

# SEPTEMBER 2019 JOURNAL

 INTOSAI  
**WGEI**  
Working Group on Audit of Extractive Industries





## Foreword

Dear Colleagues,

Resources from extractive industries have the potential to transform the economies of countries and better the lives of their citizens. Supreme Audit Institutions (SAIs) are therefore duty bound to ensure that these resources are efficiently managed so that the benefits are derived.

The International Organisation of Supreme Audit Institutions (INTOSAI) established the Working Group on Audit of Extractive Industries (WGEI) to be a platform from which SAIs could interface in building their internal capacities to audit extractive industries by providing a platform for sharing knowledge and experience.

One of the tools adopted by the Working Group was publication of Newsletters. Since 2015 colleagues both within and outside the INTOSAI have submitted articles in which they have shared their knowledge, insights and trends in the industry. I take this opportunity to appreciate all those who have contributed to the WGEI Newsletter over the years.

In this edition of the WGEI Journal we share with you the knowledge accumulated through the WGEI Newsletter in the last four years, and it is my desired wish that you will find it fruitful and fulfilling.

Pleasant reading

Yours Sincerely,



John F.S. Muwanga

Auditor General

Republic of Uganda

WGEI Chair



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**WGEI**  
NEWSLETTER

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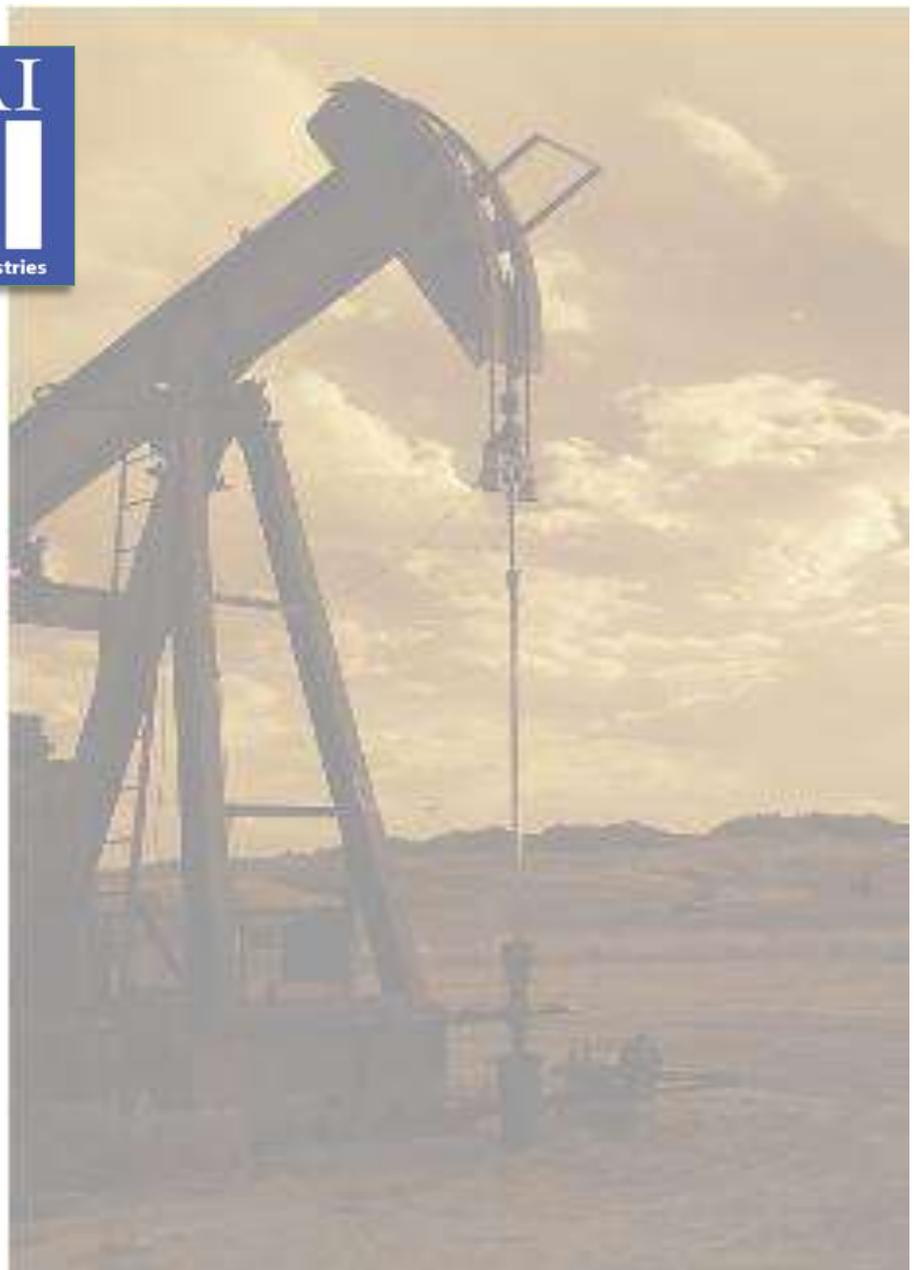
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ISSUE NO. 15 | SEPTEMBER 2019

## **About this issue:**

Welcome to the fifteenth edition of the WGEI newsletter! In this edition of the newsletter, you can read about WGEI All Members meeting in Manila 27th - 29th May, “Open Data - Build Trust”: EITI Global Conference 2019, Highlights of the AFROSAI-E Annual Extractive Industries Workshop 2019, Making Extractive Industries Audit Reports Publicly Accessible, Lessons learned from building Extractive Industries Audit Capacity: the Office of the Auditor General of Uganda - A good practice note.

Have a nice read!

## Need to know

WGEI All members meeting in manila, 27th – 29th May (By Stefanie Grace G. Fernandez - Norwegian Audit Office)

It has been three years since the last WGEI All Members meeting was held in Mombasa, Kenya in August 2016. This year's big event was the 4th WGEI All Members meeting which was successfully hosted by the Commission on Audit of the Philippines from 27-29th May in Manila. A number of activities have been implemented during the last three years. The meeting was therefore an opportunity to report to WGEI members, the INTOSAI community and external stakeholders on the progress of WGEI activities. Likewise, it offered a space for SAI members and external stakeholders to exchange knowledge and experience based on their latest work in the field of extractive industries.



*Commissioner of the Commission on Audit of the Philippines, Mr. Jose A. Fabia, welcomes the delegates*

Since its inception, WGEI held annual members' meetings until 2016. In 2017 the Steering Committee resolved that the All Members meeting should be organized every third year while the Steering Committee working meeting should be held annually. The 4th WGEI All Members meeting was attended by the WGEI SAI members, observers, INTOSAI bodies and regional secretariats as well as external stakeholders in the extractive industries. Some of the external stakeholders who took part in the meeting were representatives from Oxfam, Natural Resource Governance Institute (NRGI), The World Bank, Extractive Industries Transparency Initiative (EITI) and the Mines and Geoscience Bureau of the Philippines. The highlights of the meeting include the progress reports on each of the main activities of the [WGEI Activity Plan 2017-2019](#) and the proposed WGEI Activity Plan for 2020-2022. The WGEI Secretariat presented the proposed Activity Plan and gathered inputs from its members. Two panel discussions were

held to discuss beneficial ownership as well as how SAIs can work with external stakeholders to combat illicit financial flows. Furthermore, the INTOSAI regional secretariats delivered presentations on their latest activities in extractive industries in their respective regions.



*WGEI Steering Committee meeting with all of its ten members*

At the end of the last day of the meeting, the ten members of the WGEI Steering committee gathered to summarize the outcomes and resolutions based on the discussions and inputs from the WGEI members. The Steering Committee also discussed potential sources of funding for the implementation of WGEI activities, the WGEI Chairmanship from 2023 and specific action plans based on the meeting resolutions.

Meeting presentations and progress reports for each activity can be accessed [here](#).

Looking back at each All Members' meeting since 2014, we observe a growing number of SAIs joining the Working Group as well as an increasing number of external stakeholders being engaged in WGEI activities. During the 4th All Members meeting, we also witnessed how SAI members were active in discussions and enthusiastic about participating in WGEI activities. All these developments are a positive step towards achieving WGEI's goal of creating an arena for knowledge and experience sharing and promoting the audit of extractive industries, and thereby contributing to good governance, accountability and transparency.



WGEI All members meeting, Manila 2019

“Open Data - Build Trust”: EITI Global Conference 2019 (By Stefanie Grace G. Fernandez - Norwegian Audit Office and Annicken Tvenge – Norwegian Audit Office/Audit Service Sierra Leone)



Mark Robinson, Executive Director of EITI, during the opening session

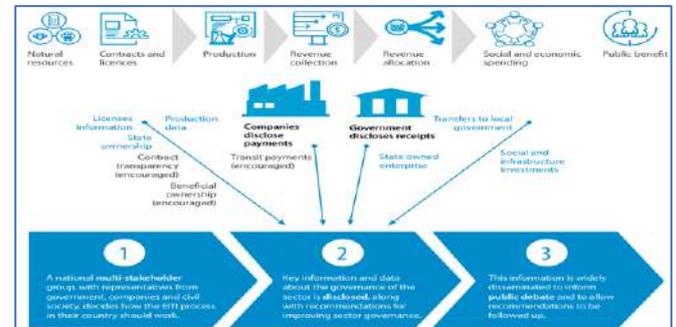
Every three years the Extractive Industries Transparency Initiative (EITI) organises a Global Conference. The topic of this year’s event, which took place in Paris in June, was “Open Data - Build Trust”. More than 1000 stakeholders representing government, multinational corporations, international organisations and civil society, discussed transparency, accountability and governance of the extractive industries sector. Representatives from the Supreme Audit Institutions (SAI) of Iraq, Mozambique, Norway, Uganda and Sierra Leone were among those present.

**EITI**

EITI is an international organisation that works to promote transparency and good governance in the oil, gas and minerals sector, also called extractive industries (EI). EITI promotes better understanding of the sector and encourages public debate. As of today there are 52 countries implementing [the EITI Standard](#), a global standard for the good governance of extractive industries. The standard requires the disclosure of information from every [step of the EI value chain](#), from awarding the resource extraction rights to how

revenues benefit the public. For each implementing country, a multi-stakeholder group (MSG) is established with representatives from the government, EI companies and civil society.

Below is an illustration depicting how the EITI works with transparency in three main steps:



Source: EITI Progress Report 2018

During the Global Conference, [2019 EITI standard](#) was launched. The new standard focuses more on systematic disclosure of extractives data as a default rather than EITI reports. The standard mandates all implementing countries to publish contracts and licenses signed from 2021. It also contains new requirements on environmental reporting (should cover material environmental payments by companies to governments, and encourage disclosures of contextual information related to environmental monitoring) and gender (requires MSGs to consider gender balance in their representation and disclose employment data by company, gender and occupational level).

**Transparency builds trust**

The theme “Open Data, Build Trust” was chosen to embody [three elements](#): Open data as the norm, building trust as the bedrock, and demonstrating relevance for the global agenda. Transparency was the topic throughout all sessions under the conference (see conference page for full programme). Some of the issues covered in the sessions were:

- Transparency on costs and cost auditing in the petroleum sector
- Civil society’s role in promoting transparency, accountability and sustainability in the governance of natural resources
- [Quantifying the economic, environmental and social costs and benefits of extraction](#) and why it is important to publish this information
- [How transparency about ownership can strengthen anti-corruption work](#)

- Why open contracts and agreements are important, and the benefits of such disclosure
- How EITI contributes to the implementation of the Sustainable Development Goals
- How data and economic models can be analysed and used in order to find suitable fiscal regime in extractive industries
- How open data can enhance state-owned enterprise performance and benchmarking
- Transparency related to the [social, environmental and local impacts of extractives](#)



Panel discussion “Cost auditing in the petroleum sector: A missing item on the transparency agenda?”

The role of Supreme Audit Institutions in the EI sector was highlighted in some of the sessions, such as the panel discussion on «*Cost auditing in the petroleum sector: A missing item on the transparency agenda?*». EITI’s work includes the disclosure of contracts and agreements, the amount paid by the companies to the government in taxes and the amount the government has received in tax revenue. Some of the questions raised were whether there is also a need to disclose the information on companies’ costs and the government’s audit of these, what would be the role of SAIs in this regard and how cost audit reports can be used more actively. A [study](#) by Oxfam shows that there are a number of challenges with such cost audits. However, Oxfam also suggests potential measures that government, civil society, international development organisations and EI companies can take to handle these challenges.

During another session, on “Leveraging information technology in EITI mainstreaming”, assuring the quality of the data in the license and contract databases and cadastre systems that many public entities are now developing, was mentioned as an important role of the SAIs. Some even suggested that when systems improve, and publication of data is automated, validation of data will no longer be needed, as validation moves into the SAIs. SAIs are getting stronger, and some participants predicted that there

will be a time when EITI is no longer needed in parallel with the SAIs’ work.

In addition to the executive sessions, a parallel session called the “Pitch Corner” was held, where organisations and local EITI offices from different countries delivered a short presentation on trends, developments and work done in the EI sector in their respective countries.

**Government and industry leaders announced their commitment to transparency and good governance.**

At the end of the conference, around 30 leaders from EI companies, government ministers and other public sector entities from different countries pledged to contribute to more transparency and good governance of the EI sector. The governments of Denmark and France will continue to support EITI financially. The multinational petroleum company Total promised to lead by example with progressive corporate transparency policies. The governments of Guyana and [Tanzania committed to publishing contracts](#) from the oil, gas and mineral sector. And Ecuador, Equatorial Guinea and Zimbabwe are considering making an application to join EITI.

**Relevance of the EITI to the SAI**

So why should SAIs care about what happens in EITI and the developments in the EITI standard? The EITI process and reporting provides the following benefits to SAI auditors:

- Easy access to information: The EITI process provides alternative ways of accessing documents from companies, through the national EITI secretariat.
- Identify discrepancies and recommendations that can be used by the EI auditors for planning (risk assessment).
- Encourages companies to disclose their beneficial ownership (direct or indirect ownership or control), which is very useful in assessing transfer pricing issues.
- Enhances openness in reporting. Implementing countries are expected to produce EITI Reports on an annual basis.

In many EITI implementing countries, the multi-stakeholder group sends reporting (disclosure) templates from the government entities to the SAIs for certification while the EI companies’ disclosures are sent to their private auditors for certification, before

reconciliation of the government receipts and the companies' payments. The role of the SAI is therefore crucial in the EITI reconciliation process.

For WGEI and for SAIs, the EITI Global Conference was an excellent opportunity to learn more about different perspectives, current challenges and progress in the EI sector, and the work of other organisations, many of which organised informative side events. It was also a good opportunity to get to know EI stakeholders such as [Natural Resource Governance Institute \(NRGI\)](#) and [Responsible Mining Index Foundation](#) and discuss areas for possible synergies and collaboration between them and SAIs. NRGI was represented in many of the sessions and panels, and had published several relevant articles. These are available on [NRGI's EITI conference page](#). NRGI and EITI are some of the external stakeholders WGEI has been reaching out to and cooperating with, as we aim to reach our common goal in promoting transparency, accountability and good governance in the EI sector.

After the conference, EITI has reached out to INTOSAI about possible future workshops between SAIs and EITI.

### Highlights of the AFROSAI-E Annual Extractive Industries Workshop 2019 (By Allan. K. Amany – OAG-Uganda)



*Participants pose for a photo at AFROSAI-E offices in Pretoria, South Africa*

The audit of extractive industries continues to gain momentum both at the national level where SAI's are involved in the audit of public funds and on the international agenda where transparency in the exploitation of natural resources is a key focus. Most African governments have realized the potential the extractive industry can have on their economies and social transformation of its citizenry if well managed and as a result SAI's are in the spotlight more than ever before as citizens, civil society and other stakeholders intensify their demand for accountability for the exploitation of natural resources. To keep abreast with the emerging risks within the industry, AFROSAI-E developed and circulated an exposure draft on audit

considerations for the EI sector and subsequently launched an e-learning course on the audit of extractives for public sector auditors. Following the circulation of the exposure draft, a workshop organized by AFROSAI-E was held from 3-7 June 2019 in Pretoria, South Africa to get feedback from the SAI participants on the exposure draft and the latest industry developments.

The workshop was well attended by participants from over 14 SAIs. The discussions featured a host of topical issues in extractives among which included transfer pricing, risk assessment along the EI value chain, fiscal regimes and many others. Throughout the discussions and experience sharing by participants, it came out clearly that the challenges faced by the participating SAIs were not unique in nature; from inadequate capacity of the staff involved in the audit of extractives, mandate limitation of most SAI's on the extent to which they can carry out the audit given that most of the companies involved in the exploitation of these natural resources are privately owned and the contracts with the governments do not provide for the audit of their operations through a direct engagement. This issue was singled out by most SAI's as the biggest challenge in executing their mandate. Opacity in contract negotiations and the high level of secrecy that characterizes the extractives sector most especially regarding the contracts and limited information sharing amongst the government ministries, departments and agencies involved in the sector was also seen as a challenge despite most SAI's having constitutional powers to access information.

The challenge of information and knowledge asymmetry between SAI staff and companies involved in exploitation of the resources cannot be underestimated given that the companies usually have better knowledge due to their international foot print and diversely skilled workforce. The participants concluded therefore that SAIs need to have a dedicated EI sector audit unit to build capacity and ensure a comparable level of expertise. To illustrate this point, SAI Uganda made a presentation on the key enablers for its successful EI establishment among which included; Top management support/buy-in, staff skilling and competencies, staff training and retention, creation of in-house knowledge sharing platforms like the energy taskforce, a platform that encourages idea sharing involving top management.

The workshop concluded with the participating SAIs drawing up action plans ("Pretoria 2019 Declaration") highlighting the key action points and the implementation timelines which will form a basis for

assessing the SAI's performance in the next AFROSAI-E workshop.

## [Making Extractive Industries Audit Reports Publicly Accessible](#) (By Gilbert Makore - OXFAM International)

### **Supreme Audit Institutions as Custodians of Finite Extractive Resources**

Mining, oil and gas resources have the potential to significantly contribute to countries' socio-economic development. Socio-economic benefits stream in through taxes, a share of the revenues and economic linkages. The realisation of this potential- to contribute to socio-economic development- is not certain. Huge expectations for socio-economic transformation can be unmet due to poor governance of the sector characterised by negotiating poor terms with companies, failure to effectively monitor company operations, poor use of revenues that accrue from the sector and limited public participation in decision making processes. It is against this background that the role of Supreme Audit Institutions (SAIs) can be viewed. SAIs are custodians of public funds and are constitutionally mandated with ensuring that public funds are judiciously used. Public funds enable investments in social service delivery and without their precocious use, economic and social progress is all but impossible. Where a significant portion of public funds is derived from resources such as oil, gas and minerals, the role of SAIs in auditing the extractive sector becomes even more imperative.

The role of SAIs vis-à-vis the extractive sector is important due to a number of factors. Firstly, extractive resources are wasting assets which are non-renewable. There is therefore, often one opportunity to 'get things right'.

Secondly, extractive resources are also prone to boom and bust price cycles. This commodity price volatility means windfall revenues are not in perpetuity and must be secured as price downturns are all but guaranteed. Lastly, the discovery and exploitation of extractive resources also often brings with it huge public expectations of windfall benefits, material benefits and economic transformation. Where these expectations are not matched through revenues and the delivery of public goods- there is a likelihood of conflict. The role of SAIs with respect to extractive industry audits and the interface between SAIs and the public on extractives is critical.

SAIs often enjoy significant independence in how they operate and in many countries are accountable directly

to Parliament, that is, essentially the general citizenry. Extractive Industries (EI) audit findings must be known to the public as extractive resources are juridically owned by the public and often only held in trust, by the government. Additionally, where EI audit reports are made, they must make sense to the public, as the office is directly accountable to the public, through Parliament.

### **Citizens Are Often Unaware of the Role of SAIs and their Performance**

However, what often happens is that there is a chasm between the publication or public disclosure of EI audit reports or findings- and the public's knowledge, familiarity and engagement with the audit findings. The effectiveness of SAIs is not just in providing information that ensures that leakages of public funds are plugged and that there is some remedial action. The effectiveness also lies in the extent to which SAIs facilitate the public's access to information, access to public participation and access to justice- in the discharge of its mandate.

A report is only useful to the extent that it is owned, understood and used by the public. While SAIs are often seized with complex and technical audit undertakings, a major audience for audit findings should be the public. SAIs should ordinarily provide information for different interlocutors, including the public, to meaningfully participate and influence the governance of the sector.

There is often significant media attention when SAIs launch audit reports. However, this media attention often only lasts a few weeks. The disclosure of audit findings is often at the tail end of a long audit process. In some country contexts, citizens, particularly those in far flung communities do not even know of the existence and role of SAIs.

With respect to extractive industries, civil society and local communities have been clamouring for improved transparency and accountability. EI audit reports, be they petroleum cost audits or value for money audits (special audits) are an important element in the EI transparency and accountability toolkit. The information disclosed by SAIs and the credibility of the office itself are often unquestioned as this is a governance institution that is constitutionally established. Information and data disclosed by SAIs is, in the eyes of government institutions, more credible than that disclosed by civil society organisations.

In countries like Zimbabwe, where international transparency initiatives such as the Extractive Industries Transparency Initiative (EITI) are absent or

moribund, it is often EI audit reports that offer a solitary window into the challenges bedevilling the EI sector in a country. Conversely, where international standards are adopted and implemented, such as in Uganda and Tanzania, respectively, reports from the office of the auditor general provide useful additional data and information. In Uganda, the audit of the Petroleum Fund is an example, while in Tanzania, the Controller and Auditor General (CAG) audits into the mining sector have gone onto establish the likelihood of illicit financial flows in the sector. The availability and accessibility of this information is the bedrock of citizen participation.

