the Extractive Industry*", which is placed at level **3 (three)** of Quality Assurance as defined in the paper on "Quality Assurance on Public goods developed outside Due Process" approved by the INTOSAI Governing Board in November 2017, has been developed by following the Quality Assurance process as detailed in the Quality Assurance Certificate given by the Working Group Chair.

The product is valid till **31 December 2022** and, if not reviewed and updated by **31 December 2022**, it will cease to be a public good of INTOSAI developed outside the Due Process.

A handwritten signature in blue ink, appearing to read 'Rajiv Mehrishi'.

Rajiv Mehrishi
Chair of INTOSAI Knowledge Sharing and
Knowledge Services Committee



**Quality Assurance Certificate
Chair of the Working Group
Audit of extractive Industries (WGEI)**

This is to certify that "***Briefing note: The Role of Supreme Audit Institutions in the Good Governance of the Extractive Industry***" which is placed at level **3 (three)** of Quality Assurance as defined in the paper on "Quality Assurance on Public goods developed outside Due Process" approved by the INTOSAI Governing Board in November 2017 has been developed by following the Quality Assurance processes as detailed below.

In developing the document, the Briefing note has been circulated to the following groups for feedback and comments:

- i. Subject matter experts from SAI Norway*
- ii. Subject matter experts from Extractive Industries Transparency Initiative (EITI)*
- iii. The ten member WGEI Steering Committee*
- iv. The document was circulated to all WGEI members for additional comments prior to all WGEI members meeting in Manila, Philippines from 27th to 29th May 2019, to enable them provide comments during the Manila meeting.*
- v. This document was endorsed by WGEI members under activity 6 of the WGEI work plan on presentation by SAI Norway, seconded by SAI India following proposal by SAI Nigeria during the meeting.*

The product developed is consistent with relevant INTOSAI Principles and Standards.

The product is valid till **31 December 2022** and if it is not reviewed and updated by **December 2022**, it will cease to be a public good of INTOSAI developed outside the Due Process.

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CHAIR OF THE WORKING GROUP ON AUDIT OF EXTRACTIVE INDUSTRIES



The Role of Supreme Audit Institutions in the Good Governance of the Extractive Industry



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This briefing note aims to provide external stakeholders and the public a quick overview of the role of Supreme Audit Institutions (SAIs) and how SAIs can contribute to good governance in the extractive industries sector.

The Role of Supreme Audit Institutions in the Good Governance of the Extractive Industry (EI)

The role of SAIs is to oversee:

- ... the management of public finances
- ... that public entities comply with rules and regulations
- ... the performance of government programs and policies

SAIs play an important role in the EI sector in order to ensure the following:



Transparency
Accountability
Sustainable Development

I. Introduction to Supreme Audit Institutions (SAIs)

A. What are SAIs?

Supreme Audit Institutions (SAIs) are the highest Audit Institution of a country. SAIs are known mainly for their role in overseeing the management of public finances, i.e. government revenue and expenditure. Many SAIs also audit public entities' compliance with rules and regulations, and the performance of government programs and policies. By scrutinizing public financial management and performance, SAIs provide assurance that public resources are used prudently and efficiently for the benefit of the citizens.

In most countries the SAI¹ will report audit findings to the parliament of that particular country. The parliament will then follow up on the findings by making recommendations and if needed carry out hearings with the responsible accounting officers. Usually, this parliamentary follow-up is performed by a Public Accounts Committee (PAC). Parliaments represent the citizens, and the SAI is an instrument to assist parliament with oversight over government's management. Through this mechanism, SAIs help ensure governments' accountability to their citizens.

A key factor for effective audit of government institutions is the level of independence the audit institution has from the government hierarchies that it is supposed to audit. Independence refers to financial autonomy, the ability to make administrative decisions without interference and the freedom to determine the scope of audit. An independent and professional SAI is therefore an important actor in a country's accountability chain, as it promotes public sector transparency and accountability.