### ***How to improve access to information related to EI audit reports***

To close the gap between the information disclosed and the information that is accessed by the public, SAIs will need to significantly invest in communication and making reports more accessible. Currently most audit reports are voluminous and dense; and not necessarily sector specific. They are often as inaccessible to civil society organisations as they are to local communities. While actors such as civil society, the media and parliament- have a role in distilling and analysing audit findings for the benefit of the public, SAIs equally have a role in ensuring that reports are accessible. There is already some work that is on-going to address this- the International Organisation of Supreme Audit Institutions (INTOSAI) Working Group on Extractive Industries (WGEI) is increasingly engaging with civil society organisations.

Some of the strategies that can be used by SAIs and funding or strategic partners to improve access to information related to EI audit reports and bridge the gap between public disclosure and information use are detailed below;

- SAIs should explore directly engaging civil society organisations and the media to share audit findings. With respect to EI findings, SAIs should specifically engage with organisations that are working on extractive issues. An

example could be directly sharing audit findings with EITI multi-stakeholder groups and or national civil society coalitions working on extractives.

- SAIs should consider sharing audit findings with relevant parliamentary committees. In most countries, these are committees responsible for providing oversight on the extractive sector and public accounts.
- SAIs should consider making considerable investments in improving communication through simplifying EI audit findings and reports. This may include making simplified summaries with visualisations that communities and civil society organisations can easily comprehend.
- SAIs should endeavour to make themselves more accessible to the public. This may mean creating sub-national offices at provincial or district levels. SAI Uganda is an exemplar in this regard as it has 11 provincial offices across the country. Where resources are limited and this is not possible, SAIs should make periodic outreach visits to district or subnational levels.
- SAIs should consider undertaking evaluations on the use of EI audit reports and these evaluations should inform future approaches to VfM audits and public disclosure of the same.
- Publicise the role of SAIs and how citizens can engage with their offices.

Access to information is the basis for citizen participation and access to justice in the extractive sector. SAIs often produce credible reports that should ordinarily support CSO, parliamentary and citizen engagement in the governance of the extractive sector. These good reports are often inadequately used. There is a need for SAIs to reimagine how they package and present audit findings and how they can make their offices more accessible to local citizens.

## THE OFFICE OF THE AUDITOR GENERAL OF UGANDA - A GOOD PRACTICE NOTE



*Trygve Christiansen of SAI Norway presenting lessons learned at the 4th WGEI members meeting in Manila*

There is a strong call within the INTOSAI community for more systematic compilation of the many experiences, tools and lessons learned by different SAIs and partners in auditing within the field of Extractive Industries (EI). Against this backdrop, the Offices of the Auditor General of Uganda (OAGU) and Norway (OAGN) decided to document OAGU's experiences in building up audit capacity in this field from a "lessons learned" perspective.

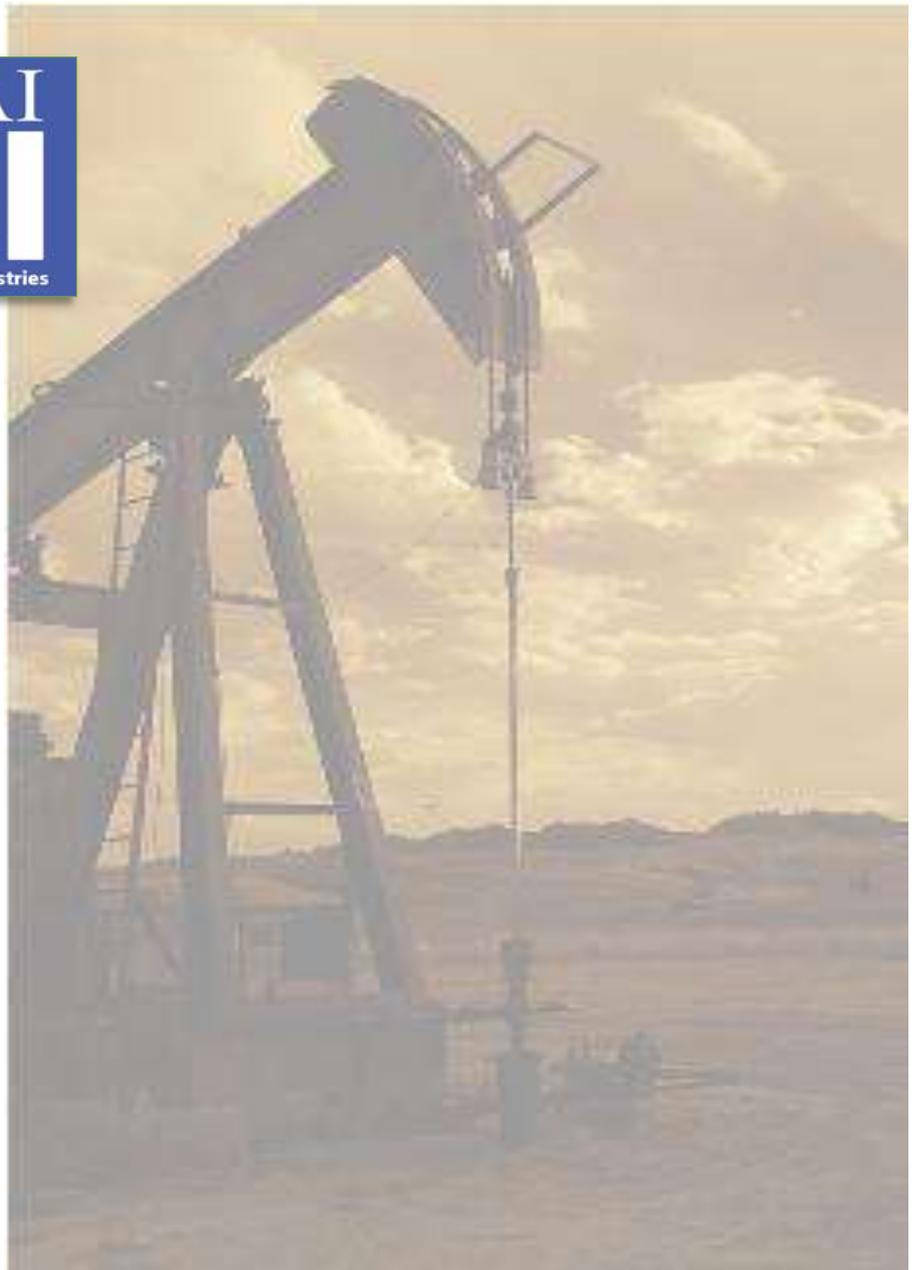
At the WGEI Meeting in Manila in May 2019 and at the AFROSAL-E EI workshop in June, lessons were presented.

The lessons will also be published on the WGEI website soon, along with a good practice note that goes into more detail about the various lessons and provide examples of the results of the lessons. Stay tuned for more information on the website.





**WGEI**  
NEWSLETTER



# INSIDE THIS ISSUE

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Recent good practice tools and resources developed for ensuring effective mine closure

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SAI Fiji and Extractive Industries, AFROSAI-E Launches E-Learning for Extractive Industries Sector Auditors

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Investing in African Mining Indaba at 25

ISSUE NO. 14 | APRIL 2019

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Have a nice read!

## Need to know

Recent good practice tools and resources developed for ensuring effective mine closure (By Annicken Tvenge – *Senior Audit Adviser, OAG Norway and Resident Adviser, Audit Service Sierra Leone*)

This year's Investing in African Mining Indaba had Sustainable Economic Growth on the agenda. At the conference, thousands of government representatives, mining companies, investors, interest groups, non-governmental organisations and consultants discussed topics such as environmental sustainability, local content, community development, economic opportunities, resource nationalism, responsible investments and mine closure.

Discussions on mine closure revealed that:

- Abandoned and orphaned mines is a vast problem. Canada alone has tens of thousands. In South Africa, 6,000 mines were abandoned over the last two decades, and a large number are expected to be closed in the next ten years. Drops in commodity prices have led to expected increase in closures all over the world.
- There is a lack of regulations and standards for mine closure. Governments in many countries lack capacity to implement mine closure plans. Governments must make sure that there are local agencies with skilled people responsible for ensuring that mine closure is carried out as it should be.
- Mine closure is not planning for an event; it is a process. Mining activities can go on for decades and the nature of the activities may change over time. The surrounding environment and the mining activities' impact on the surroundings can also change. In order to plan for mine closure decades away, plans must be under continuous revision.
- Reclamation and closure are technical and complex. Insufficient funding is the largest barrier to land and environmental remediation. There is a need for regulation on financial obligations for rehabilitation and environmental management.
- The mining industry's effect on people's livelihood is the biggest of all industries. Whereas mine closure used to be associated with only environmental concerns, closure is now seen as concerning also land use, social, economic and sustainability issues. Mining must be seen as beneficial to the communities,

and the communities must be involved in issues of mine closure. Stakeholder engagement used to take place after closure. Now it is commonly agreed that it should take place before, during and after closure. Even legacy sites require stakeholder engagement, regardless of how long ago they were abandoned.

At a side event to the Mining Indaba, the International Council on Mining and Metals (ICMM)<sup>1</sup> launched an [Integrated Mine Closure – Good Practice Guide](#), with the purpose of increasing uniformity of good practice across the industry. The guide highlights progressive closure, where monitoring and review feeds into planning and design, in an iterative process. The process will consider environmental, social and economic concerns. ICMM believes the suggested disciplined approach to integrated closure planning will result in:

- Consistent and transparent engagement with stakeholders
- Community participation in planning and implementing actions that underpin successful closure
- Stakeholder support of closure decisions
- Better management of closure throughout the mining life cycle
- More accurate closure cost estimates
- Early identification of risks and mitigation strategies
- Progressive reduction of liabilities
- A shared vision for the post-closure period
- A better social transition for affected stakeholders as the mine moves from operations to closure
- Opportunities for lasting benefits being recognised and planned for adequately

The guide explains in detail how mine closure can be planned, implemented, monitored and governed, and also includes a collection of tools for monitoring, measurements and inspections, minimum closure plan contents and more.



Source: [ICMM Integrated Mine Closure](#)

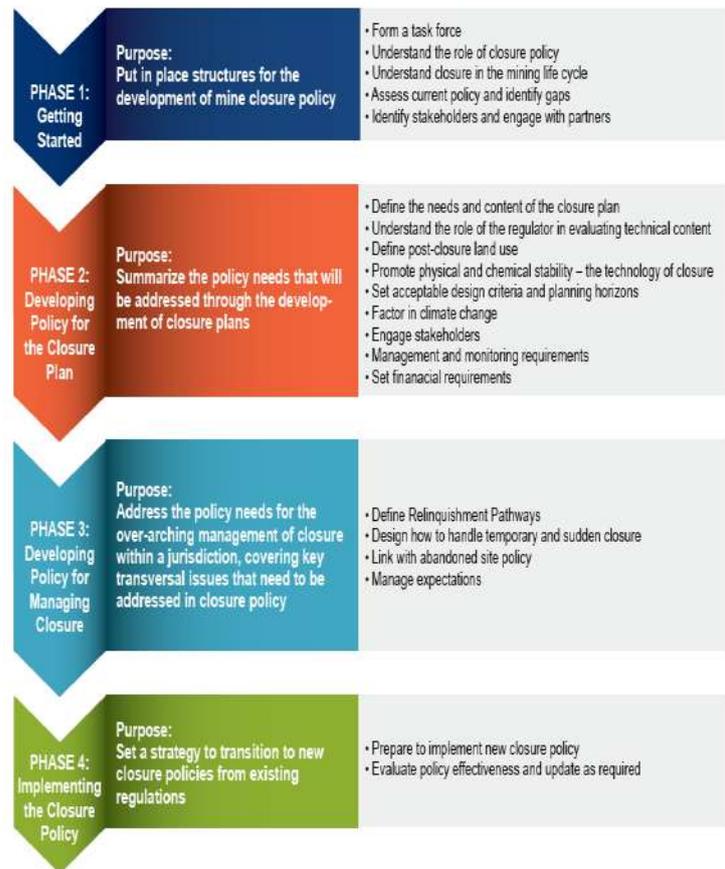
The good practice guide has a chapter on closure costs. However, the ICMM has also launched a document on [Financial Concepts for Mine Closure](#), which aims to enhance the understanding of key financial concepts as they relate to mine closure. The document explains in further detail the applicable international standards, key concepts in mine closure accounting, and the different types of mine closure cost estimates and their key elements, such as use, considerations, calculations, method, cost basis, update requirements, success factors and more.

At the seminar, reference was also made to the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF).<sup>2</sup> IGF's [Mining Policy Framework](#), a non-binding policy guidance tool, lays out international best practice in six key pillars of mining law and policy. The pillar on Post-mining Transition describes what governments should do with regards to ensuring that mining entities prepare and update closure plans, ensuring the development of financial assurance mechanisms for mine closure, and accepting a leadership role for orphaned and abandoned mines in their jurisdiction.

Reference was also made to the Asia-Pacific Economic Cooperation's (APEC) [Mine Closure Checklist for Governments](#), which provides policy makers with essential elements of a successful mine closure governance framework, including developing policy for the closure plan, developing policy for managing closure and implementing the closure policy. Some characteristics of good policy highlighted in the document are:

- Ensure adequate financial assurance
- Avoid prescriptive regulations
- Update mechanisms (regular closure plan and financial assurance updates and approvals)
- Define outcomes (defined by key stakeholders)
- Legislate stakeholder involvement

- Alignment (with existing regulatory framework and with development targets, strategies and plans)



Source: [APEC Mine Closure Checklist for Governments](#)

During the sessions there was also mention of various tools and software that companies can use in order to plan for, monitor and report on environmental and social issues including mine closure. Among those mentioned was Towards Sustainable Mining (TSM) and Initiative for Responsible Mining Assurance (IRMA) Mine Measure self-assessment tool. Global best practice for mining companies is to use such tools, which would also make it easier for government to follow up.

So why should SAIs care about such non-binding guidelines and best practice tools? As auditors, we should naturally seek to find our criteria in laws and regulations. However, the global development of such regulations has been uneven. Where sufficient criteria are lacking, we must turn to guidelines, best practice tools and industry standards. These documents do not merely inform us about what we should expect from government, companies and other stakeholders when it comes to mine closure. They also provide updated facts and data, possibilities for benchmarking with other countries or regions, glossaries of relevant terms, useful tools, models and illustrations, good sources for further reading, and plenty of inspiration for audit topics and audit recommendations.

[1](#) ICMM is an international organisation working to strengthen environmental and social performance in the mining and metals industry.

[2](#) IGF is a voluntary initiative supporting its member nations to leverage mining for sustainable development to ensure negative impacts are limited and financial benefits are shared.

### [SAI Fiji and Extractive Industries](#) (By SAI Fiji)

SAI Fiji became a member of the INTOSAI WGEI Steering Committee to promote the audit of extractive industries in order to stimulate good governance and sustainable development in the Pacific Association of Supreme Audit Institutions (PASAI) region.

On 24 April 2018, a five-member WGEI Committee was formed within SAI Fiji. The Committee chaired by the Auditor-General meets every month. One of the key focuses of the Committee is to carry out research, promoting and sharing information on extractive industries in the PASAI region to the INTOSAI WGEI Steering Committee.

It has almost been a year since the establishment of the Committee whereby we have embarked upon a few challenges to build a moderate foundation for audit in the area of extractive industries. For SAI Fiji and few other SAI's in the PASAI region, audit in the area of extractive industry is indeed a new undertaking considering the limitation of capacity surrounding the matter.

However, SAI Fiji is putting in place efforts and structures to undertake audits in this area by identifying the need to build capacity and knowledge of extractive industries. One of the ways this has been done is through allocation of funds through the budget process for staff to pursue opportunities to embark on trainings, attachments and related activities both locally and overseas.

Furthermore, one of the key achievements of the Committee this year was to design and carry out a survey on extractive industries in the Republic of Fiji using the seven-value chain. Based on responses received, the survey design has been improved and submitted to the PASAI Secretariat for circulation to members for completion electronically. We envisage that the survey will provide valuable information on the scale of extractive industries in the PASAI region, the level of audit activity and opportunities for development.

The survey closes on 5<sup>th</sup> April 2019 following which results will be analysed by the Committee and shared with the INTOSAI WGEI Steering Committee.

### [AFROSAI-E Launches E-Learning for Extractive Industries Sector Auditors](#) (By Edmond B. Shoko., AFROSAI-E)

The growth of the extractive industries sector in Africa is escalating and continues to present challenges for the public sector. The regulatory framework that is needed to ensure sustainable development of the sector, a fair share of income and an equitable distribution of that income, is complex and challenging. As part of keeping abreast with the emerging risks in this sector, AFROSAI-E has designed, developed and launched a basic e-learning course on the audit considerations for the EI sector for public sector auditors.

The aim of the course is to introduce SAI auditors (Financial, Compliance & Performance) to the key concepts, principles and terminology in the audit of extractive industries by SAIs. Its main objectives are to:

- Enhance the understanding of SAIs unique constitutional assignment and responsibility for good national governance and sustainability in extractive industries.
- Enhance the understanding of the distinctive characteristics and considerations exceptional for the extractive industry sector (and how to apply these in financial, compliance and performance audits).

As a result of taking the course, we expect participants should be able to understand and comprehend the key concepts, principles and terminology in the audit of extractive industries.

Over the years, AFROSAI-E has obtained an understanding that the knowledge of the EI sector varies from one SAI to another and from one auditor to another. As such it is always the case that when we deliver workshops and courses on capacity building, participants are always at different levels of knowledge and understanding of the EI sector. This negatively affects the participatory learning environment and possibly the final take away from the workshop by participants. Going forward, AFROSAI-E intends to use this e-learning as a tool towards blended learning. We believe that through the understanding and comprehension of key concepts, principles and terminology in the audit of extractive industries – SAI staff will be able to participate actively at the AFROSAI-E; extractive industries training workshops.

Whilst the main target group of the e-learning is SAI auditors of all ranks and profiles who have never done an EI sector centric audit and possibly know little if anything about the subject matter, it may also be used by experienced EI auditors as it is based on some of the latest knowledge, practices and initiatives in the EI sector globally.

The e-learning course can be found on the AFROSAI-E Learning Management System (LMS). As such it can be accessed via various devices including smart phones, tablets and laptops at the convenience of the user. The course is based on the AFROSAI-E Guidelines on the audit of extractive industries. It has four chapters and an introduction with a background on the EI sector. Within each chapter there are knowledge checks which try to highlight some key learning points of the chapter. At the end of the course, there is a general 20 question assessment which has a 60% minimum pass rate for a participant to be awarded a certificate of completion. The certificate of completion is a pre-requisite for attending AFROSAI-E workshops on the EI sector. Throughout the course, we have created an avatar called Kichaka Mosiye who facilitates the e-learning. As a facilitator, Kichaka combines several delivery technics designed to optimise screen learning. These techniques include; audio, video, text, pictures, interactivities.

For further knowledge on how to access this e-learning, interested parties can contact Edmond B. Shoko or Nikeziwe Khanyile on [edmond@afrosai-e.org.za](mailto:edmond@afrosai-e.org.za) or [nkhanyile@afrosai-e.org.za](mailto:nkhanyile@afrosai-e.org.za).

### Investing in African Mining Indaba at 25 (By Sheilla Ngira (WGEI Secretariat/SAI Uganda))

The Investing in African Mining Indaba celebrated its 25<sup>th</sup> anniversary this year. The Indaba was held from 4<sup>th</sup> to 7<sup>th</sup> February 2019. The conference brought together 6192 delegates comprising of government representatives, mining executives, investors and government ministers. It was an opportunity for the delegates to discuss and gather knowledge on the state of mining in 2019, and what the future looks like for the mining industry.

The Indaba was addressed by His Excellency Nana Akufo – Addo, the President of Ghana who said that Ghana has embarked on a campaign to eliminate illegal mining, particularly small-scale artisanal mining. This has reduced the level of pollution in the rivers affected by the practice. He also emphasised the need to diversify mining to include other minerals, in addition to gold.

The conference was also graced by the presence of His Excellency Cyril Ramaphosa, President of South Africa, who in his address emphasised the need for government and other players in the mining sector to work together for the mutual benefit of all. His Excellency outlined the principles he believes are necessary for the success of the mining sector. These include:

1. Companies must foster growth in areas where they operate
2. Partnerships with local governments are vital. Companies should share their knowledge and expertise with municipalities, particularly when it comes to infrastructure development.
3. The mining sector must invest in improving the living conditions of its employees.
4. There must be investment in education and training.
5. The sector should partner with education institutions and contribute to curricula and provide job training opportunities
6. Beneficiation must be embraced
7. Companies must invest more in health and safety of their employees.
8. Mining must provide internship and job opportunities as well as make SMEs a priority in the supply value chain.
9. The development of women in mining must be prioritised.
10. Companies must have the courage to include employees in the shareholding of their businesses.



H.E. Cyril Ramaphosa, President of South Africa, addressing the Indaba

Among the notable events at the Indaba was the 'Sustainable Development Day' which saw key stakeholders discuss responsible and sustainable mining. Sustainable development is defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. Key messages from the discussions were:

- Research has shown mining to be destructive and not constructive.
- There should be transparency and accountability in the mining sector.
- Sustainable Development Goals should be incorporated in the Extractive Industry
- Communities most affected by mining should be involved in discussions about mining and the development to be derived from it.
- Governments need to collaborate with all stakeholders to avoid environmental degradation and acceleration of climate change.
- There is a need to diversify to other industries in order to create sustainability.



Panel discussants at the Indaba

Another noteworthy event was the *'Intergovernmental Summit'* at which discussions were held with Mining Ministers aimed at integrating best practices in the industry. Key messages from the discussions included:

- African countries score very low on the Human Development Index compared to other mineral producing countries.
- Mineral resources should serve as a catalyst to industrialisation in Africa.
- The ever- increasing illicit Financial Flows from Africa exacerbate the problem of poverty.
- There is need for policy certainty in the mining industry in order to attract investment.
- The responsibilities of all stakeholders in the industry should be defined, clearly distinguishing between the roles of government and those of the companies.
- Mining will change in the next 30 years and industry has to prepare to mine differently using technologies such as remotely piloted aircrafts, drones, robotics, etc.

To illustrate what this change in mining might look like, another event, *'Mining 2050'* was held to showcase the most innovative technologies designed to streamline mining operations, improve safety and save money. To learn more about these innovations, follow the link <http://www.wgei.org/other-resources/> to access the presentation made at the Mining Indaba.

Concurrently with the Investing in African Mining Indaba, members of Civil Society and Communities met in Cape Town for the **Alternative Mining Indaba**. This is an initiative that was designed to give a voice to the communities that are most impacted by mining 'through exposure to polluted air, water and soil, through disease and poverty, loss of lives and eking out of un-rehabilitated mining sites.'<sup>1</sup> For further information about this initiative, check out their website at [altminingindaba.co.za](http://altminingindaba.co.za)

Related websites

- [www.miningindaba.com](http://www.miningindaba.com)
- [www.panafgeo.org](http://www.panafgeo.org)
- [www.IGFMining.org](http://www.IGFMining.org)

<sup>1</sup> Alternative Mining Indaba: Declarations commemorating 10 years of Growing stronger and forging forward.

*Oil and gas parallel audit in action (By Sybrand Struwig - SAI South Africa)*

The regional project "Performance auditing in the oil and gas industry" is funded by the Netherlands Ministry of Foreign Affairs and led by the Netherlands Court of Audit (NCA) in partnership with AFROSAI-E. Partners in the program are SAI Tanzania, SAI Mozambique and SAI Kenya. The purpose of this regional project is to further improve the quality of performance auditing activities in the oil and gas industry and to stimulate capacity building and knowledge distribution in the region. The kick-off of the project (including SAI leadership and audit teams) took place on 4<sup>th</sup> and 5<sup>th</sup> February 2019 at the premises of AFROSAI-E in Pretoria, followed by a three-day workshop for the audit teams (6<sup>th</sup> -8<sup>th</sup> February) to start working on their audit designs.

The objectives of this kick-off meeting were twofold: To discuss recommended areas of focus from the perspective of extractive sector specialists to identify and agree on the audit topics for this regional project.

All participants registered for the event (33) attended the kick-off meeting, including the Auditors-General from SAI Tanzania and SAI Kenya. SAI Mozambique was represented by one of their Judge Counsellors. After the welcome remarks by leadership, the Founder and President of Resources for Development ([Res4Dev](http://Res4Dev)) contextualized and presented the commonalities of the value chain of the oil and gas sector in Tanzania, Mozambique and Kenya. The presentation included an explanation on how audits can contribute to an increase of the return in public value from natural resource wealth. A fair share requires coordinated

activity across the value chain. This includes a good deal (original contract, amendments, and infrastructure) and monitoring project costs and project revenues (volume and value). With the oil-projects entering the construction phase in the three countries, it has been recommended to prioritise the audits around monitoring and assess the “whether” and the “how”. The participants were advised to formulate system performance audit topics within the following four focus areas: (i) assess government effectiveness and efficiency (ii) processes, information, capacities and results; (iii) assess cross-government responsibilities for management; and (iv) preparedness / anticipate future risks.

Each country team had formulated “cost monitoring” as an audit topic for one of their studies, allowing for a parallel audit. The preliminary objective of the parallel audit will be “to assess the effectiveness of the systems put in place by government and to monitor costs incurred by International Oil Companies under the Production Sharing Agreements”. In addition to the parallel audit on cost monitoring, an additional three audit topics were identified. SAI Kenya intends to monitor the implementation of the exploration provisions in the Production Sharing Contracts. SAI Mozambique intends to assess whether existing mechanisms in Mozambique are adequate and efficient to ensure environmental protection of natural resources in the production of gas. SAI Tanzania intends to look into the public investment decision around a specific gas pipeline put into place.



*From left: Judge Counselor Amilcar Mujovo Ubisse (SAI Mozambique), Auditor General Edward Ouko (SAI Kenya), Vice President Ewout Irrgang (NCA), Chief Executive Officer Meisie Nkau (AFROSAI-E) and Auditor General Mussa J. Assad (SAI Tanzania)*

The kick-off meeting was followed by a three-day workshop to support the audit teams on their audit designs, which included the formulation of the objective of the studies, audit scope, key questions and sub-questions. The trainers facilitated the

harmonization of the questions for the parallel audit, ensuring answers can be compared. To this end, the key question for the parallel audit for all three countries has been formulated in close alignment with the following question: “To what extent has government an effective system in place to monitor the costs incurred by the international oil companies as per the signed / model production sharing agreement”. To facilitate the alignment of the parallel audit and to ensure peer learning, the three audit teams working on the parallel audit (cost monitoring) will get together again in Pretoria (premises AFROSAI-E) mid- May 2019, followed by coaching of the other audit team of SAI Kenya at the same location. The other two teams will be visited in their countries. The objective of this second gathering is to finalize the audit framework, define core questions for the main study and plan the main study.



*Participants at the kick-off meeting on parallel performance audits in Oil and gas at the AFROSAI-E office in Pretoria*

**Partnership with other parties**

A representative of the INTOSAI Working Group of Extractive Industries (WGEI) attended both the kick-off meeting and workshop. The representative shared relevant WGEI reports that the SAIs can consider when designing their audit plans including additional external resources.

As a partner in this program, AFROSAI-E has been closely involved in developing the agenda for the kick-off meeting, and has taken care of all logistical arrangements in-country. The kick-off meeting and workshop took place at the premises of AFROSAI-E. The AFROSAI-E Extractive Industry Guidelines were consulted by the participants prior to the event.

Strengthening the knowledge and understanding of undertaking performance audits in the petroleum sector is essential to assist resource-rich countries in

securing a fair share of the revenues generated from the sector. To that end, a learning module on Performance Auditing in the Petroleum Sector is being developed as part of this project. The learning module will be made available as a stand-alone module offered through the online learning platform of AFROSAI-E in 2020.

As WGEI the working group will continue supporting this project in its effort to promote the audit of extractive industries within the INTOSAI community in order to promote good governance and furtherance of the UN Sustainable Development Goals.

**WGEI Secretariat visits OAGN and external stakeholders in Oslo** *(By Stefanie Grace Fernandez - Norwegian Audit Office)*

The WGEI Secretariat, consisting of Mr. Maxwell Ogentho, Ms. Sheilla Ngira and Mr. Emmanuel Angole, held meetings in Oslo from March 25<sup>th</sup> to 29<sup>th</sup> with the Office of the Auditor General of Norway (OAGN) and external stakeholders such as the INTOSAI Development Initiative (IDI), The Norwegian Oil for Development (OFD) and Extractive Industries Transparency Initiative (EITI), to promote WGEI activities.

**Meeting with OAG Norway**

As a member of the WGEI Steering Committee, OAGN has close cooperation and is in regular correspondence with the Secretariat to keep track of WGEI activities and the implementation of the WGEI Activity Plan. The working meeting in March dealt predominantly with preparations for the WGEI Members meeting in May 2019, drafting a new Activity plan for 2020-2023, updating the website and planning future WGEI activities.



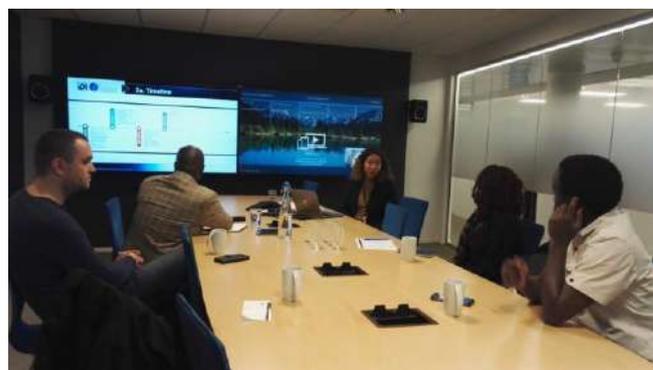
*From left: Øivind Berg Larsen (Head of the International Division, OAGN), Emmanuel Angole (WGEI/OAGU), Sheilla Ngira (WGEI/OAGU), Jens Gunvaldsen (Secretary General, OAGN), and Maxwell Ogentho (WGEI/OAGU)*



*From left: Emmanuel Angole (IT-expert, WGEI/OAGU), John Green (IT-expert, OAGN), Anne Hald (IT-Expert, OAGN), Geir Ambro (Project coordinator Uganda, OAGN), Trygve Høgseth Christiansen (Project Coordinator and Head of the Petroleum program, OAGN), Sheill*

**Meeting with IDI, OFD and EITI**

Having the main responsibility for Activity 6 *Networking with external stakeholders* in the WGEI Activity Plan, Norway serves as the focal point between WGEI and key external stakeholders. During the visit this March, the Secretariat met with Karina Mera Warholm from IDI to discuss the development of an e-learning platform for the working group. One of the goals of WGEI is to develop an e-learning course on relevant topics within extractive industries, which can be made accessible to the WGEI members. In addition to IDI, the Secretariat held a meeting with the Norwegian Oil for Development Initiative (OFD) as well as EITI and presented highlights of WGEI’s main activities.



*From Left: Trygve Christiansen, Maxwell Ogentho, Karina Mera Warholm (IDI), Sheilla Ngira and Emmanuel Angole*

## Trainings and events

### Natural Resources for Sustainable Development course

The next online ***Natural Resources for Sustainable Development*** course will start Monday 6 May 2019.

This is a 12-week course developed by the Natural Resource Governance Institute, the Columbia Center on Sustainable Investments and the World Bank.

The course will teach you

- How countries translate natural resource wealth into sustainable development outcomes
- How governance of extractive industries impact long term economic development
- The policies necessary for the sustainable management of natural resource wealth
- Why communication between government, industry, and citizens is critical to sustainable natural resource management

The course is taught through video presentations, questionnaires, provided reading and discussion forums.

And best of all – you can do it on your computer, at your own pace, and it is completely free of charge!

To read more, or to sign up, please visit the [course website](https://www.edx.org/course/natural-resources-for-sustainable-development-2). (<https://www.edx.org/course/natural-resources-for-sustainable-development-2>)



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Underground assets and illicit financial practices brought under the spotlight in Pretoria

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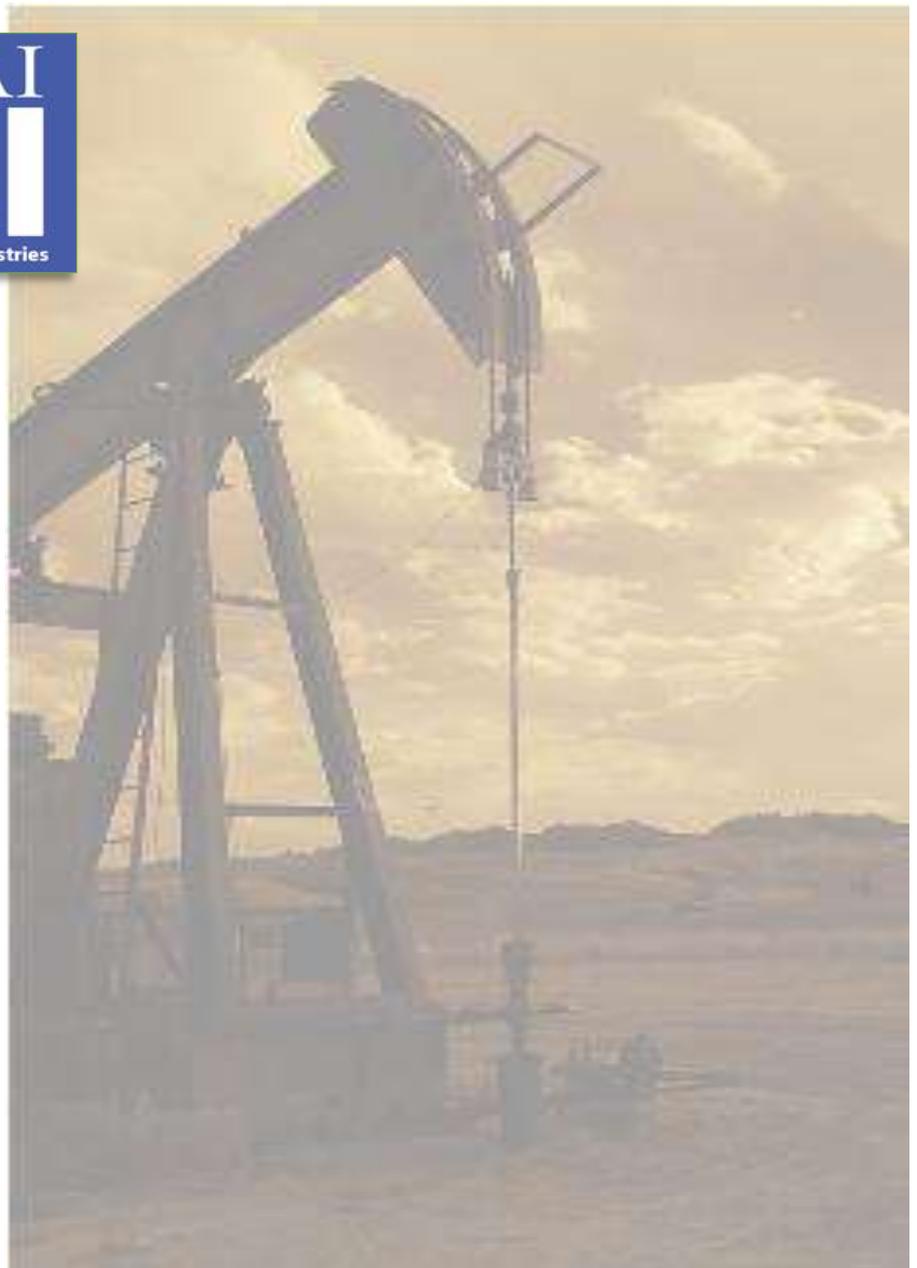
A holistic approach to audit of extractive industries

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10th Meeting of the KSC Steering Committee

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WGEI Steering Committee (SC) Working Meeting, September 2018



ISSUE NO. 13 | DECEMBER 2018

## **About this issue:**

Welcome to the thirteenth edition of the WGEI newsletter! In this edition of the newsletter, you can read about Underground assets and illicit financial practices brought under the spotlight in Pretoria, A holistic approach to audit of extractive industries, 10th Meeting of the KSC Steering Committee, WGEI Steering Committee (SC) Working Meeting, September 2018.

Have a nice read!

## Need to know

### Underground assets and illicit financial practices brought under the spotlight in Pretoria (By Auditor General of South Africa)

The mining of the world's assets below the ground has fallen prey to illicit financial flows (IFFs), robbing countries of valuable revenue that could be used for the benefit of citizens. This was the subject of the second annual meeting of the Steering Committee of the International Organisation of Supreme Audit Institutions (INTOSAI) Working Group on the audit of Extractive Industries (WGEI) held in Pretoria from 25 to 27 September 2018.

With representatives of SAIs from nine countries that make up the steering committee of the WGEI in attendance, the objective of discussing IFF was to understand the practice and its impact. In his welcome address, Mr. Jan van Schalkwyk (SAI SA) indicated that countries with large extractive sectors such as Russia, Mexico, Malaysia, Nigeria, Brazil, South Africa and Indonesia are all listed among the top 10 sources of IFF. Guest speakers from the South African Revenue Service (SARS), the Financial Intelligence Centre of South Africa (FIC) and the Department of Mineral Resources of South Africa (DMR) provided great insight on the types of IFFs, their respective efforts to track and stop it and its impact on extractive industries in particular.

The term 'illicit financial flows' first appeared in the 1990s to describe a number of cross border activities. The term was initially strongly associated with capital flight. It now generally refers to cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred or used, that crosses borders. This falls into three main areas:

1. The acts themselves are illegal (e.g., corruption, tax evasion); or
2. The funds are the results of illegal acts (e.g., smuggling and trafficking in minerals, wildlife, drugs, and people); or
3. The funds are used for illegal purposes (e.g., financing of organised crime).

In-depth studies have found that the different types of IFFs are often linked in exchanges and relationships that involve corruption, organised crime, and international commercial fraud.

The role of the WGEI in dealing with IFFs is spurred on by the report of the United Nations Economic Commission for Africa that says 'track it – stop it – get it'. Mr. Schalkwyk further contextualised its role by

saying: 'The WGEI alone will not be able to stop this practice, but your efforts in promoting good governance in the extractive industries, where accountability and transparency is assessed at each stage of the extractive industry value chain, will be the fundamental shift in the tide.'

Mr. Pieter Alberts from the FIC provided valuable insights through case studies on how IFFs are committed. He also highlighted that the FIC works closely with SARS, the Public Protector, the Hawks and other international agencies to address IFFs and stressed that a cooperation agreement should be established with auditors-general to further promote transparency.

From the perspective of SARS, Ms. Keamo Kuypers explained transfer pricing in the context of IFFs and described how big corporate companies evade taxes by setting up their headquarters in tax havens. She also described how SARS detects potential illicit transaction and what typical risk factors they consider in this regard.

Supporting these sentiments and really crystallising the impact of IFFs for the members of the WGEI, was Ms. Irene Singo, the CFO from the Department of Mineral Resources. Speaking in the South African context, Irene explained that Base Erosion and Profit Shifting (BEPS) is recognised as a risk to realising true value from South Africa's mineral resources. This, she explained, undermines the national economic sovereignty and erodes the social and economic development impact.

Mr. Sybrand Struwig, the representative of SAI-SA to the WGEI said: 'It was clear from the presentations made by our guest speakers that IFFs is a complex and multi-facet process which one role player can't effectively detect, stop and recover alone. In this regard the engagements with FIC, SARS and DMR re-emphasised the need for all tasked to assess, regulate and audit to work together to build public confidence. I therefore believe that we as working group representatives were able to *extract* all that was worth from our peers and expert guest speakers, *exploit* all that was valuable from our deliberations and *produced* all that matters in our collaboration on the topic of auditing in the extractive industries.'

While the main theme of the annual meeting was illicit financial flows, the WGEI also addressed other priorities impacting it. Their discussions covered the design of a funding plan for the WGEI, establishment of Terms of Reference for each activity, the rollout of the Extractive Industries training framework, the

development and utilisation of an auditor’s toolkit, INTOSAI regional participation in the WGEl and collaborative audits.

Members of the working group also took some time out to enjoy a bit of the ‘wild side’ of Pretoria when they were treated to a game drive and had dinner among the lion enclosures where they were joined by Mr. Kimi Makwetu – Auditor General of South Africa.

The chairperson of the WGEl, Mr. John Muwanga, Auditor-General of Uganda, expressed his gratitude to SAI-SA for hosting the WGEl meeting and said it was very engaging with fruitful discussions on the progress of the implementation activities of the WGEl. In his words, ‘The arrangement to bring in external subject matter experts to address the committee members on the important topic of illicit financial flows brought in the required external influence to WGEl. We achieved a lot during the meeting and charted a new course.’

### A holistic approach to audit of extractive industries (By Allan K. Amany - OAG-Uganda)

The discovery of mineral resources usually promises to bring prosperity in form of higher tax revenue, increased employment, improved infrastructure and trade, greater growth and wealth creation for all. However, many resource-rich countries have not lived up to their development potential due to the “resource curse” of the negative effect of natural resources on the economy, society and politics in these nations. Even where the extraction of natural resources has led to economic growth, it has not necessarily been translated into better human development outcomes.

The exploitation of natural resources begins with the government’s decision to extract for jurisdictions where the sub-soil natural resources ownership rights are retained by government. Governments hold the rights to their resource endowments and they decide who should undertake exploration and production of oil, gas and minerals and under what terms. The exploration and production rights may be allocated by the government using various mechanisms which include concession, production sharing agreement, service agreement, and licence based on several investor selection mechanisms which include open door mechanisms (first come, first served basis or direct negotiations) or through a competitive bidding process. Regardless of the mechanism used to allocate and grant rights for the extraction of natural resources, Supreme Audit Institutions (SAIs) need to focus attention on “Award of Contracts and Licences” a stage considered critical to the Extractive Industries (EI) value chain because a badly negotiated contract has a ripple

effect on the subsequent stages of the value chain and could potentially erode the benefits accruing from the exploitation of the natural resources.

The EI value chain encompasses the government’s decision regarding the exploitation of natural resources, awarding contracts and licenses, regulation and monitoring operations, collection of taxes and royalties, revenue management and distribution and implementation of sustainable development policies as illustrated in the figure below.