The International Organization of Supreme Audit Institutions (INTOSAI) operates as an umbrella organization for the international SAI community. For more than 50 years, it has provided an institutionalized framework for SAIs to promote development and transfer of knowledge, improve government auditing worldwide and enhance professional capacities, standing and influence of member SAIs in their respective countries.

In the INTOSAI community, the **Working Group on the Audit of Extractive Industries (WGEI)** was established in 2013 to facilitate knowledge sharing and networking for SAIs related to audit of the EI sector in order to promote good governance and sustainable development in the extractive industries. The scope of the working group includes oil, gas and solid minerals. WGEI currently composes of 45 members and is chaired by SAI Uganda from 2014 to 2022.

B. What are the benefits of SAIs?

SAIs deliver value and benefits to their respective countries by:

- (i) Strengthening the accountability, transparency and integrity of government and public sector entities
- (ii) Demonstrating ongoing relevance to citizens, Parliament and other stakeholders and
- (iii) Being a model organization through leading by example

¹ There are three established institutional models of SAIs: Westminster, Judicial and Board. For further reading, see *Features and Functions of Supreme Audit Institutions (2001, October)*. PREM notes Public sector. The World Bank.

These three objectives can be met by following the accompanying 12 principles, illustrated through the figure below (ISSAI 12):



C. Three main types of audit

In 2010 INTOSAI has endorsed a set of auditing standards: The International Standards for Supreme Audit Institutions (ISSAIs). The ISSAIs cover four different levels. Levels 1 and 2 contain guidance and requirements on independence, code of ethics, value and benefits of SAIs and quality control system. Level 3 and 4 describe the fundamental principles on how to plan, implement and report the conducted audits. In conformity with the auditing standards above, there are three main types of audit: financial, compliance and performance auditing:

Financial audit

This is an audit of financial statements with the purpose of enhancing the degree of confidence of intended users of the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

Compliance audit

The objective of compliance auditing is to enable the SAI to address whether the activities of public sector entities are in accordance with applicable authorities (laws, regulations and rules) governing those entities.

Performance audit

A performance audit, sometimes referred to as “value for money”-audit, focuses on whether government undertakings, systems, operations, programs, activities or organizations are performing in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvements.

II. The Role of SAIs in the Extractive Industries Sector

A. What is the extractive industries (EI) sector?

Extractive industries usually refer to the oil, gas and mining industries. Extractive processes include oil and gas extraction, mining, dredging and quarrying, and it can be both on land and under water. The illustration below shows a simplified overview of the key players and stakeholders in the EI-sector.

Figure 2: Overview of the key players and stakeholders in the extractive industries sector



Key stakeholders	Examples
SAI community	SAIs, INTOSAI and its regional bodies, WGEI, INTOSAI Development Initiative (IDI)
Government authorities	Ministries responsible in the EI, revenue authorities
Oil, gas and mining companies	Total, Exxon Mobil, BP
EI organizations	International Petroleum Industry Environmental Conservation Association (IPIECA), International Council on Mining and Metals (ICMM)
Multilaterals	World Bank, International Monetary Fund (IMF), United Nations (UN)
NGOs	Extractive Industries Transparency Initiative (EITI), Publish What You Pay (PWYP), Natural Resource Governance Institute (NRGI)

B. Why are SAIs important for the extractive industry?

Research over the last decades have shown that several resource-rich countries do poorly on both development and governance indices. Essentially, empirical studies found that some resource-rich countries had lower economic growth and less democracy compared to countries without an abundance of natural resources. This phenomenon is known as the *resource curse* or *paradox of the plenty*. There are many reasons for this, but it is clear that the challenges are related to transparency and accountability in the government. As the role of SAIs is to increase the accountability and transparency of government management of public resources, the importance of SAIs in ensuring good governance of a country's resources becomes more evident.

In the extractive industries sector, a strong and effective SAI may contribute to better and more transparent oversight of the industry, improve governance and help to ensure that natural resources are managed in the best interest of the public. SAIs' mandate and contribution span the entire EI value chain, from the development of strong legal frameworks, to fair and transparent revenue collection and distribution, and the monitoring of environmental impact and sustainable policies. The role of SAIs in the extractive industries may vary between countries, depending on the mandate and the knowledge of the SAI itself, the maturity of the sector and the regulatory framework in place.