Figure 1: Extractive industries value chain

The value chain concept provides a comprehensive integrated approach to developing extractive industries. As compared to the other segments of the value chain like regulation and monitoring of operations, collection of taxes and royalties, revenue management and allocation where quite a number of reports have been authored by SAIs, “Award of contract and Licences” segment reviews by SAIs remain scanty. It should be appreciated that the concept of value chain in the extractives industries highlights the importance of how the individual “links” in the chain create overall benefit for the extractive industries. Therefore, strengthening one link in the chain may push undesirable performance to other parts of it; hence necessitating a holistic approach.

In extractive industries, contracts/concessions/licenses span a long period of time and therefore a host government that consents to unfavourable terms may not realize better human development outcomes for its citizenry from the extraction of natural resources. Whereas it can be argued that it is incumbent on the relevant government ministry/department/agency to secure favourable contract terms that foster sustainable extraction of natural resources, a review of contracts and licences is still necessary and SAIs should take keen interest in this aspect of the value chain. For example, a well-functioning revenue management and allocation system is of limited value if the initial contract is not balanced and does not allow the government to capture sufficient taxes and royalties from the industry.

To further demonstrate the significance of the risks associated with the “Award of Contracts and Licences” segment of the value chain and the ripple effect to other stages of the value chain, below are highlights of some areas that SAIs could focus on.

- Local content requirements. In a bid to promote the local economy with regards to extractives industries, host governments normally embed local content requirements as part of the contract negotiations. This is likely to be a source of risk since the public officials responsible for the award of contracts or licences may impose particular local companies onto those foreign companies wishing to operate in the country to enter into partnerships. This could in turn affect effective monitoring and enforcement of compliance if the local partner fails to perform since the value is accrued to the corrupt public officials.
- Opacity in contract negotiations. Contracts negotiated in secrecy exacerbate the risk of violating or circumventing the existing laws for payment of taxes and royalties by setting incredibly low rates compared to the national rate and offering tax exemptions. This would in turn lead to potential revenue losses to the host government.
- The award of licenses and contracts in extractive industries is usually characterized by various payments among which include signature bonus. This is very common in the oil and gas industry where a one-off payment is made to the host government upfront in exchange for the company being granted a right to exploit a natural resource. This kind of payment is susceptible to abuse by public officials involved in contract negotiations due to the non-uniform criteria used to define its size. Therefore, it could constitute an avenue for bribery payments. It is critical that SAIs take keen interest in ascertaining how such one-off payments are determined.
- Inadequate legislative, regulatory and governance framework in licensing and contract award processes. It is of fundamental importance that the laws, rules and procedures governing the choice of systems for the award of natural resource extraction rights are clearly stipulated. This helps to mitigate corruption and investments that are not in the public interest and foster accountability.

It is therefore incumbent on SAIs to focus on, and institute robust auditing procedures for this key segment of the EI value chain because neglecting it could result in erosion of all the benefits associated with natural resource exploitation.

## **Trainings and events**

### **10th Meeting of the KSC Steering Committee** *(By Sheilla Ngira, CoP WGEI/OAG-Uganda)*

The 10<sup>th</sup> meeting of the KSC Steering Committee was held in Kampala Uganda from 20<sup>th</sup> to 22<sup>nd</sup> August 2018. The meeting was attended by representatives from the SAIs of Uganda, India, France, Indonesia, Philippines, China, and the INTOSAI Development Initiative (IDI), INTOSAI General Secretariat and Professional Standards Committee (PSC). The purpose of the meeting was to receive reports on the activities of the Working Groups (WG) and chart a way forward. The key messages from the meeting included:

- WG should embrace the INTOSAI Community Portal
- SAIs should focus on audit of SDGs
- The Quality Assurance process for all Non-IFPP products should be adhered to
- WG need to devise mechanisms of engaging more with the INTOSAI regions
- 

#### **INTOSAI Community Portal**

The INTOSAI Community Portal is an initiative of the KSC and IDI designed to provide a single online point of access to the KSC and all its Working Groups. Once work is completed, all WG will be required to migrate their websites to the Portal; each WG will have its own page. Users of the Portal will be able to request video conferences, write blogs, participate in a Community of Practice, post exposure drafts and events in the calendar, among others.

Administration of the Portal will be the responsibility of the KSC, while the WG will update the content on their pages, and the IDI will be in charge of outreach support. The Portal is currently in the testing phase. WG and SAIs are encouraged to use the webinar and video conferencing facilities of the Portal.

WGEI is working closely with the KSC Secretariat to ensure that its website is ready for migration to the Portal.

#### **Audit of SDGs**

Cross-cutting priority 2 of the INTOSAI SP 2017-2022 requires SAIs to contribute 'to the follow-up and review of the SDGs within the context of each nation's specific sustainable development efforts and SAIs' individual mandates.' SAIs can play their part by undertaking high quality audits of the implementation of SDGs by

their governments and thereby contribute to value and benefits for citizens.

A number of WG are incorporating audit of SDGs in their activities. IDI together with KSC are running a Programme aimed at supporting SAIs to conduct high quality audits of SDGs. The WGEI through an initiative led by the SAIs of South Africa and Zambia is promoting consideration of SDGs in the audit of Extractive Industries. WGEI will monitor the success of the initiative by collecting data and information, assessing the pace of implementation and measuring the milestones achieved. All members are called upon to support the initiative and provide relevant information to the Secretariat and the SAIs of South Africa and Zambia.

### Quality Assurance process for Non-IFPP products

The 3 Goal Chairs (KSC, CBC and PSC) issued a Joint Paper on Quality Assurance for Non-IFPP Documents which is applicable to all documents developed on or after December 2017. The process provides for 3 levels of quality assurance namely: level 1 where the document undergoes a process similar to IFPP documents, level 2 which involves external stakeholders and level 3 where the process is limited to the WG.

The process requires:

- All documents to contain a Statement of Quality Assurance,
- The Goal Chair to sign a Quality Assurance Statement,
- The WG Chair to sign a Quality Assurance Statement,
- Documents to include a revision/expiry clause, and
- All documents to have an annex outlining the quality assurance measures taken.

This development is very relevant to WGEI since it is currently working on a number of Non-IFPP products. All efforts will be made to comply with the Quality Assurance Process.

### Engaging with the INTOSAI regions

The INTOSAI regional organisations are very active within their respective regions and as such have close working relationships with their member SAIs. Through discussion the KSC Steering Committee concluded that the KSC and WG would be able to reach out to a large number of SAIs if they engaged more with the INTOSAI regional organisations. Greater outreach to the SAIs could result in:

- The WG and the KSC serving SAIs better

- Widespread utilisation of WG products among SAIs
- Improvement in sharing of information and knowledge on audit

WGEI has members from all the INTOSAI regions and would benefit from strengthening its relationship with the regions. While the Steering Committee is making efforts to reach out to the regional organisations, all members are encouraged to promote WGEI and its activities within their regions.

The key messages from the 10<sup>th</sup> KSC Steering Committee meeting were discussed at the annual WGEI Steering Committee meeting, and it was resolved that efforts will be made to incorporate them into WGEI activities.

WGEI Steering Committee (SC) Working Meeting, September 2018 (By Stefanie G. Fernandez – Norwegian Audit Office)



The Auditor-General of South Africa (AGSA) hosted the second WGEI Steering Committee Working Meeting, which was successfully held at AFROSAI-E's premises in Pretoria from 25<sup>th</sup>-27<sup>th</sup> September 2018. Some of the main discussions tackled involved the status for the implementation of the [WGEI Activity Plan 2017-2019](#), the rolling-out of WGEI products, and the strategies for engaging WGEI members and INTOSAI regional bodies. The theme of the external speakers' presentations was "Illicit Financial Flows" with keynote speakers from the [Financial Intelligence Centre of South Africa](#), [South African Revenue Services](#) and [Department of Mineral Resources of South Africa](#).

The meeting was attended by the Steering Committee members as well as representatives from the [Capacity Building Committee \(CBC\)](#) and [AFROSAI-E](#). Meeting presentations can be accessed [here](#).

### New Steering Committee members on board

As resolved in the [Washington meeting](#) last year, the number of WGEI Steering Committee (SC) members was increased from 5 to 10 members. In addition to SAI

Uganda, USA, South Africa, Iraq and Norway, the current SC members also include SAI Zambia, SAI Ghana, SAI India, SAI Fiji and SAI Ecuador. This year's meeting was therefore the first working meeting with the new WGEI Steering Committee member composition. The rationale for the expansion is both to ease the implementation of the WGEI activities and to ensure a Steering Committee with representatives from all INTOSAI regions. Currently, the Working Group has Steering Committee members from six INTOSAI regions, namely, AFROSAI, ARABOSAI, ASOSAI, EUROSAI, OLACEFS and PASAI.

### **Updates on the implementation of the WGEI Activity Plan**

Promoting good governance as well as facilitating knowledge sharing and networking in the extractive industries (EI), are some of the goals the Working Group aspires to. In its Activity Plan, the Working Group has identified six main activities to be conducted in order to achieve its goals, whereby each activity is led by one or two SC members. During the working meeting in Pretoria, each Activity Leader reported on the status of their respective activity and laid out the tentative action plans for 2019.

### **Rolling out WGEI products and tools**

2018 has also been a year of developing various WGEI products and tools. The Pretoria meeting therefore deliberated on the process of finalizing and rolling out these tools. These products include the "*Briefing note on the role of SAIs in the extractive industries*", the "*EI Training framework*" and the "*Extractive Industries Toolkit (EI Toolkit)*". The Briefing note aims to provide external stakeholders and the public a quick overview of the role of SAIs in the extractive industries as well as how SAIs can contribute to good governance in this industry. The second WGEI product, the EI Training Framework, lists the relevant topics to include and issues to consider in conducting EI trainings. It serves as a guide to SAIs in planning and providing trainings on the audit of extractive industries. Lastly, the EI Toolkit is a toolkit for auditors explaining each of the steps in the extractive industries value chain as well as the key considerations in auditing extractive industries. Moreover, it provides an overview of other relevant resources and guidance for auditors in conducting EI audits.

### **WGEI is about its members**

As WGEI was established for the benefit of its SAI members, a number of discussions also touched on how WGEI can involve its members in its activities as

well as engage the INTOSAI regional secretariats, to facilitate knowledge and experience sharing in the audit of EI. A first step in doing so was changing the composition of the SC to include members from different INTOSAI regions. Each Steering Committee member will therefore serve as an advocate for WGEI activities in their respective regions.

As a next step, each Steering Committee member will aspire to actively reach out to the SAIs and regional secretariats in their region. This is to ensure that the SAI community is aware of and informed about WGEI, its activities and how SAIs can benefit from it. As a Working Group, WGEI aims to create a platform where SAIs can exchange knowledge and experience about the EI, thereby contributing to strengthening SAIs' capacity to conduct EI audits and promoting good governance and transparency in the extractive industries.



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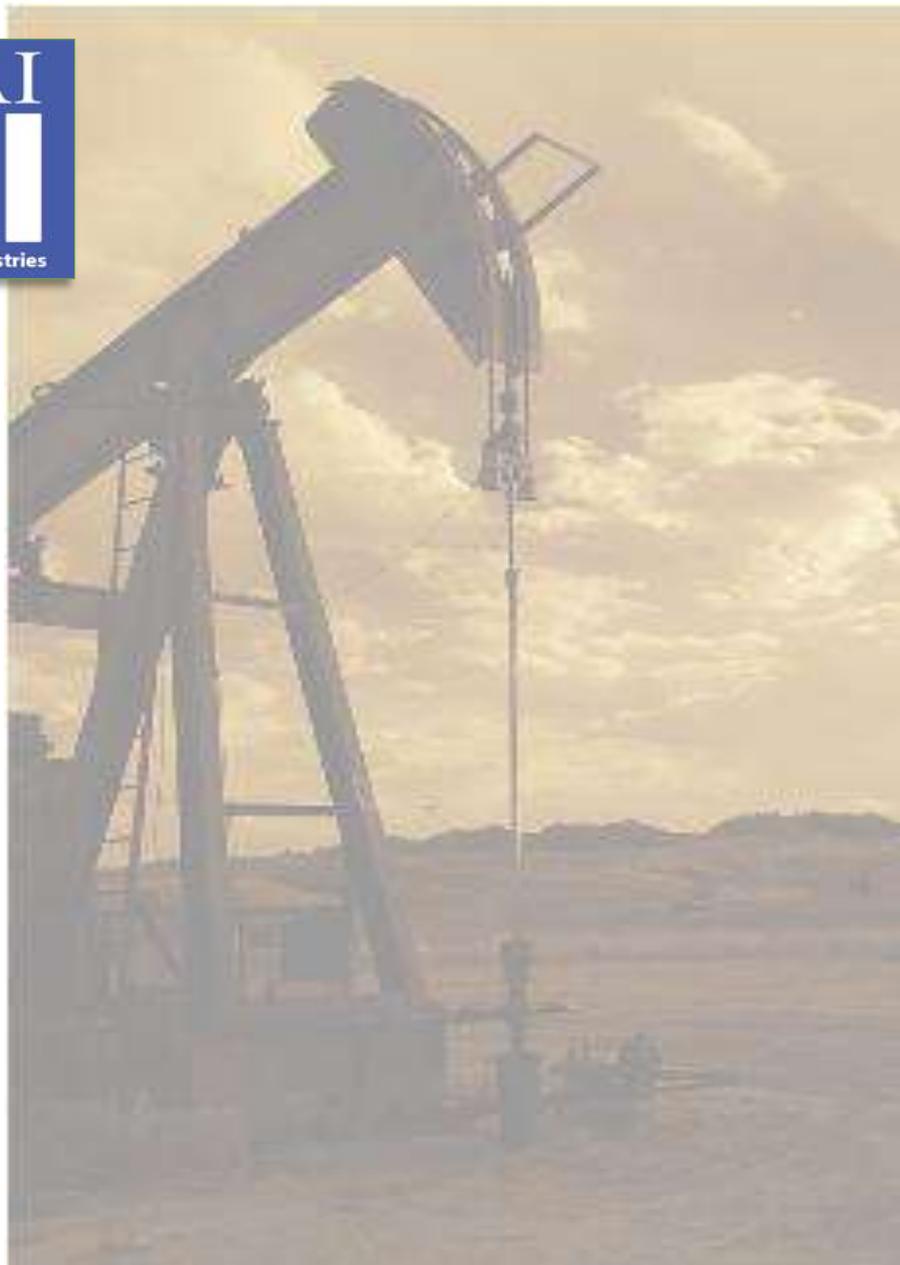
Watching Every Last Cent: New Tools for Monitoring Oil and Mineral Revenues

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Real Time Cost Monitoring and Audit Under the Production Sharing Agreement (PSA) In Uganda's Petroleum Sector

## Need to know

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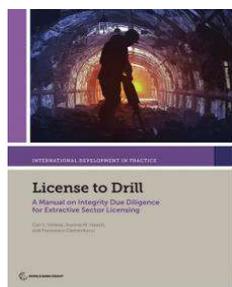
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### About this issue:

Welcome to the twelfth edition of the WGEI newsletter! In this edition of the newsletter, you can read about New World Bank Manual and other Resources could Increase Transparency in Extractive-Sector Licensing and Assist SAIs During Reviews, Watching Every Last Cent: New Tools for Monitoring Oil and Mineral Revenues, Real Time Cost Monitoring and Audit Under The Production Sharing Agreement (PSA) In Uganda's Petroleum Sector, Transfer Pricing Risk and the Extractive Industries: A Case Of Uganda, WGEI Steering Committee meeting 25<sup>th</sup> to 27<sup>th</sup> September 2018, Transfer Pricing (TP) Course held in Freetown Sierra Leone from 4th To 8th June, 2018.

Have a nice read!

## New World Bank Manual and other Resources could Increase Transparency in Extractive-Sector Licensing and Assist SAIs During Reviews (By US Government Accountability Office)



A new resource from the World Bank’s Financial Integrity Unit is now available and could be of assistance to Supreme Audit Institutions (SAI) when conducting audits using the extractive-industries value chain.<sup>[1]</sup> The value chain

describes the different steps of the development process, from discovery through extraction, to lasting value creation for society.<sup>[2]</sup> An important step in the value chain is the award of contracts and licenses. The World Bank’s *License to Drill: A Manual on Integrity Due Diligence for Licensing in Extractive Sectors* (Manual) is a toolkit of recognized concepts, good practices, and efficient options for policymakers and practitioners seeking to implement or improve integrity-screening systems in extractive sectors. The introduction of the manual underscores that, although the causes can be complex, there is widespread agreement that regulatory governance systems lacking transparency and having weak oversight and enforcement institutions facilitate an environment where rent-seeking and corruption thrive.



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Extractive Industries Value Chain

Co-author of the Manual and Senior Financial Sector Specialist for the World Bank Cari Votava described it as a tool to improve quality and transparency of integrity due-diligence components of regulatory governance in the extractive sectors. Ms. Votava explained that, although there are many points in the extractive-industries value chain where corruption vulnerabilities can emerge, licensing decisions are perhaps the most critical. She noted that few countries

can benefit when unsavory persons are granted licenses to operate in extractive sectors.

### Desk Manual Aims to Reduce Corruption Risks during Licensing

One of the overarching goals of the Manual is to identify good-practice options for reducing corruption risks in extractive industries by outlining methods to improve the licensing process, both to maximize the quality of entrants and to improve transparency at an early stage in the value chain. Before extractive licenses are granted or renewed, it is important to know who exactly the potential recipient is, including the beneficial owner, or natural person who ultimately owns or controls a legal entity or benefits from its assets. An effective and transparent licensing process can filter out many parties who might not act in a responsible manner, and it may have a positive impact on economic returns. Specifically, the Manual offers options for implementing effective and low-cost integrity-screening systems such as

- criminal-background checks,
- beneficial-ownership checks, and
- conflict-of-interest checks.

### International Frameworks Provide Potential Audit Criteria

International frameworks provide potential criteria for SAIs to use when reviewing issues related to the extractive-sector value chain. For example, the Manual uses the “fit and proper” concept from Principle #5 on Licensing of the Basel Core Principles for Effective Banking Supervision as criteria for ways to improve the quality of entities entering the extractive sector.<sup>[3]</sup> The fit and proper principle requires systemic and thorough integrity background checks on banking-license applicants, including documenting the identity of the beneficial owners of entities seeking bank charters.

Additionally, the Manual uses Extractive Industries Transparencies Initiative (EITI) Requirement #2 as criteria.<sup>[4]</sup> EITI Requirement #2 obligates countries to publicly disclose the identity of beneficial owners, among other things. According to the Manual, the disclosure of beneficial ownership requires the identification and verification of identity, which is done best before licenses are granted.

An additional framework that may be of use to SAIs when they consider corruption-related fraud risks during the awarding of contracts and licenses is the U.S. Government Accountability Office’s (GAO) publication *A Framework for Managing Fraud in Federal Programs* (Fraud Risk Framework).<sup>[5]</sup> According to GAO, fraud is obtaining

something of value through willful misrepresentation.<sup>[6]</sup> The Fraud Risk Framework, which was issued in July 2015, identifies leading practices to help program managers combat financial and nonfinancial fraud.<sup>[7]</sup> It also can be a useful source of criteria for SAIs in conducting program audits. Among other steps, the Fraud Risk Framework emphasizes the need for programs to plan regular fraud risk assessments and assess risks to determine a fraud risk profile. As part of assessing risks, managers are to determine where fraud can occur and the types of fraud the program faces, such as fraud related to financial reporting, misappropriation of assets, or corruption. Managers may consider factors that are specific to fraud risks, including incentives, opportunity, and rationalization to commit fraud. Additionally, the Fraud Risk Framework emphasizes that entities should design and implement a strategy with specific control activities to mitigate assessed fraud risks and collaborate to help ensure effective implementation. Lastly, the Fraud Risk Framework directs managers to evaluate outcomes using a risk-based approach and adapt activities to improve fraud risk management.

<sup>[1]</sup>Cari L. Votava, Jeanne M. Hauch, and Francesco Clementucci, *License to Drill: A Manual on Integrity Due Diligence for Licensing in Extractive Sectors* (Washington, D.C.: International Bank for Reconstruction and Development / The World Bank, 2018). <https://openknowledge.worldbank.org/bitstream/handle/10986/29809/9781464812712.pdf>.

<sup>[2]</sup>African Organization of English-speaking Supreme Audit Institutions, *Guideline: Audit Considerations for Extractive Industries* (November 2015).

<sup>[3]</sup>Basel Committee on Banking Supervision, *Core Principle for Effective Banking Supervision* (Basel, Switzerland: Bank for International Settlements, 2012). <https://www.bis.org/publ/bcbs230.pdf>.

<sup>[4]</sup>Extractive Industries Transparency Initiative, *The EITI Standard 2016* (2017). <https://eiti.org/eiti-requirements#eiti-requirement-2>.

<sup>[5]</sup>GAO, *A Framework for Managing Fraud in Federal Programs*, GAO-15-593SP (Washington, D.C.: July 28, 2015). <https://www.gao.gov/assets/680/671664.pdf>.

<sup>[6]</sup>GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: September 2014). <https://www.gao.gov/assets/670/665712.pdf>. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) updated its internal-  
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control guidance in 2013 with the issuance of a revised Internal Control—Integrated Framework. GAO’s Standards for Internal Control in the Federal Government adapts principles in the COSO guidance for the government environment, such as requiring managers to consider the potential for fraud when identifying, analyzing, and responding to risks.

### [Watching Every Last Cent: New Tools for Monitoring Oil and Mineral Revenues](#) (By Isabel Munilla and Kathleen Brophy, OXFAM America)

Every year, mining, oil and gas companies pay hundreds of billions of dollars to governments around the world. However, many countries rich in natural resources fail to translate this resource wealth into economic growth. [Between 2010 and 2015, we estimated that oil produced in developing countries alone amounted to about \\$1.55 trillion in government revenue. But the secrecy around these deals prevents citizens and regulators from tracking these monies to make sure they are spent on reducing poverty.](#)

Unfortunately, [revenue risks in the sector are many](#). Companies can easily employ various forms of tax avoidance and other tactics to minimize or potentially withhold payments due to the state. Company payments can be siphoned off as bribes or other illicit flows, completely bypassing government coffers. Once payments have been made to central government, they can also disappear during transfers to subnational governments. Governments must demonstrate to citizens that they are confronting these risks and using all strategies available to avoid revenue leaks and capture all potential revenues due to the state from the sale of scarce natural resources.

Thankfully, global transparency norms are changing and government regulators, such as SAIs, have a new suite of tools to fight for every last cent of their country’s oil and mineral wealth. After almost 15 years, Oxfam and its allies in the [Publish What You Pay](#) coalition were successful in achieving a new global norm of oil, gas and mining transparency. Since 2010, payment disclosure laws have been passed in the US, EU, Norway, the [UK](#) and [Canada](#), requiring companies listed on stock exchanges (and in some cases incorporated within these markets) to publicly disclose their payments to governments in all countries where they operate. All countries listed (except the US) have enacted their laws, providing regulators with a treasure trove of new data for revenue risk analysis. The [Extractive Industries Transparency Initiative \(EITI\)](#), which is now being implemented by over 50 countries, requires transparency of project payments and

receipts, subnational revenue, national oil and mineral company revenue, beneficial ownership and more. For the first time ever, we have access to detailed information regarding some of the most important transactions in the world.

### ***Why is this information unique and why should SAIs care?***

In the case of corporate project payment disclosure, the data provides a unique window into project payments by companies for specific contracts, and to specific government entities. Payments are disclosed annually by government entity paid and according to the company contract giving rise to the payment. This allows analysis of the revenue inflows to specific ministries, national oil, gas or mineral companies or subnational governments. In cases where a certain percentage of company project payments must be distributed by law to a subnational government, these disclosures can allow the calculation of the transfer amounts, and comparison to subnational government receipts to identify whether money has disappeared in the transfer. Similarly, payments to ministries and national oil companies can be analyzed in conjunction with budget allocation and forecasting plans for each government institution receiving payments. In cases where a certain oil and mineral project accounts for a large share of a government's revenue, this data may be of significant value. The information is also unique due to its author – the company department with reporting liability to securities or financial regulators in their home market or financial market. The quality of the data, its authorship, its reporting regularity and the disaggregation of the data are valuable features that make it unique.

[Online platforms now exist to make finding these new disclosures easier.](#) This newly available data is now being used in resource rich countries around the globe. One key use of the disclosures is to compare the disclosed payment data with government reports regarding the receipt of funds. In countries implementing the EITI, this payment reconciliation regularly occurs on a project by project basis. However, these new disclosures also provide us with information in non EITI countries.

A [recent report](#) by Global Witness provides additional guidance on how to use EI company payment data for a range of analyses that can identify red flags, including verifying royalty payments, assessing fair market commodity value, assessing reasonableness of profit taxes or confirming high-risk one-time payments. Indeed, civil society in many countries is undertaking analysis using the newly available project-level

disclosures to query government, conduct investigations, inform public debate and demand accountability.

### ***Data at work: Reconciling corporate and government payment data in Uganda's oil sector***

Corporate payment disclosures are particularly helpful in Uganda, where citizens do not have access to such information domestically. Civil society organizations in Uganda were able to use oil company payment disclosures to cross check receipts reported by the Bank of Uganda. Uganda's Public Finance Management Act created a Petroleum Fund designed to receive all oil-related revenues, and requires the relevant minister to table reports to parliament including "the source of the petroleum revenue". Therefore, in 2016 for the first time, the Bank of Uganda reported on the source of deposits into the Petroleum Fund. Unfortunately, the fiscal year used by the Bank of Uganda for reporting differs from that of the companies.

Using the available information, civil society groups compared Bank of Uganda disclosures alongside 2015 payment data disclosed by Tullow Oil and French oil supermajor Total. [According to their analysis](#), the government did not report approximately US\$14 million in payments disclosed by Tullow and Total. This may have been because the payments were transferred by the Ugandan government into its temporary oil revenue holding account, for which the government did not disclose receipts. Tullow suggested that it may be because the Ugandan government does not consider some of the payment types shown in Tullow's disclosures to be oil revenues (VAT, withholding taxes, national insurance, etc).

No matter the case, civil society organizations in Uganda used this information later when presenting to the Public Accounts Committee of Parliament during the so-called "[Presidential Handshake](#)" controversy. Civil society used this information to argue for more clarity in Petroleum Fund reporting as well as tighter controls regarding all deposits into and withdrawals from the Fund.

### ***Data at work: Evaluating uranium contract negotiation outcomes in Niger***

The payment data published by Areva makes possible an initial assessment of the negotiations that took place between Areva and Niger in 2014 when renewing uranium contracts. While civil society hoped to see increased revenues from uranium extraction after this historic agreement, the conclusion is quite clear: the negotiation did not lead to increased payments by

Areva to Niger to extract uranium. Nigerien uranium accounts for nearly 30% of the French company's production but Niger receives only 7% of Areva's payments to producing countries. The information published by Areva suggests that the new pricing formula applied to the royalty fees could have resulted in a 15 million euros decrease in royalty fees paid to Niger. It also indicates that Areva's uranium exports from Niger to France could be undervalued compared with prices for Nigerien uranium exports by other companies, which may have reduced Areva's contributions by between 10 million and 30 million euros in 2015. This information and analysis was recently published in the 2017 report [Beyond Transparency: Investigating the New Extractive Industry Disclosures](#).

### ***From payment to contract disclosure: Seizing new opportunities for accountability***

Civil society and other accountability actors such as SAIs can now effectively monitor extractive industry revenue payments to ensure that the maximum amount of revenue is equitably and efficiently returned to the citizenry in the form of high quality public goods and services. However, to analyze payments it is necessary to understand the original terms and fiscal regime agreed upon by the government and company during contract negotiations. Contract disclosure is essential to make full use of payments being disclosed.

For this reason, Oxfam and ally organizations such as NRGI have been advocating for widespread contract disclosure in the global extractive industries. Thanks to these efforts, contract disclosure is an emerging global norm. To date, nearly 1,600 contracts from oil, gas and mining projects in 90 countries [are publicly available](#). Governments are leading the charge as well. Twenty-six (26) countries now have mandatory contract disclosure laws including INTOSAI- WGEI members such as Ghana, Mozambique, Niger, Senegal, Sierra Leone and Tanzania. Contract disclosure in the extractive industries has also been endorsed by the IMF and is required by the World Bank's IFC and the European Bank for Reconstruction and Development for its private investments in oil, gas and mining.

A significant group of oil and mining majors now support contract disclosure in some form. According to Oxfam's recently published [Contract Disclosure Survey](#), 18 oil and mining companies have made statements in support of contract disclosure. These include oil companies such as Total, BP, Shell, Equinor (formerly Statoil), Petrobras, Kosmos Energy, Tullow Oil, and mining companies such as BHP Billiton, Rio Tinto,

Newmont Mining, Barrick Gold and Vale, among others.

Contract disclosure paired with reports on payments to governments allow for robust analysis of extractive industry activity in a given country. In several countries, Oxfam and ally organizations have used disclosed contracts to undertake economic analysis of a range of projects to assess fiscal regimes, project revenues and highlight risk areas. Recently, [Open Oil](#) analyzed a recently negotiated agreement between ExxonMobil and the government of Guyana. [The economic modelling](#) gleaned several important insights including one major conclusion that Guyana's shares of profits agreed to in the contract is "outlier low."

With such progress, Oxfam is now focused on getting the data to those who need it most. This data could be incredibly useful to national accountability institutions including SAIs. Alongside civil society, SAIs could benefit from this information for analytical purposes and risk assessments when conducting audits in the extractive industries. In this way, these data sources could supplement nationally available information and provide a credible point of comparison. Oxfam encourages SAIs to make use of these new disclosures as another important tool for ensuring accountability from both companies and governments in resource rich countries.

### [Real Time Cost Monitoring and Audit Under the Production Sharing Agreement \(PSA\) in Uganda's Petroleum Sector \(By Henry Luwemba Kasule – OAG-Uganda\)](#)

A number of fiscal regimes are applied in the Petroleum industry by different countries. It is difficult to evaluate one system over another as countries have specific conditions within them that favor one over another. Uganda as a country employs Production Sharing Agreements. Under these agreements, a company is licensed to undertake all risks involved in petroleum exploration. Should the company be successful, it is entitled to a share of the profit after recovering the costs incurred in the search for petroleum. This regime is good for Uganda as the country does not carry any exploration risk. Additionally, as the petroleum sector requires very skilled labour and specialized technology that was initially not in the country, the companies that were licensed brought with them the necessary skill set and technology.

The petroleum legislation in Uganda allows the government to undertake an audit of all the company's

costs to ensure that only necessary and economical costs involved in the search for petroleum are paid to the company under the cost recovery regime. These are referred to as cost recovery audits. The role of undertaking cost recovery audits is mandated to different institutions in different countries. For some, the National Oil Company undertakes the cost recovery audits, for others it is the Ministry of Petroleum or any other regulator, while for others it is the Supreme Audit Institution.

Irrespective of who undertakes the audit or review, the purpose is to ensure that only necessary and economical costs are recovered by the oil companies. However like all audits, the cost recovery audits are undertaken after an activity has been done or after the close of the year. Because of this, the audit serves to assist future operations and does not necessarily improve past or current operations. Additionally, exploration activities can happen over more than one year or across two calendar years especially for activities undertaken towards year end for example drilling deep wells, setting up central processing facilities and some surveys. As a result, the issue of cut off for activities that occur across two or more years occurs. It is important that an effective and efficient criteria is applied for reporting costs cutting across different periods. These particular incidences make the need for regular monitoring of all activities under the PSA very important.

Monitoring can take on many different forms for example field monitors deployed at all times in the fields, regular sharing of petroleum data in the form of daily drilling and activity reports, or installing smart meters. For any form of data sharing, it is important to determine who actually owns the data from petroleum activities. The company collects the data but it is important that this information is shared with the Government at no extra charge. Occasionally, oil companies have proprietary information and in many instances involving data exchange, the issue of confidentiality between the two parties is important and should be addressed beforehand.

### **The Ugandan Perspective**

The monitoring role starts at the budget approval stage. The petroleum regulations mandate that an Advisory committee is set up within 30 days of signing a petroleum agreement. The Advisory Committee considers the work programs, budgets and costs submitted by the licensed company. The companies are expected to submit their work programs and budgets for review at least 60 days before the beginning of the year. This is to enable adequate

revision of these budgets and work programs. The Advisory Committee is expected to convene meetings to deliberate on the work programs or budgets. The Petroleum Authority of Uganda (the Regulator) is authorized to either approve the submission of the Advisory Committee or reject it -with reasons. The licensed companies are allowed to resubmit the budgets and work programs to the Petroleum Authority thereafter. This is the first stage of cost monitoring applied in Uganda.

The Petroleum legislation allows the Government free access to any data it requires. Part nine of the Petroleum Exploration Development and Production Regulations 2016 detail the reports that should be submitted to the regulator by the licensed companies. These include daily, weekly, and monthly reports. Additionally, activity reports should be submitted at the end of each activity. Examples of reports that should be submitted include; a daily drilling report, a casing and cementing report, a daily mud report, a health, safety and environment report, a daily geology report, a daily cost estimate report, a choke manifold and blow-out preventer test report, a daily operations report, and a kick sheet.

Form 12 of the above mentioned regulations lists the reports that should be provided to the Regulator by a licensed company. Additionally, the company is required to submit real time data to the regulator for any drilling campaign. This should keep the Regulator informed of all activities as they occur. Furthermore, the daily drilling and operations report that is submitted should have at least a 24 hour forecast. This gives an estimation of the costs expected to be incurred in the next 24 hours. The objective of requiring all this information to be submitted is to ensure that the Regulator gets regular updates on all activities and the costs involved. This is an important step for cost control by the Regulator. This data once submitted can be reviewed early enough before the final cost recovery audit. This enables real time monitoring of the petroleum activities.

This is in addition to the monitors assigned to the licensed companies. A monitor employed by the Regulator stays in the field and sends his/her own reports about each activity on a daily basis to the Regulator. The monitors are rotated regularly. The monitoring role is undertaken by staff of the Petroleum Authority and all other institutions involved such as the National Environment Management Authority, and the Uganda Wildlife Authority for activities in national parks. The monitoring reports are important for the audit as they give first hand accounts of what

happened in the field in addition to the reports from the companies.

Real time monitoring is important for both the company and the Government. For example, if a well is drilled and it was expected to use 100 casings but it uses only 80 casings, both the Government and the drilling team will immediately be aware of the amount of casings used rather than waiting for a stock taking exercise. This improves inventory movement on the company's part. It also ensures that by the time the final cost audit is undertaken, most of the costs have been reviewed through this mechanism.

Furthermore, should there be an incident that could potentially jeopardize the progress of the well or make it difficult to complete any drilling campaign, this information is relayed to the Regulator immediately. This enables quick remedial action both at budget level and at the point of work in the field. Since all costs to be incurred should have undergone the approval process, should they rise to a point at which they may exceed the budget, all parties involved will be aware. Furthermore, it is important for a company to notify the Regulator about such occurrences. This limits incidences of costs exceeding budgets.

Review of all this information is important in order to undertake a comprehensive audit of the sector. This review can be initiated as early as when quarterly cost statements are submitted to the Regulator. The value of work done can be audited and redundancies put in place for any delayed invoicing. Real time audit reviews by nature are meant to ensure that costs are controlled at an early stage. They furthermore reduce the work to be undertaken at the end of the year. As a result, the audits will take a shorter time to be completed.

## Conclusion

As profit is a function of cost, it is important that costs are kept at a minimum. Real time review and monitoring activities are important for both the Regulator and the licensed companies and should be encouraged. During the final cost recovery audit, these cost reports are useful for both the contractor and the auditor as they are expected to communicate with the final cost recovery statement submitted to Government. For activities cutting across more than 1 year, care should be taken for any cost recovery to be made. The costs submitted for recovery should have been approved in the year they are incurred irrespective of the fact that the activity was initiated the previous year.

All this is done to ensure that the Regulator is kept abreast of all activities in the field, but it is also beneficial to the company. This might seem like a lot of information but the oil and gas industry is run on information and any information asymmetry is dangerous for either party. From the reporting requirements, it can clearly be seen that cost control is not a preserve of only the cost monitors but also geologists, drilling engineers, environmentalists' auditors and all concerned parties.

## Transfer Pricing Risk and the Extractive Industries: A Case of Uganda (By Godwin Matte - OAG-Uganda)

There has recently been significant debate about Uganda's double taxation treaties with countries like Mauritius and the Netherlands and the amount of revenue lost through these agreements. Much as this is an issue, there is an even deeper underlying problem. Countries around the world and especially resource rich African countries are grappling with the ever increasing threat of multi-national company transactions. Over 60% of international transactions are between companies within the same group structure, which exposes the countries of operation to the risk of transfer mispricing.

In simple terms, the price at which one company sells to another company within the same group structure is the "transfer price". This price can be abused through "transfer mispricing". The "arms-length principle" however requires companies to transact as though they were non-related (Independent).

The extractive industries comprise majorly mining and oil and gas from which many African countries derive their revenue. As a result, the issue of transfer mispricing should be of major concern to these states otherwise they will not realize the full potential revenues associated with the sector.

It is important to understand the extractive industries value chain for both mining and petroleum and assess the risk across this chain based on the functions performed at each stage. According to the Natural Resource Governance Institute (NRGI), the value chain consists of the Acquisition and exploration phase, Development and production, Transportation, Refining and finally trading, marketing and sales of petroleum or minerals. There are however different variants of the value chain introducing aspects of the legal framework, contract award, licensing and revenue allocation and management.

Depending on what stage of the value chain a country is, the risk of transfer mispricing may vary. A lot of focus is normally centred at the end of the value chain where revenue begins to flow to the country and thus the cost aspects that determine the resultant revenue are often ignored.

To put this into perspective, there have been numerous discussions around the value of the Extractive Industries Transparency Initiative (EITI) to a country like Uganda. However, despite the various facets of the EITI guidelines, more emphasis is placed on transparency of the revenues earned from payments made by the oil companies. This ignores the cost element that could be inflated by practices like transfer mispricing resulting in further erosion of revenues. This affirms the significance of cost recovery audits under a production sharing regime in the petroleum industry. In the exploration and development phase of the oil and gas industry where Uganda lies, different transfer pricing risks may arise. This is more of an expenditure phase and thus more emphasis is placed on cost management. As earlier mentioned, it is the efficient monitoring and management of these costs that will provide us with an adequate share of revenue at the end of the value chain.

Locally registered oil companies (subsidiaries) receive various forms of support from their headquarters (parent company) during this phase. This phase involves numerous technical and research oriented studies normally performed at a technical hub at the headquarters or another low tax jurisdiction. The studies are usually undertaken using a time-rate system whose rates are subject to debate. These are considered high value adding services. It is still important to ensure that these rates are at arms-length and that these studies and research are of benefit to the subsidiary incurring the cost.

Further, parent companies may offer loans to their subsidiaries to aid in cost intensive exploration and development work programs. There is always a risk that these rates are above average market rates or international comparable interest rates on loans to similar projects in similar jurisdictions. Other low value adding support services such as legal services, audit and accounting need adequate attention to establish the value added to the subsidiary and the cost and markups charged.

At the end of the value chain, the risks tend towards the pricing mechanisms and the marketing costs for the oil or minerals. The parent company could set up a marketing hub at the headquarters or a low tax jurisdiction to market and sell the products on behalf

of the subsidiary. It is important to understand the functions of these hubs, the risks they incur and their ability to provide this service. It is also vital to ensure that the marketing cost charged is comparable to what an independent party would pay for the same service. Pricing becomes more complicated especially with related party transactions. The parent company or marketing hub could offer lower prices for the products sighting quality reasons. The government should hence have the capacity to determine the quality of its products. Further, the subsidiaries could enter into long term hedging contracts with the parent or marketing hub to buy the products at lower prices than the prevailing market rate. All these measures erode the revenue due to the country, if not checked.

Legislation plays an important role in addressing these issues. Uganda has transfer pricing regulations enshrined within the Income Tax Law. Many other countries however lack sufficient legislation. The OECD (Organization for Economic Co-operation and Development) through the BEPS (Base Erosion and Profit Shifting) project has made significant steps in designing guidelines on tackling transfer pricing issues across the globe. Many countries have adopted these guidelines (Uganda inclusive) and if implemented, should reduce the loss of revenue through transfer mispricing.

It is important for this legislation to be consistently applied in both mining and petroleum agreements. Uganda's petroleum sharing agreements consistently refer to the arms-length principle between related party transactions, which gives the country a buffer against the risks involved. Further, regulation 73 of the Petroleum Exploration Development and Production regulations 2016 clearly defines the mechanism of pricing crude oil clearly making reference to the arms-length principle and a "norm price" mechanism that provides a buffer against transfer mispricing risk.

Transfer pricing audits normally fall within the mandate of the revenue authority. Within the East African region, both Tanzania and Kenya have recognized the risk and conducted separate transfer pricing audits across various sectors. The Tanzania Revenue Authority in particular has performed audits in both the mining and petroleum sectors. These audits require efficient co-ordination of government agencies such as the Ministry of Energy, Sector regulators, the Office of the Auditor General and the Revenue Authority.

The International Monetary Fund (IMF) estimates that over USD 50 Billion annually is lost from Africa through Illicit Financial flows especially by aggressive transfer

mispricing arrangements. Resource dependent African countries thus need to enhance their capacity in the audit and review of transfer pricing issues in the extractive industries to reduce these outflows.

### **Trainings and events**

#### [WGEI Steering Committee meeting 25th to 27th September 2018](#) *(By WGEI)*

The WGEI Steering Committee meeting will take place in Pretoria, South Africa from 25<sup>th</sup> to 27<sup>th</sup> September 2018. The meeting will be attended by members of the Steering Committee and WGEI Observers. The purpose of the meeting will be to discuss the progress made in implementing the WGEI activity plan, and future plans. WGEI members are encouraged to bring to the attention of the Secretariat any matter that they wish the Steering Committee to discuss at the meeting.

#### [Transfer Pricing \(TP\) Course held in Freetown Sierra Leone from 4th To 8th June, 2018](#) *(By Godwin Matte – OAG-Uganda)*

Transfer pricing (TP) is an ever-growing concern for resource rich under-developed countries. The OECD (Organization for Economic Co-operation and Development) and the BEPS (Base Erosion Profit Shifting) project have gone a long way in preparing guidelines and regulations that such countries can adopt in order to tackle this problem. African countries are losing over USD 50 Billion a year to Illicit Financial Flows majorly through TP.

A training workshop on TP in the Extractive industries was held at the Audit Services office in Freetown, Sierra Leone from 4<sup>th</sup> to 8<sup>th</sup> June 2018. The training was conducted by transfer pricing experts from SAI Norway and SAI Uganda purposely to enhance the capacity of the audit staff and the relevant stakeholders on the subject.

Sierra Leone produces Iron ore, Rutile, Diamonds, and Gold amongst other minerals on which the economy is predominantly dependent. This increases the country's exposure to TP risk considering that the majority of the licensed mining companies are foreign multinationals.