Furthermore, there is a close link between extractive industries and the UN Sustainable Development Goals (SDGs). The 17 SDGs mainly focus on three dimensions, namely economic growth, social inclusions and environmental protection, which are related to extractive industries. SAIs play an important role in the implementation of the SDGs and in ensuring that the EI sector contribute in achieving these goals.

C. The EI value chain and areas of audit

The EI value chain illustrates seven different steps² involved when transforming natural resources into revenue and ultimately economic growth and value for the citizens of a country. The value chain is frequently used to illustrate the government implication in each of the steps. Each step represents a critical and distinct area necessary for the generation of value (in revenue, employment, capacity building etc.) for the population of a country. The table below describes each step in the value chain, potential audit topics along the same lines as well and examples of relevant audit reports conducted by various SAIs.

The EI value chain	Description	Examples of areas for audit	Examples of Audit reports
1. Legal and regulatory framework	A basis for sound management of the extractive industry sector is to have up-to-date laws and regulations, policies and institutions with clear segregation of duties.	The SAIs may audit whether laws are supported by relevant regulations and instructions, and point to overlap or blurred lines of responsibilities between institutions	<u>Environment audit report on regulation and monitoring of drilling waste management in the Albertine region by National Environment Management Authority (NEMA) (Uganda 2014)</u>

² The 7-step EI value chain referred to here was developed in 2013 by the group of English-speaking African SAIs (AFROSAI-E), based on the World Bank classification.

<p>2. Exploration and data management</p>	<p>In order for the extractive industry to develop the government needs to map its reserves. Data on oil and gas resources are mainly gathered through seismic surveys and drilling, and data on mineral resources are gathered from geological samples.</p>	<p>The SAIs may audit whether relevant data are properly managed and secured, and that government has control and ownership of the data generated.</p>	<p><u>Performance Audit on Hydrocarbon Exploration Efforts of Oil and Natural Gas Corporation Limited (Ministry of Petroleum and Natural Gas) (India 2012)</u></p>
<p>3. Award of contracts and licenses</p>	<p>Contracts and/or licenses are granted by government to companies to explore, develop and produce extractive industries resources. This process should ideally follow the rules of a competitive procurement process to ensure that the most competent and cost-effective companies are chosen.</p>	<p>The SAI may audit whether the process of handing out contracts and licenses was transparent and designed to attract companies that are competent and do conform to government policies. SAIs may also audit whether the process is in line with laws and regulations.</p>	<p><u>The Office of the Auditor General's investigation into administrative practice in connection with the awarding of production licences in the petroleum sector (Norway 2010)</u></p>
<p>4. Monitoring of operations</p>	<p>The government shall monitor the activities of extractive industry companies on a number of areas. Production figures, both quality and quantity, should be verified by independent controllers. Risks related to health, safety and environment needs to be addressed and followed up through inspections and review of safety routines, impact assessments etc.</p>	<p>The SAI may audit whether the government complies with its roles as a regulator of the extractive industries. It may assess how government carries out inspections and gets assurance on the quality of reported information from the EI companies.</p>	<p><u>Interior's Oil and Gas Production Verification Efforts Do Not Provide Reasonable Assurance of Accurate Measurement of Production Volumes (USA 2010)</u></p>
<p>5. Assessment and collection of revenues</p>	<p>Government has a number of tax instruments at its disposal for revenue collection purposes. Royalties, production sharing, bonuses, taxes etc. are all intended to give government its fair share of revenue. Risks may relate to wrong calculation of revenue based on wrong input data, or inflation of costs by the companies.</p>	<p>The SAI may audit how the government agency tasked with collecting revenue has established an effective system for revenue collection, which ensures adoption of international best practice such as the OECD guidelines on transfer pricing.</p>	<p><u>Coordinated Audit about the Oversight of the Public revenues from the Exploration and Production in Brazil, Colombia and Peru. (Joint Audit 2014)</u></p>
<p>6. Revenue management and allocation</p>	<p>After collection of revenue, the next step is to allocate the funds. Revenue may be used for next year's budget, reserve funds, transfer to local communities etc.</p>	<p>The SAI may follow the revenue flow and reconcile figures. If they</p>	<p><u>Audit on financial management of the petroleum fund as well as compliance and</u></p>