The workshop involved participants from other Government agencies and civil society such as the National Mining Agency (NMA), the National Revenue Authority (NRA) and the Sierra Leone Extractive Industries Transparency Initiative (SLEITI), which emphasized the value of an interagency co-ordinated effort in addressing this TP problem.

Discussions majorly centred on the fiscal aspects of mining and petroleum contracts, key TP risks within the Extractive industries value chain, TP legal framework and documentation, the TP audit process, Functional Asset Risk analysis, Comparability databases and tackling various case studies.

The participants were actively involved in experience sharing throughout the course and showed a great desire to increase their knowledge on the subject. Possible areas for future audits were discussed and an action roadmap was agreed upon. This was a positive step in the capacity building process and the continued co-ordination between the various SAIs in the Extractives Industries.



# INSIDE THIS ISSUE

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AFROSAI- E Is Updating Its Audit  
Guideline for Extractive Industries

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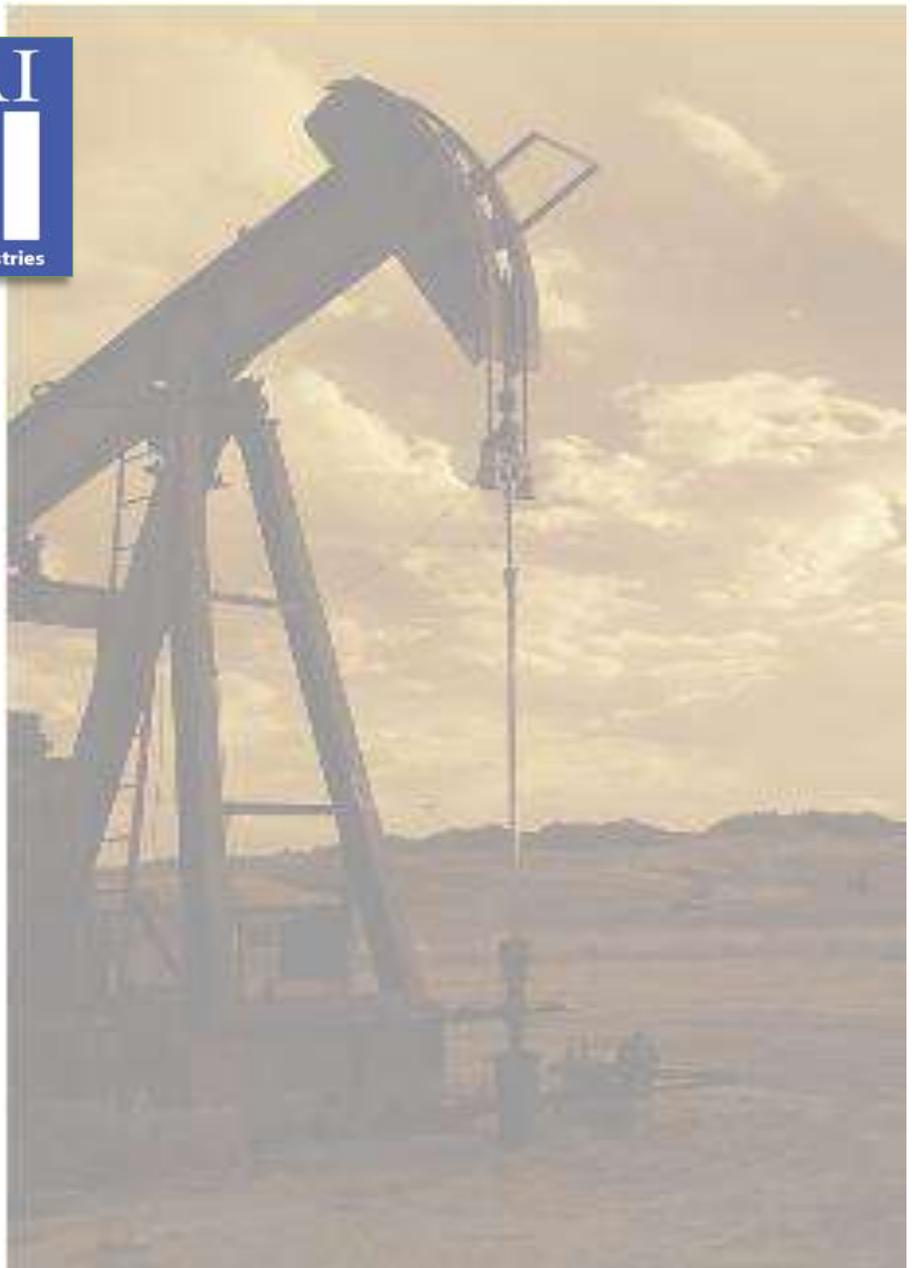
The Audit Office of Vietnam Audit on  
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and Mining during the period 2014-  
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Artisanal Mining in Uganda

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SAI Uganda: Meeting the Challenge  
of Extractive Industry Auditing



ISSUE NO. 11 | MAY 2018

**About this issue:**

Welcome to the eleventh edition of the WGEI newsletter! In this edition of the newsletter, you can read about AFROSAI- E Is Updating Its Audit Guideline for Extractive Industries, The Audit Office of Vietnam Audit on The Licensing of Mineral Exploration and Mining during the period 2014-2016, Artisanal Mining in Uganda, SAI Uganda: Meeting the Challenge of Extractive Industry Auditing, Zambia Hosts The 2nd meeting of the INTOSAI Working Group On Extractive Industries (WGEI) Learning Taskforce.

Have a nice read!

## Need to know

### [AFROSAI- E Is Updating Its Audit Guideline for Extractive Industries](#) (By Nikeziwe Khanyile – Technical Assistant Manager/AFROSAI-E)

The currently in force AFROSAI-E guideline on “Audit Considerations for Extractive Industries” was updated from a 2013 version in the year 2015. The update resulted in some sections of the 2013 version being deemed irrelevant after implementation in the region, such as detailed audit procedures, being removed. Some of the sections were re-written in order to clarify that the principles applied to oil and gas are equally applicable to mining. With the passage of time as the AFROSAI-E region matures in the audit of the EI sector, and in line with the founding principles of AFROSAI-E on incessant innovation – an updated version of the guideline is required.

The growth of the Extractive industries sector in Africa is escalating. This sector continues to present a number of challenges for the public sector. The regulatory framework that is needed to ensure a sustainable development of the sector, a fair share of income and an equitable distribution of that income, is complex and challenging. It has been noted that the current guideline needs to be conscious of some of the latest developments, trends and initiatives in the extractive industries post the industry’s “super cycle”. Under the current and previous versions of this guideline, the AFROSAI-E region has embarked on several audit projects in the EI sector whose indelible experiences need to be formally documented and catalogued as good practice. Currently there is no single platform which exists as such a body of knowledge. As audit practice has revealed with time, the guidelines have existed exclusively as informers of knowledge to the audit teams, it has been noted that the guidelines can also be redesigned into both an informer and an auditing tool for the SAIs.

It is the developer’s opinion that if the above needs are addressed, this guideline will be once again positioned to continue enhancing the institutional capacity of SAIs in understanding how the Extractive Industries sector can be organized in petroleum and mineral producing countries and to assist auditors in performing audits in a more efficient and effective manner.

The desired objectives to address the needs stated above are to update the current AFROSAI-E Extractive Industries guideline to:

1. Inform the users on the latest developments, trends and initiatives in the sector;

2. Show case progress in the AFROSAI-E region experiences through giving real SAI examples;
3. Position the guideline as the backbone for development of an AFROSAI-E, e-learning program on EI sector audits;
4. Ensure the guide is both an informer and a tool for SAI in the EI sector.

### [The Audit Office of Vietnam Audit on The Licensing of Mineral Exploration and Mining during the period 2014-2016](#) (By Phan Truong Giany – Deputy Director Department of International Cooperation SAI Vietnam)

In 2017, the State Audit Office of Vietnam conducted an audit on State management of mineral exploration and mining during the period 2014-2016 at the Ministry of Natural Resources and Environment (MONRE), Ministry of Industry and Trade (MOIT) and 08 provinces/cities. One of the most important tasks of the audit was “auditing the licensing of mineral exploration and mining”.



*Mining in Vietnam*

The Vietnam Mineral Law 2010 regulates that the licensing for mineral exploration and mining is under the jurisdiction of the MONRE and provincial people’s committees, in which:

- Provincial People’s Committees shall grant the mineral exploration licenses for minerals which are used as common construction materials and minerals in scattered and small-scaled areas zoned off by the MONRE and licenses for salvage mining of minerals;
- The Ministry of Natural Resources and Environment (MONRE) licenses other types of resources and minerals.

Statistical figures of licenses for the exploration and mining of minerals granted during the period 2014-2016 are demonstrated as follows:

*(i) Granted by MONRE:*

No.	Year	Mineral exploration license				Mineral mining license			
		Total	New license	Extended license	Transferred license	Total	New license	Extended license	Transferred license
1	2014	34	30	03	01	41	38	03	01
2	2015	37	36	01	0	44	40	02	02
3	2016	37	33	03	01	25	21	01	03

(ii) *Granted by People’s Committees of 63 provinces/ cities:*

– In 2014: Granted 1,114 licenses for mineral activities, including 473 mineral exploration licenses and 641 mineral mining licenses.

– In 2015: Granted 853 licenses for mineral activities, including 408 mineral exploration licenses and 439 mineral mining licenses.

The audit findings revealed several weaknesses of the licensing process for mineral exploration and mining in Vietnam during the period 2014-2016, such as:

(i) *Regarding licensing procedures:*

– Some exploration dossiers licensed by MONRE did not receive the localities’s response of licensing in time.

– Licensing procedures did not comply with regulations: Exploration licenses were granted to auditees when they had not fulfilled the obligation to pay fees.

– In some provinces, dossiers approving mineral reserves were not proved to have been inspected and supervised by the Department of Natural Resources and Environment. Besides, these did not include dossiers of appraisal on mineral reserves, meanwhile the capacity dossiers did not meet the necessary requirements for organizations operating in the field of minerals exploration; some organizations/bodies conducted minerals exploration and fulfilled their financial obligations without minerals mining licenses from the Department of Natural Resources and Environment; or the approved dossier lacked documents showing the equity commitment letter.

(ii) *The implementation of zoning restricted areas and planning of the local’s construction materials development*

– Overlapping planning: The planning for mineral activities did not consider the master plan of socio-economic development in 2020, and vision 2030; there was overlapping in some aspects of local mineral planning and local socio-economic development planning; coastal industrial zones overlapped with the zoning of national mineral reserves; general planning and planning of construction materials development was not appropriate in terms of planning period; insufficient statistics on the remaining reserves of minerals at the time of formulating the planning scheme.

– The MONRE shall delineate and announce the areas with small-scale and scattered minerals. Areas which have not auctioned their mineral mining rights should be reported to the Government before reaching a final decision.

– The delineation of most localities did not meet related requirements of the Government.

(iii) *The granting of mineral licenses in some localities was against the regulations stipulated by the law, applied for inappropriate subjects with wrong competence, proved to be overlapped and carried out without planning.*



With the above mentioned audit findings, SAV made the following suggestions to the MONRE and Provincial People’s Committees aimed at rectifying existing shortcomings in the licensing process for mineral exploration and mining:

*For the MONRE:* Examine and consider revoking licenses of enterprises with violations; Direct related provinces to clarify the overlapping of zoning coastal industrial zones with the planning of mineral reserves so as to report to the Prime Minister for settlement; Instruct and guide mines to complete dossiers of applications for the re-granting of mineral licenses as

stipulated in the Vietnam Mineral Law; to charge fees for the licensing of mineral exploration and mining.

*For Provincial People's Committees:* Enhance inspection, examination and review to promptly detect violations in the mineral field; apply administrative sanctions towards violations under their competence; direct tax offices to take measures to deal with debts arising from the fees of granting minerals mining licenses, natural resource tax, environmental protection fees and enterprises' land rents for mining ; inspect and review all mines already licensed but not operating in the prompt manner required by current regulations for handling and withdrawing licenses as stipulated in the Vietnam Minerals Law; identify and deal with enterprises illegally mining minerals or enterprises conducting minerals mining but not carrying out post-licensing procedures; withdraw the licenses granted to enterprises that have conducted mineral exploration and mining but not obeyed the law.

–SAV'WGEI–

### Mining in Uganda: The case for a National Mining Company (By Henry Luwemba Kasule – Senior Auditor - OAG-Uganda)

In Uganda Minerals are owned by the state in trust for the people of Uganda as stated in the Mining Act 2003. However, there is no requirement for state participation nor to have a company or corporation that can hold the commercial interests of the state in the mining industry.

Bearing in mind the mineral sector contributed as much as 30% of Uganda's GDP in the early 1950s in comparison to the current situation where it only contributes less than 1%, there is need to come up with catalysts that can stimulate the development of this once captivating Industry.

In the petroleum sector, the need for the formation of national companies arose from the importance accorded to petroleum. Petroleum was seen as such an important commodity that government participation was deemed a necessity. State participation in the mining sector has not had the same verve as in the petroleum sector. However there is steady increase in state participation around the world.

Initially countries were comfortable with legislation and regulations. This however seems to be changing-at least in East Africa where the new mining act 2016 in Kenya requires that a national mining corporation is

put in place. The purpose of the corporation is to be the investment arm of the government in the mining sector. The functions of this corporation include but are not limited to; engaging in mineral prospecting and mining, investing on behalf of the national government, acquiring by agreement or holding interest in any undertaking, enterprise or project associated with the exploration, prospecting and mining among others.

Tanzania's new mining bill has a number of mechanisms the government has come up with in the mining sector these include the Ministry, a Mining Commission (supervision and regulation), the Geological Surveys of Tanzania (Geological mapping, data collection) Gem and Minerals Houses, The Government Minerals Warehouse (central custodian of all metallic mineral and gemstones won by mineral right holders in Tanzania). All interventions made to ensure adequate state control.

Through these recent interventions, Kenya and Tanzania are ensuring more control in the mining sector. In order to effectively talk about state involvement in the mining industry, it is important to determine two concepts; ownership and control. Ownership is determined by the fact that the minerals are owned by the citizens. Does ownership tantamount to control? Is the setting of effective regulation and monitoring adequate control?

There is a strong correlation between the need to nationalize and the price of the minerals. When the metal process or mineral prices are high, the need to nationalize the mineral sector is fever pitch. When the prices drop, the interest in nationalization reduces as well. Demand for minerals has also increased. This has raised further national interest in the mining industry.

While it is easy to form a national petroleum company due to the fact that petroleum is a homogenous substance, this is not the same with the mining companies. Minerals are varied in nature and as a result, there is a need to have different technologies for the different minerals in terms of extraction.

### The case for a national mining company in Uganda

Currently, the Directorate of Geological Surveys and Mines regulates the mining sector. The commercial aspects are left to the miners i.e. they can look for the market and undertake their own mineral processing. The closest Uganda has to a national mining company is Kilembe Mines Limited. – A company currently undertaking care and maintenance of the vast Kilembe Mine complex.

In Uganda, the National Mining Company would go a great extent in developing national, social economic and political objectives. However, balancing the commercial and noncommercial aspects is normally the most difficult part of any national enterprise- this does not mean that it cannot be achieved. Section 18 of the Mining Act 2003 allows for the development of a mineral agreement. However, this seems to be an option rather than a requirement. Currently there is no model mineral agreement that Uganda could follow or apply.

For any mineral agreement signed, there should be a requirement for state participation in the commercial management and development of its mineral resources. This will not only ensure sharing of knowledge and technology but it will be necessary when the International companies walk out or stop production. It is a characteristic of the extractive industries that if for any reason the production companies can no longer make the required profits, they close shop even if the petroleum or mineral resources are still in the ground.

The technical know-how developed by the National Mining Company will be able to be used for continued development of the industry. Furthermore, this will provide an opportunity for the state to directly spur development in the sector through its direct participation.

While state participation does not necessarily spur development in the sector, considering the state in which the Uganda mining industry is, state participation is welcome.

In order to effect state participation, it is imperative for adequate financing to be provided.

For example a number of agreements could require that the interest of the state is carried up until that time when the state is ready or up till production. In that way the carried interest is recouped during production. Additional mechanisms intended to ensure that the state benefits from the mining industry, which are not discussed in this paper, can be put in place.

Furthermore, it would be prudent for the government to establish if it wishes to acquire the right for exploration only, refining/ beneficiation or for both these activities. Some states prefer to only get involved in the refining and beneficiation and not venture into the highly risky exploration stage.

There is a further need for prioritisation, the government could choose what minerals it should best

invest in. Uganda is endowed with more than 20 minerals capable of providing adequate economic returns for all involved.

## Conclusion

As Uganda's mining industry is in what could be considered a 'budding' stage. The need to introduce a National Mining Company should be considered specifically to ensure that the commercial interests of the state are effectively managed.

There are countries where national mining companies have had a successful union with privately owned companies as is the case for Botswana and Namibia with the companies appropriately named Debswana and Namdeb respectively. This could be easy in a way that they both trade in only one commodity – diamond. It is however necessary for skill development for Uganda to acquire a National Mining Company. Its objectives and mandate should be well laid out in legislation. Direct state participation might give a much needed boost to Uganda's Mining Sector.

[SAI Uganda: Meeting the challenge of Extractive Industry Auditing \(By INTOSAI-Donor Cooperation Secretariat\)](#)

Did you know that the Office of the Auditor General of Uganda is enhancing the benefits of extractive industries to citizens?

Here is how:

- Strong SAI leadership, cooperation and harmonized donor support
- Auditing to ensure the use of oil industry revenue for the benefit of Ugandans
- Empowering local communities working in the mining sector
- Taking auditing to the next level with its risk analysis system
- Leading the INTOSAI Working Group on Extractive Industries
- Pushing the government to assess the right balance between benefits from the new oil industry and the preservation of valuable natural environments.

Do you want to know how OAG Uganda together with members from the [INTOSAI-Donor Cooperation](#) got there and what the plans for the future are? Click [here \(http://intosaidonor.org/stories/enhancing-the-benefits-of-extractive-industries-to-citizens-the-uganda-story/\)](http://intosaidonor.org/stories/enhancing-the-benefits-of-extractive-industries-to-citizens-the-uganda-story/) to read the whole Uganda story!

## Trainings and events

### Zambia Hosts the 2nd meeting of the INTOSAI Working Group on Audit of Extractive Industries (WGEI) Learning Taskforce *(By Ellen Muleya Chikale – Head Public Relations SAI Zambia)*

The Office of the Auditor General Zambia hosted the second meeting of the INTOSAI Working Group on Audit of Extractive Industries (WGEI) learning task force in Lusaka, Zambia from 9<sup>th</sup> to 12<sup>th</sup> April, 2018. The purpose of the meeting was to review and update the draft Extractive Industries Training Curriculum.

The meeting was officially opened by the Permanent Secretary of the Zambian Ministry of Mines Mr. Paul Chanda. In his remarks he said that the Office of the Auditor General remains key in helping government to manage natural resources in the best interest of the public.

Mr. Chanda has also said that the Office of the Auditor General is keen on ensuring that there is accountability regarding the taxes the country was reaping from the mining sector. He said that the significance of the Extractive Industries (EI) has been noticed by several international networks and foras, INTOSAI included.

Mr. Chanda observed that the EI were known for generating high economic rent which is the difference between the value and the cost production and there is need to audit it effectively.

He noted that the Task Force meeting was in line with the country's Seventh National Development Plan (SNDP) first pillar development outcome number 2 where Zambia was focusing on having a diversified and export-oriented economy with value added to mineral products.

And speaking earlier, Acting Auditor General Mr. Ron Mwambwa said that the meeting would help build capacity in the participating countries to handle the task of auditing the Extractive Industries as it was a very complex matter.

Mr. Mwambwa further intimated that member countries of WGEI and the INTOSAI community at large stand to benefit once the capacity is built as reports that will be coming out will be of great value to the citizenry.

Meanwhile, Assistant Director of Audit in the Office of the Auditor General Uganda Mr. Anthony Kimuli in a speech read on behalf of the Auditor General of Uganda Mr. John Muwanga said most countries lack

capacity and knowledge to audit the Extractive Industries effectively and efficiently.



*Mr. Anthony Kimuli - Assistant Director of Audit in the Office of the Auditor General Uganda*

Mr. Muwanga said it was against this background that a working group on extractive industries was set up within the auspices of INTOSAI to help member countries to provide assurance to their citizens that governance structures that oversee the utilisation of public resources including oil, gas and minerals were sound and transparent and attain the best value.

He further explained that if SAIs carry out effective extractive industry audits, their governments would manage these huge revenue generating resources in the best interest of their citizens thus lead to the achievement of the sustainable development goals (SDGs).

He hoped that the curriculum which was being developed would be used by INTOSAI to impart better knowledge and skills in their auditors to audit the EI for the betterment of the welfare of their citizens in their countries.



*Group Photo*

The meeting was attended by eight countries namely India, Iraq, Vietnam, Ghana, Zimbabwe, Norway, Uganda, Zambia and a representative from the AFROSAI-E.



# INSIDE THIS ISSUE

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Linking Extractive Industries and the Sustainable Development Goals

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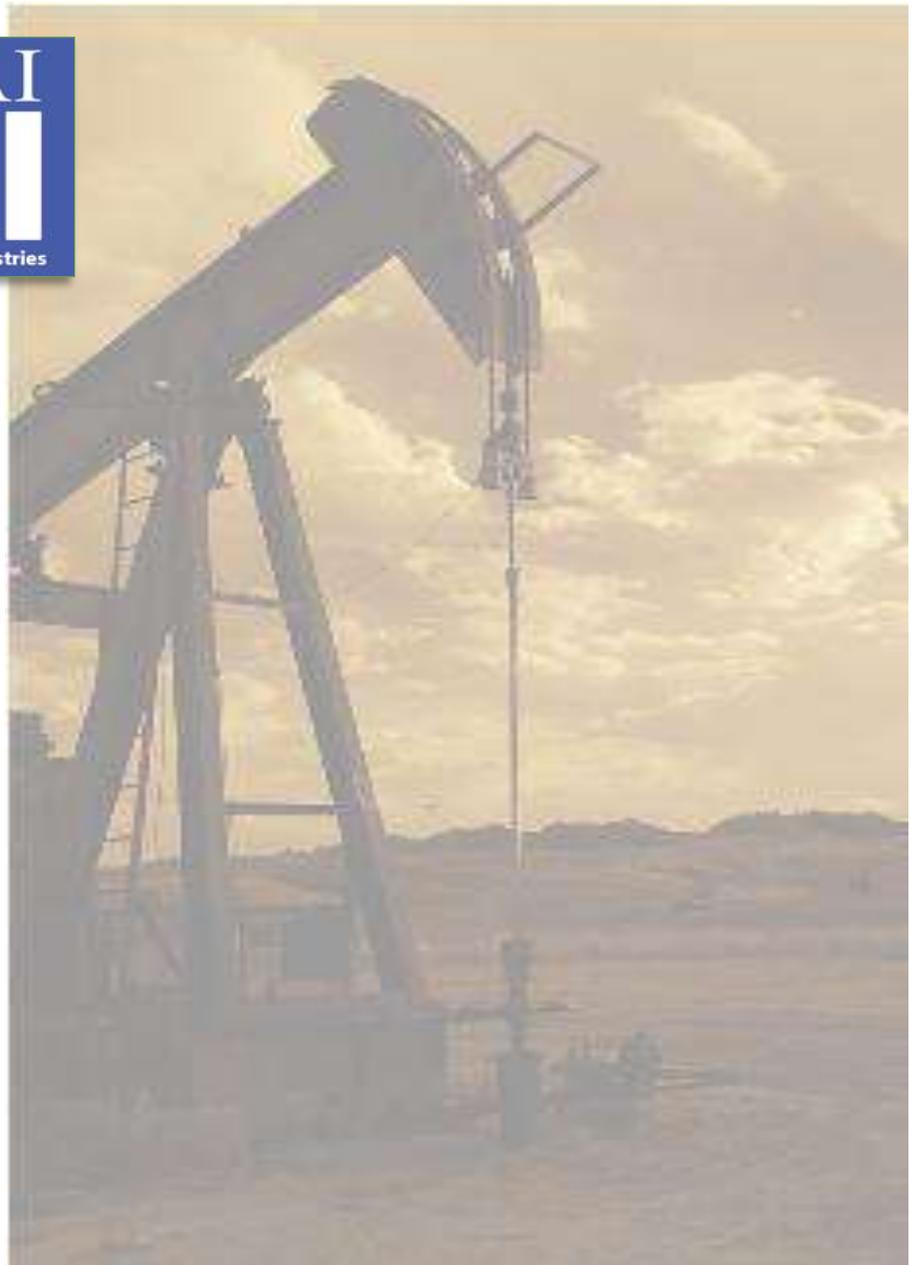
Four Ways Supreme Audit Institutions and EITI Can Bolster Each Other

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How Bankable is Uganda's Energy and Extractives Sector?

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Peer Learning Event for EITI Implementing Francophone Countries in Africa



ISSUE NO. 10 | FEBRUARY 2018

## About this issue:

Welcome to the tenth edition of the WGEI newsletter! In this edition of the newsletter, you can read about Linking Extractive Industries and the Sustainable Development Goals, Four Ways Supreme Audit Institutions and EITI Can Bolster Each Other, How Bankable is Uganda's Energy and Extractives Sector?, Transfer Pricing Course held in Oslo 21st-22nd November 2017, Peer Learning Event for EITI Implementing Francophone Countries in Africa.

Have a nice read!

## Need to know

### Linking Extractive Industries and the Sustainable Development Goals (By Sybrand Struwig and Chrisna Botha, SAI South Africa)

Extractive industries have a vast global footprint and present a primary sector in many countries. Approximately 3,5 billion people live in countries rich in oil, gas or minerals. In 2010, it was estimated that the formal mining sector alone employed more than 3,7 million workers, with a further 25 million people working in artisanal and small-scale mining operations. Research in Peru also indicated that for each direct job in the mining industry, 14 indirect jobs are created.

In addition to having such a widespread presence in the world, extractive industries contribute both benefits and drawbacks to countries rich in resources. These industries provide energy sources that contribute to a country's electricity-generating capacity as well as fuel and gas sources for transportation and manufacturing purposes. They further directly and indirectly form an important part of a country's economy; for example, governments as owners of mining resources derive revenue from these industries, while this revenue enables the functioning of the country's economy. Extractive industries have an impact on job creation, or the lack thereof. They affect the environment, or the degradation thereof. In addition, these industries influence local content through policies requiring the procurement of goods and services from local suppliers, and employing local workers, feeding back into the country's economy. They contribute to the development of skills, which can again be hindered by a lack of infrastructure. The industries also have a social impact as they are often associated with inequalities, conflict, and corruption – to name but a few.

On 1 January 2016, the 17 Sustainable Development Goals (SDGs) of the United Nations' 2030 Agenda for Sustainable Development officially came into effect. The intention of these goals is to achieve sustainable development, focusing on three dimensions: economic growth, social inclusion, and environmental protection – almost as if entirely to address the impact of extractive industries.

Indeed, extractive industries encompass all three of these dimensions. However, in analysing the 17 goals, 169 targets and 231 indicators of the SDGs, there is no specific reference to extractive industries or the use of non-renewable resources. Aiming to establish a direct link to only one goal, target or indicator is an unrealistic expectation though, as the effects of extractive industries cannot be considered in isolation.

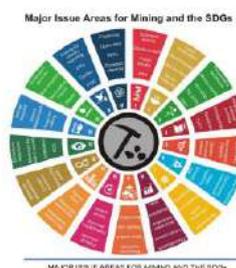
The SDGs were designed to work in the spirit of partnership or integration, and they are strongly interrelated – contributing to one SDG is likely to affect another. For example, supplying access to affordable and reliable energy (SDG 7) enables economic activity and social development (SDGs 1, 10 and 11). In providing sustainable energy, extractive industries support goal 1 (ending poverty in all its forms everywhere) by creating and providing jobs. It contributes to reducing inequalities within and among countries (goal 10), as it stimulates the income growth of the bottom percentage of the population, empowering and promoting all by providing equal opportunities. And with regard to goal 11 (sustainable cities and communities), it may support positive economic, social and environmental links between different developments.

The International Finance Corporation, the Global Oil and Gas Industry Association for Environmental and Social Issues, and the United Nations Development Programme (UNDP) carried out mapping exercises to show the potential contributions that the extractive industries can make towards the fulfilment of each of the 17 SDGs, as follows:



Key issue areas for Oil and Gas mapped to the SDGs

The UNDP, the World Economic Forum, and the Columbia Center on Sustainable Investment of the Columbia University conducted a similar exercise in relation to the mining sector, and came up with the following:



Major issue areas for Mining and the SDGs

The 2030 Agenda for Sustainable Development, which encourages governments to manage extractive industries in the best interest of the public, noted that ‘our Governments have the primary responsibility for follow-up and review, at the national, regional and global levels, in relation to the progress made in implementing the goals and targets over the coming fifteen years’. The International Organization of Supreme Audit Institutions (Intosai) community has responded to this development by including SDGs in their cross-cutting priorities for achieving their 2017-22 goals.

Supreme audit institutions (SAIs) can, through their audits and consistent with their mandates and priorities, make valuable contributions to national efforts to track progress, monitor implementation and identify improvement opportunities across the full set of SDGs.

SAIs have been called by the international community through their Working Group on Auditing of Extractive Industries (WGEI) to contribute, within their mandates, to the success of the SDGs in relation to the auditing of the extractive industry sector.

The major objective of the WGEI is to promote the audit of extractive industries within the INTOSAI community to support good governance and sustainable development, consistent with the 2030 Agenda for Sustainable Development. The WGEI can therefore contribute considerably in linking extractive industries and the SDGs.

The SDGs will matter for the extractive industries, and in return extractive industries will matter for the SDGs. Future audit topics in this combined area are vast. Many audits have been performed in the area of extractive industries – although these audits may not necessarily mention a related SDG, a direct or indirect link can be made to an SDG by interpreting the audit theme, topic, objective and/or scope.

Understanding the specific areas within an extractive industry value chain, and how it may connect with one or more of the SDGs, will be key to identifying possible audit topics. However, this will require additional research and refinement. There are many ways in which audits can be initialised and also different audit disciplines that can be applied in auditing extractive industries. The process is expected to start with government’s priorities that should be informed by the SDGs, consistent with the 2030 Agenda for Sustainable Development.

As SAIs and the WGEI, our practical implementation of keeping governments accountable for spending state resources responsibly is done through our audits and related services in the spirit of International Standard of Supreme Audit Institutions (ISSAI) 12, *The value and benefits of supreme audit institutions – making a difference to the lives of citizens*.

As SAIs, we can keep government accountable through the three main types of audits we conduct:

1. Assurance engagement on the auditing of a set of financial statements
2. Performance audit and auditing predetermined objective achievements
3. Auditing compliance with legislation

Furthermore, SAIs can contribute to the SDGs through the following four approaches:

1. Auditing national systems of follow-up
2. Performance audit of programmes that contribute to SDGs
3. Assessing and supporting SDG 16
4. Being a model of transparency and accountability

Audits of extractive industries are gaining momentum, and incorporating SDGs in such audits will present multiple opportunities for reducing the negative impact of this sector.

#### Four Ways Supreme Audit Institutions and EITI Can Bolster Each Other (By Dana Wilkins and Edna Osei - NRGi)

The board of the [Extractive Industries Transparency Initiative](#) is meeting in Oslo this week to discuss, among other issues, the [mainstreaming](#) of extractive sector reporting. As focus moves away from EITI reports to governments’ own systems, it is important to examine the initiative’s relationship with key domestic actors like supreme audit institutions.



Photo by U.N. photo/J. Moss

Supreme audit institutions (SAIs) and EITI have a lot in common. Both involve reconciling extractive sector accounts. Both work across the resource governance [decision chain](#). Both hold themselves and others to high technical and ethical standards. And both are focused on ensuring public resources are managed well and in citizens' best interests.

Not enough is known, however, about how SAIs and EITI can bolster each other's important and complementary work.

NRGI staff have supported EITI since the beginning of the initiative, and EITI-related analysis, technical assistance and training is a key component of many of our country programs. But when we asked some NRGI colleagues how national audit offices (or courts or boards, depending on the country) had come up in their EITI work, none could point to a clear example.

So we asked a few people at the EITI secretariat. Luckily, they were able to share some examples of SAI involvement in standard-setting, quality assurance and even some direct engagement with EITI processes (more on this below). They also mentioned that this is an area they are starting to explore themselves, with SAI representatives participating in a [November 2017](#) conference in Cameroon.

Then, during a recent meeting with the Ghanaian Audit Service, we had the chance to test some of our ideas about how to strengthen the links between SAIs and EITI.

It is clear that there is a lot of potential around these links. Here are a few of the biggest opportunities that we see so far, with some caveats:

1. **SAIs can provide reliable data for EITI analysis.** In order to reconcile company payments with government receipts, EITI bodies must be able to rely on the government data they use. However, an independent [review of EITI processes around the world](#) found that [data quality and assurance](#) is a common challenge. Because SAIs are already mandated, often constitutionally, to provide a regular, independent check on the accuracy of all government accounts, national EITI processes should be able to turn to SAIs for verified data. This is already happening in some countries, including Ghana. As EITI countries begin to [mainstream](#), it is likely that SAIs will play an increasingly important data verification role. *Caveat:* Not all SAIs operate according to

international auditing standards called for by the EITI, an issue specifically flagged by several past EITI reports.

2. **SAIs can advise national EITI bodies on auditing systems.** Because of their mandate, SAIs are necessarily experts in verifying and reconciling government data. They also have a bird's-eye view of resource governance across different government institutions, as well as expertise in verifying non-financial data that EITI has only recently begun to cover, such as company production figures and contractual obligations. Several national EITI processes, for example in Mongolia and Liberia, are already leveraging this expertise through sustained technical assistance or targeted support, such as designing company reporting templates. *Caveat:* Not all SAIs have the internal expertise or resources to provide this support.
3. **SAIs can build on EITI findings, and vice versa.** Given their complementary mandates and processes, SAIs and EITI bodies are well-positioned to cross-reference each other's findings and reinforce important recommendations. For example, EITI reports can flag and make recommendations around any extractives-related findings from previous SAI reports (e.g., discrepancies, inefficiencies and unverifiable figures). SAIs can use EITI reports to identify major risk areas and dig deeper into disclosure discrepancies, as has been the case in Zambia. Where necessary, they can also act in concert, reinforcing each other's calls for greater transparency and accountability. *Caveat:* The legitimacy and effectiveness of both depend on their independence, real and perceived. SAIs in particular must take great care to avoid any potential undue influence.
4. **SAIs can participate in [national EITI multi-stakeholder groups](#).** Every EITI-participating country has a national multi-stakeholder group. In some countries, like Iraq, SAIs are formally represented in the group. Having a seat at the table might allow a SAI to directly contribute to strengthening the country's EITI priorities and processes. It might also help raise the SAI's profile in public debate around extractive resource governance, ultimately helping it be more effective. *Caveat:* This opportunity is particularly context-specific. Participating in a multi-stakeholder group is not the only, or necessarily the best, way for a

SAI to influence EITI processes and raise its profile. SAIs must always maintain their objectivity and independence, so it might be better for them to participate as observers, if at all.

As long-standing supporters of EITI and somewhat new and deeply committed advocates for SAIs taking a more active role in resource governance, NRGI is keen to explore ways to maximize the relationship between these two important parts of the accountability ecosystem.

[Dana Wilkins](#) is a capacity development officer with the Natural Resource Governance Institute (NRGI). [Edna Osei-Appiah](#) is an Africa associate with NRGI.

### How Bankable is Uganda's Energy and Extractives Sector? (By Godwin Matte - OAG-Uganda)

A 2015 report on Ease of Doing business by the World Bank ranked Uganda 150 out of 189 countries. Uganda ranks below its East African community neighbours except Burundi, and according to the Uganda Investment Authority (UIA), Foreign Direct Investment (FDI) in 2013 was valued at USD 1.19 Billion mainly from India and China. The country's energy and extractive sector has seen significant investment in the electricity sub sector through the on-going Karuma and Isimba Hydro Power projects and investment in oil and gas exploration.

The Ministry of Energy Strategic Investment Plan 2014/15 to 2018/19 indicates that currently less than 7% of the rural population has access to electricity services. The government aims at increasing this figure to 24% by the year 2019. Uganda is endowed with numerous natural resources, which if efficiently utilized would broaden the diversity of the energy mix and strengthen the country's energy security position. Resources for potential exploitation include geothermal with more than 40 geothermal sites under exploration, solar and wind energy, nuclear, oil and gas amongst others.

Given that the country is grappling with limited access to cheap energy despite the abundant unexploited energy resources, how can the government attract more investment into the sector to achieve the goal of attaining middle income status by 2020?

In order to answer this, it is important to understand how investors structure their financing and what factors would positively motivate an investment

decision especially in the energy sector that requires significant sums of capital. One of the most commonly adopted structures used to finance high cost projects is by setting up a "Project Finance" arrangement.

In simple terms, a project is considered bankable if lenders are willing to finance it. Project Financing involves financing a particular project in which lenders look initially to the cash flows and earnings of the project as the source of funds to repay the loan and to the assets of the project as collateral to the loan. Most project financings will involve limited recourse to the sponsor (Government) beyond the assets that are being financed. In other words, in case of failure to repay the loan, the lenders are almost restricted to only the project assets and have limited access to other non-project related assets to recover the loan. It is hence important for lenders and governments to properly review and address all the risks involved in project financing. The key to project financing is that lenders will not make an investment decision until the project is fully de-risked and there is guaranteed certainty that their funds will be recouped from the project cash flows.

Lenders will assess the bankability of a project, where there is an acceptable balance of risks and all possible risks can be analysed. The magic of project financing consists of distributing the different risks associated with a project to the various participants who have a particular interest in the success of that project, in such a way that each participant assumes a portion of project risks but none bears all. There are a number of risks that lenders/investors will look to eliminate especially in developing countries like Uganda.

Firstly, the completion risk; this is one of the fundamental risks in any infrastructure project involving construction such as power dams. The completion risk assumed by the lender arises in situations where for all practicable purposes, completion of the project or facility so that it operates to the full capacity and specifications originally planned proves to be futile. In Uganda, delays and late completion of energy projects is eminent as projects are more often than not, behind schedule. Such conditions are not favourable to lenders and have to be addressed to attract the right financing. This is normally mitigated through the adoption of completion guarantees and turn-key contracts to shift the risk to the EPC contractors.

Secondly, lenders/investors seek to address the market risk. The market comprises two elements, the existence of the market for what is generated from the project and confirmation that the price at which the products sold is sufficient to service the project debt.

Lenders typically require a level of certainty as to the future demand and sales prices of the output to be produced by a project and justification that the project is capable of delivering its output at market prices.

In Uganda's case for example, the 250MW Bujagali project's bankability was strengthened by a Power Purchase Agreement (PPA) with GOU guaranteeing a market for the power produced by the dam. In addition, the investors sought a price of USD 0.11/KWH (highest in East African Community) that is sufficient to service the project debt. The project was structured similar to a 'take or pay' arrangement where the power is sold at a pre-agreed price, which assures the lenders/investors of cash flows since there will be demand for the power as long as the agreement is in place and is honoured. Under take or pay arrangements, whatever agreed production is not consumed, is still paid for by the buyer under the PPA. This introduces the aspect of deemed energy because the producer is deemed to have generated power and sold it to government. In addition, the current low crude oil prices have made it challenging for the oil companies to make final investment decisions since production will only be profitable above the break-even price.

It should however be noted that such agreements can be costly to developing countries like Uganda if not well negotiated. Currently the government is seeking possible avenues of renegotiating the agreement so as to reduce the cost of power to at least USD 0.072/KWH. Such renegotiations might reduce the tariff in the short run but turn out to be costlier in the long run in terms of interest payments since the lenders still have to be paid back the pre-agreed principal and additional interest, just over a longer period. The upcoming crude oil pipeline to Tanzania will also typically have an off take agreement in place to lock in the crude market and provide comfort to the financiers on future cash flows.

Another major risk worth mentioning is the political and regulatory risk. When a project company fails to pay dividends or interest on its loans due to government restrictions on overseas remittance of funds, failure of the government's banking system caused by civil war and conflict, government expropriation of the project or in certain instances breaches of the terms of key concessions, then this is political risk. Risks relating to changes in the law, regulation and tax regimes can't be ruled out especially if a country is in an economic crisis. Lenders and investors are keen on such risks and in some cases contracts or concession agreements are structured with stabilization clauses to protect the investors from

such drastic changes that suit the government at their expense.

Investors are obviously more attracted to stable political environments and countries with well-structured and incentivized fiscal regimes. In Uganda's energy and mineral sector, the laws, regulations and tax regimes are under constant review either to encourage more investment or to ensure that the government generates the most out of such deals. Case in point is the tax law on oil and gas, which has witnessed transformation to accommodate the expectations of investors and at the same time, stay in tandem with international bench marks. Further, Uganda's mining policy is also undergoing revision to accommodate aspects such as artisanal mining and better management of licensing.

Environmental risks also play a significant role in today's environmentally sensitive society. Investors are keen on the possible environmental impact and carry out such assessments to ensure that investment decisions are made after a thorough understanding is established. For example, under Uganda's latest oil licensing round, parts of the Albertine Graben attracted no interest due to the environmentally sensitive nature of the license area.

With all these risks in mind, it is important to ask the question on what efforts can be made to address these risks so as to attract the much needed investment in the sector. The government has adopted a number of Public Private Partnerships (PPPs) and one of the most common ways of implementing PPPs in managing infrastructure is through the concession approach. This consists basically in transferring final design, construction, maintenance and operation of the infrastructure to a private consortium, in exchange for which that consortium receives the right to charge a fee to the user or to the government on behalf of the user, for a period of time contractually agreed in advance. (Usually 20 to 30 years)

The concessions to UMEME, ESKOM and Tibet Hima Mining Ltd in the electricity and mining sectors in Uganda are examples of government efforts to attract sector investment through PPPs. However it is also arguable on whether the concessionaires always achieve the expected targets within the pre-agreed timeframes. Case in point is the concession of the Kilembe Mines Limited's assets to the Tibet Hima Chinese consortium. Reports from Kilembe mines indicate that the concessionaire is yet to adhere to several concession terms and minimum capital investments.

In conclusion, much as it is important for the government to attract the right kind of investment, it is critical to understand the country's investment risk profile in the eyes of potential investors. Quality and timely due-diligence is critical if the country is to continue with concession arrangements to mitigate the risk of under-performance by the concessionaires. The government should allocate funds to carry out its own feasibility studies by internationally reputable firms to ascertain the potential of its own resources. Additionally, extensive capacity building should be championed to enable government have able and qualified representation at the negotiating table to achieve maximum benefit from such deals. Once this is established, the right policies can be set up to de-risk the country thus making energy and extractive sector projects more bankable.