	There may be a risk of mishandling of revenue. Revenue may be allocated to non-disclosed foreign bank accounts and not follow investment rules.	exist, EITI ³ reports may give valuable input to SAIs on discrepancies which may require further investigation.	performance audit (Ghana 2015)
7. Implementation of sustainable policies	It is important to consider the possible negative effects of the EI sector, such as environmental damages and EI resource dependency. Government may reduce these risks by overseeing environmental impact assessment and implement local content policies.	The SAI may audit how laws and regulation aimed at reducing negative impact of the EI sector are being implemented and whether the system of control and oversight by government is effective.	The Netherlands as a European gas transmission hub A gas hub: benefits, need and risks (Netherlands 2014)

III. Links and resources

INTOSAI bodies

- International Organization of Supreme Audit Institutions (INTOSAI): www.intosai.org/
- Working Group on the Audit of Extractive Industries (WGEI): <http://www.wgei.org/>
- Organization of Latin American and Caribbean Supreme Audit Institutions (OLACEFS): <http://www.olacefs.com/>
- African Organization of Supreme Audit Institutions (AFROSAI): <http://www.afrosai.org/>
For English speaking SAIs in Africa, AFROSAI-E: <https://afrosai-e.org.za/>
For French speaking SAIs in Africa, CREFIAF: <http://www.crefiaf.org/>
- Arab Organization of Supreme Audit Institutions (ARABOSAI): <http://www.arabosai.org/Ar/>
- Asian Organization of Supreme Audit Institutions (ASOSAI): <http://www.asosai.org/>
- Pacific Association of Supreme Audit Institutions (PASAI): <http://www.pasai.org/>
- Caribbean Organization of Supreme Audit Institutions (CAROSAI): <http://www.carosai.org/>
- European Organization of Supreme Audit Institutions (EUROSAI): <http://www.eurosai.org>

Audit reports on Extractive Industries

- Oil and gas: <http://www.wgei.org/oil-gas-audit-reports/>
- Minerals: <http://www.wgei.org/minerals-audit-reports/>

Initiatives and knowledge centers

- GOXI – Sharing in governance of extractive industries: www.goxi.org/
- Natural Resource Governance Institute (NRGI): www.resourcegovernance.org/
- Extractive Industries Transparency Initiative (EITI): www.eiti.org/
- Publish What You Pay, www.publishwhatyoupay.org/

³ The Extractive Industries Transparency Initiative (EITI) will be a relevant tool for SAIs in auditing the EI sector. The EITI standard is a global standard that aims to promote an open and accountable management of oil, gas and mineral resources. Countries that implement the EITI Standard are required to publish timely EITI reports that reconcile government disclosures on revenues with companies' disclosure on tax payments. In this reconciliation process, SAIs have potentially at least two roles. Firstly, SAIs can follow-up on discrepancies identified in the EITI reconciliation report. Secondly, SAIs can provide assurance to reported government revenue statistics, based on the audit already carried out by the SAI.

- The World Bank on IE topics: www.worldbank.org/en/topic/extractiveindustries
- The Organization for Economic Co-operation and Development (OECD): www.oecd.org/ctp/transfer-pricing/
- U4 Anti-Corruption Resource Centre: www.u4.no/
- Chatham House – Resources: www.chathamhouse.org/research/topics/resources
- Tax Justice Network: <http://www.taxjustice.net/>
- EI Sourcebook: <http://www.eisourcebook.org/>
- One Petro: <https://www.onepetro.org/>
- Open Oil: <https://openoil.net/>
- Petropedia: <https://www.petropedia.com>

Further readings

- *Features and functions of supreme audit institutions*. (2001, October). PREM notes Public Sector. The World Bank.
- *Working with Supreme Audit Institutions*. (2005, July). How to Note. DFID Department for International Development.