### Trainings and events

[Transfer Pricing Course held in Oslo 21st – 22nd November 2017](#) (By Anders Pilskog - Norwegian Audit Office)



WGEI held a 2-days transfer pricing course in Oslo facilitated by Anders Pilskog and August Schneider from the Office of the Auditor General of Norway. The course was well attended with participants from Uganda, Sierra Leone, South Africa, Norway and the INTOSAI Development Initiative (IDI).

The aim of the course was both to emphasise the importance of transfer pricing issues within the extractive industries, and to give sessions on how to approach questions that will inevitably arise. The course first introduced the notion of transfer pricing, its significance and incentives. Moreover, the course covered different topics on transfer pricing such as the OECD guidelines on transfer pricing, transfer pricing methods, comparability and functional analyses as well as the implications of transfer pricing to the SAIs' audit of the extractive industries. By the end of the course, the participants discussed practices and experiences in auditing transfer pricing in the extractive industries sector in their respective SAIs.

### Transfer pricing in the extractive industries sector

Transfer price is a price that arises when two companies that are affiliated, in whatever way, does a transaction. This price is not subject to the same market structures as the transactions between unaffiliated companies. Since the transaction have no consequences for the company group at large, the group has incentives to shift profits to jurisdictions where the tax rate is low, and shift costs to where the tax rate is high, thus, deductions are high.

Extractive industries are, in nature, international businesses. The resource is, normally, extracted in one country and sold all over the world by a company that is located elsewhere. Furthermore, extractive industries encompasses several different sorts of trade. One thing is extraction. Others are marketing, accounting, transport, retail, legal issues, security etc. All of them within a single business group. This gives several opportunities for transfer mispricing, meaning that the price agreed upon does not reflect what the price would be under normal economic circumstances. The course provided a brief insight into the main tools of preventing transfer mispricing. The most important concept within transfer pricing is the Arm's Length Principle (ALP). This is an expression for determining the price that would (or could) occur for the same goods, under the same circumstances between unaffiliated parties. You may call it the market price, although that is slightly inaccurate.

### Comparability and functional analyses

In finding the appropriate price in line with the ALP, we need to compare it to another price made in a comparable transaction. In order to do that we have to determine what a comparable transaction would be. For many types of transactions, e.g. price of bread, price of unskilled labour or the price of a vault, the price is common knowledge or very easy to find. When the transaction gets more complicated, the pricing also becomes complicated consequently. What is the hourly rate for an engineer with a specific knowledge not available in the country? What is the market interest rate for a loan provided by a parent company to a company that is unable to get a loan in a free market due to difficulties? There are no certain answers to these questions, but there are strategies to find an answer that is acceptable although not exact. This implies that we seldom find a perfect comparable, but we can find a transaction that has a reasonable level of comparability.

The [OECD Guidelines on Transfer Pricing](#) are the most commonly used framework to combat illegal transfer pricing. There are several others, but the difference

between them is not big. According to these guidelines, a transaction is comparable if:

- none of the differences between the transactions could materially affect the price or margin, or
- reasonably accurate adjustments can be made to eliminate the material effects of any such differences.

In order to determine if one of these requirements are fulfilled, we have to do a *comparability analysis*.

The aim is to find a reliable benchmark for arm's length price, or to identify a price range which unrelated parties, in a similar setting, can agree on. The comparability analysis shall identify and disregard transactions that are not comparable and coincidental or inappropriate pricing reasons.

In short, the comparability analysis is a thorough examination of the transaction at hand. It is a process that jumps back and forth in iterative steps.

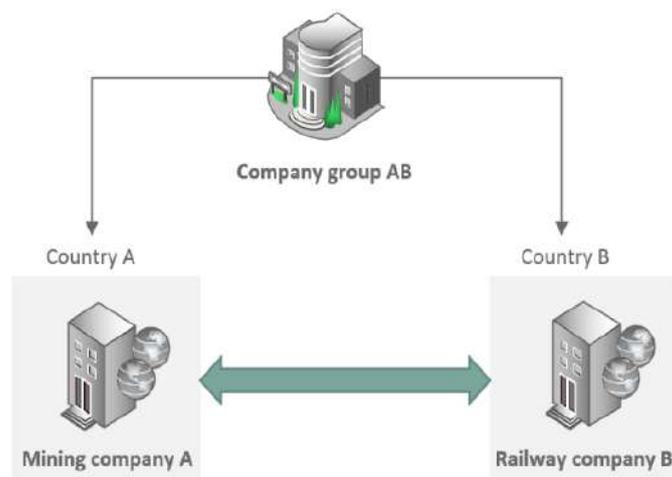
The so-called *functional analysis* is a central component in the comparability analysis. This aims at identifying the different functions of the parties. The main idea is that the function itself determines the contribution of value, and this contribution of value indicates the profit allocated to the party. In doing this there is a need for a broad-based analysis of the taxpayers circumstances. This means that you need to take into consideration the factual circumstances and environment in which the taxpayer operates.

The most important features of a functional analysis are as follows:

- identifying the function i.e. the activities and whether it is contractual or real
- analysis through fragmentation
- establishing the contractual and actual facts of the transaction for pricing purposes
- identifying which party does what, using which assets and which risk

After doing the comparability analysis, and in particular the functional analysis we might find that the compiled price of intra-group services charged to the company might be fragmented into several separate services that are much easier to find a comparable price to. The intra-group services might consist of simple accounting services, legal services, management services etc., which is easy to price one by one. The price of accounting is easy to find, the same with simple legal services and so forth. The point of the functional analysis is therefore to identify the different (if any)

micro transactions involved in the transaction as a whole.



A very simple example of the process can be a situation where we have a company group (Group AB) owning a mining company A operating a mine in country A. Group AB also has a railway transporting the ore from the mine to the shore for further shipping. This railway company (company B) has a main office in country B. There is an incentive for Group AB to make company B charge Mining A an excessive price for the transport of the ore, and thus shift profit from country A.

Through a functional analysis, we are able to identify that the only function company B performs is the transport of the ore. There are no other contributions from Company B to the transaction. This implies that Company B should only be rewarded with a normal profit for transport services by railway. A typical method to use in this situation would be a *Cost Plus method*. The Cost Plus method requires identification of a cost base, and a normal profit on that cost base.

In order to find what a normal profit for railway transport services is, we have to identify what would be a comparable railway transportation service in this situation. The comparable does not have to be perfect as long as we can adjust for the differences. Let us say there are no other railway service within the country. We can then look to a neighbour country and look at their railway service. We adjust for differences in labour costs, maintenance cost and any other relevant cost and apply that on the transport service at within the transaction. The same with the normal profit on the cost base. Very often we can use a database and find an average range of profit (e.g. between 7 % and 10 %) and apply that on the cost base. If the price in the identified transaction is outside this range, it is within the authority of the revenue authorities to set a price within the identified range.

## Importance of understanding transfer pricing for SAIs

For most SAIs the mandate to audit transfer pricing is a secondary one. In most countries, the mandate is given to the revenue authorities. However, as auditors of the revenue authorities it is crucial that the SAI has the knowledge to audit the revenue authorities' execution of auditing transfer pricing. Therefore, it is necessary for SAIs to have in depth knowledge of transfer pricing.

During the last day, the course allowed for discussions of the participants' practices and experiences with transfer pricing in their respective SAIs. This session enabled SAIs to share their knowledge and experience with transfer pricing and to explore potential arenas for cooperation to further build and improve SAIs' capacity in the audit of the extractive industries sector.

If you are interested to know more about the transfer pricing course, please contact Mr. Anders Pilskog ([anders.pilskog@riksrevisjonen.no](mailto:anders.pilskog@riksrevisjonen.no)).

## Peer Learning Event for EITI Implementing in Francophone Countries in Africa (By Trygve Christiansen, Norwegian Audit Office)



Peer Learning Event for EITI Implementing Francophone Countries in Africa

Extractive Industries Transparency Initiative (EITI) recently hosted a [peer-learning workshop](#) in Yaoundé, Cameroon (28-30 November) for Francophone Africa. A great number of French speaking African countries are working towards implementing the [EITI standards](#), to demonstrate transparency in their extractive industries sectors.

Implementing the standards is challenging. The EITI Secretariat is increasingly interested in using the work of SAIs in this process. Why? Because SAIs may give assurance on the EI revenue figures presented by government. In the EITI reconciliation process the EI companies' payments to government and government's receipts from EI revenue shall be

reconciled and compared. The companies' payments shall be verified by their own external auditors, while the government's reported receipts shall be verified by an independent auditor, preferably a SAI. The question is; how can EITI rely on the verification by the SAI?

WGEI was invited to the Yaoundé workshop to explain about the role of SAIs in auditing the extractive industries and how to rely on their work. Mr. Trygve Christiansen from OAG Norway represented WGEI as facilitator on the topic "Data reliability", which refers to the reliability of data provided by the Ministry of Finance on the EI government revenue figures. I explained that typical sources for assessing the quality of the work of SAIs are [SAI Performance Measurement Framework](#) (SAI PMF) assessment reports and [Public Expenditure and Financial Accountability](#) (PEFA) assessment reports. A better option may be to assess how SAIs are already auditing the EI value chain. The overview of audit reports along the EI value chain on the [WGEI website](#) may be a valuable source. Future EITI country reports are supposed to include an assessment of the whole EI value chain in the country. I gave a number of examples of countries which have carried out audits along the whole value chain including award of licenses, monitoring of production, revenue audits and how revenue has been allocated. These audit results may be used by EITI in assessing how the whole EI value chain in the country is working.

What shall EITI do when the SAI cannot be relied upon? In many cases in Francophone Africa they have tasked the Inspection Générale des Finances (The Inspectorate General of Finances) to perform the verification of government revenue figures. In some cases, they may have a better understanding of financial audit. The Inspection Générale des Finances typically report to the Ministry of Finance and can only account for revenue figures managed by the Ministry. In the long term it may not be sustainable to rely on an entity which is within the Ministry of Finance, for at least two reasons. Firstly, there may be other government entities such as the resource ministry or the state owned oil/mining company that collects the EI revenue. The Inspection Générale des Finances may not be able to access these figures. Secondly, the Inspection Générale des Finances is not an independent entity, but is instead accountable and dependent on the Ministry of Finance. The Cour de Comptes (Court of Audit) however is the de facto independent SAI. We discussed lengthy strategies for how to use the Cour de Comptes more in the EITI work, and how to improve their capacity of verifying government EI revenue figures.

Lastly, I learned that the SAIs of Cameroon, Senegal and Mauritania are playing an active role in the EITI reconciliation process. They assess the reporting templates which the country's Ministry of Finance shall submit to the respective country EITI representatives. To sum up, SAIs can play an increasingly active role in the EITI reconciliation process. SAIs can give assurance on the credibility of government EI revenue figures.

Also, SAIs perform audits on the whole EI value chain, not just EI revenue. With the increased scope of EITI reports, reliance can also be put on the whole work of SAIs in auditing the extractive industries. SAIs play a key role in ensuring transparency, accountability and credibility on how government manages the extractive industries sector. This needs to be stronger embedded into the [EITI reconciliation process](#).



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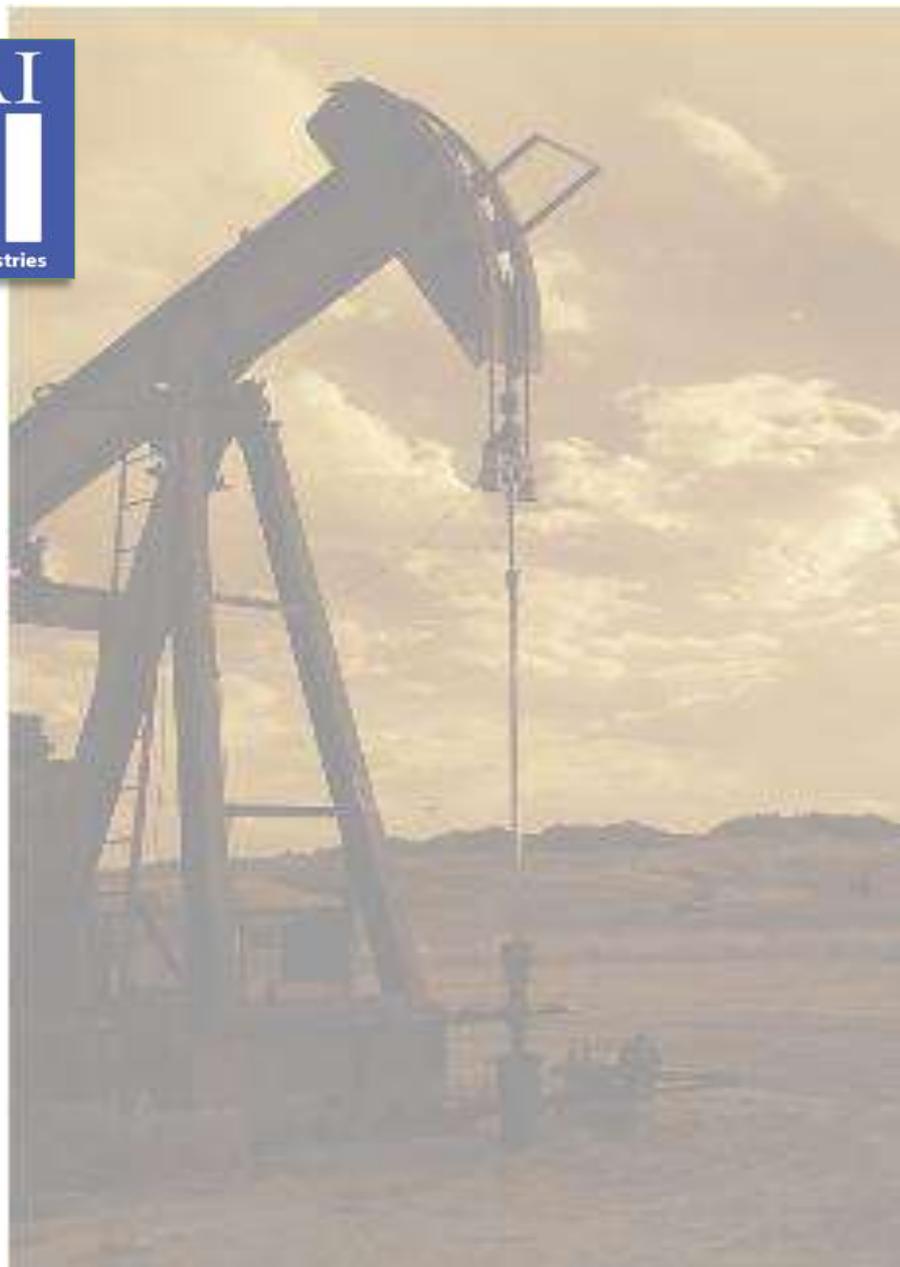
How the Resource Governance Index Can Be Used to Audit Extractives

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Many Ways to Lose a Billion

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Public Flashlight on Extractive industries: WGEI Enters Consortium with Civil Society Organizations



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**About this issue:**

Welcome to the ninth edition of the WGEI newsletter! In this edition of the newsletter, you can read about the WGEI Steering Committee meeting held in Washington on 25<sup>th</sup> – 28<sup>th</sup> September 2017, the Extractive Industries Workshop conducted in Kampala on 11<sup>th</sup> – 15<sup>th</sup> September 2017 and an upcoming training on Resource Curse on 15<sup>th</sup> – 26<sup>th</sup> April 2018. You will also read about the Role of SAIs in the Extractive Industries, How the Resource Governance Index Can Be Used to Audit Extractives and Many Ways to Lose a Billion pertaining to how resource-rich countries fail to secure a fair share of natural resource wealth. Furthermore, this edition includes an article on WGEI's engagement in to a consortium seeking for funding under the Department for International Development's (DFID) "Open Society" initiative.

Have a nice read!

## Need to know

### [The Role of SAIs in the Extractive Industries and the Importance of Building Partnerships](#) (By *Eli Wærum Rognerud, Norwegian Audit Office*)

*SAIs provide a unique check on the way governments manage a country's natural resources. Yet it is only when the results of audit have been made public, citizens are able to hold the custodians of public resources accountable. For that, SAIs cannot rely of government process alone, but must lever the engagement of media and civil society.*

ISSAI 12 defines that SAI delivers value and benefit to SAIs in a least three different ways, by:

1. Strengthening the accountability, transparency and integrity of government and public sector entities
2. Demonstrating ongoing relevance to citizens, Parliament and other stakeholders and
3. Being a model organization through leading by example<sup>[1]</sup>

Similarly, strong and effective Supreme Audit Institutions can contribute to better and more transparent oversight of the Extractive Industries (EI), improve governance and help to ensure that governments manage natural resources 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.

## How SAIs can make a difference

There are numerous issues and topics a SAI can address when auditing the EI sector. SAIs may point to institutional overlap or unclear lines of responsibilities in the legal framework, as SAI Uganda did in its [Environment audit report on regulation and monitoring of drilling waste in the Albertine region](#) (Uganda 2014). The SAI may audit whether the process of handing out contracts and licenses was transparent and designed to attract the most competent companies, as Norway did in its 2010 [Report on the awarding of production licenses in the petroleum sector](#) (Norway 2010). SAIs could also follow the revenue flow and reconcile public figures as SAI Ghana did in its [Audit on financial management of the petroleum fund](#) (Ghana 2015)<sup>[2]</sup>.

In Latin America, a group of eight SAIs carried out a joint audit on public revenue from the industry in 2013. Similarly, in 2015 a group of SAIs from English-speaking

Africa conducted parallel audits on the government's implementation of national content policies in the oil and gas sector in their respective countries. These are just a few of many examples of how SAI reports can contribute to better governance and accountability in the sector. The WGEI website features a long list of other audits and examples, categorized by the value chain. For oil and gas audit reports, see [here](#). For mining reports, see [here](#).

## SAI challenges

Strong SAIs help promoting the accountability, transparency, efficiency and effectiveness of public administration. Independent, effective and credible SAIs therefore contribute to open and stable democracies by building public trust in government institutions. In many countries however, the effectiveness of the SAI is hampered by the same deficiencies it is set up to combat. Many SAIs are unable to operate with the necessary independence, and many lack the resources, mandate or competence to audit the sector, or they are denied access to necessary data. These problem are further compounded by the international nature of the extractive industries and the proprietary characteristics of contracts and licenses that make public disclosure difficult. Perhaps most importantly, many good SAI reports never make it through parliament or into the public eye.

Yet it is only when SAIs' audit results have been made public, citizens are able to hold the custodians of public resources accountable. According to the recent Global Survey of SAIs<sup>[3]</sup>, 48% of national legislatures do not hold public hearings in which audit reports are reviewed and scrutinized. Where parliament review audit reports, the backlog is often significant, making the findings lose relevance as time passes. In Uganda for example, the parliament to date has not debated any of the Value for Money reports issued on the country's EI sector.

## Levering partnerships

Whilst recognizing the need for full independence of SAIs from all interested parties in the EI sector, a constructive engagement between SAIs, the media and civil society organizations is critical to SAIs impact. The INTOSAI WGEI has recognized this and has made it a strategic priority to strengthen its engagement with these stakeholders. Its current work plan proposes a number of activities aimed at supporting SAIs in enhancing the effectiveness and impact of EI audit through media and civil society engagement. Briefing notes and bite-size information packages on SAIs' role

in the extractive industries, talking points and training material for joint EI risk assessments and workshops, are amongst the products underway.

Similarly, SAIs should develop strategies for engaging and leveraging the engagement of media and civil society organization in following up their EI reports. In Uganda for example, media coverage of reports on waste management and local content policies stirred public debate that enforced corrective action – even if the reports were never officially concluded in parliament. Also in Uganda, annual workshops gathers stakeholders from government, industry, civil society and media for a joint discussion on sector risks. This is helping to raise awareness about sectoral challenges and the role of the Office of the Auditor General in the sector. Increased knowledge on the part of media and civil society in turn helps to promote better and more accurate coverage and utilization of audit reports. Other SAIs could consider pursuing similar strategies.

- [1] ISSAI 12; The Value and Benefit of SAIs
- [2] For a more comprehensive list of existing EI audit reports, please see [www.wgei.org](http://www.wgei.org)
- [3] INTOSAI Development Initiative, Global Survey

[Many Ways to Lose a Billion: SAIs and the Protection of Government EI Revenue \(By Don Hubert\)](#)

Resource rich countries often fail to secure a fair share of their natural resource wealth. Sometimes this is the result of weak national legislation and poorly negotiated contracts. Frequently it is the result of company strategies to minimize tax payments.

A list of national-level benefits from the extractive industries includes economic growth, employment, infrastructure, corporate social investment and taxes. Of these five, taxes are the most significant. According to the Chair of Tullow Oil, “the biggest single contribution by far that we make is the tax that we pay. And it dwarfs the others.”

Supreme Audit Institutions (SAIs) have an essential role to play in ensuring that governments get a reasonable share of EI revenues through taxes and other fiscal instruments such as royalties and production sharing.

The WGEI has oriented its work around the EI value chain. The 5<sup>th</sup> step in the chain is the “Collection of Revenues.” However, the objective is not simply to collect revenues but to maximize those revenues. Securing a reasonable share requires establishing appropriate fiscal terms in the *legal framework*,

negotiating good *contracts* with resource companies, and *monitoring* project revenues and project costs.

Governments receive less revenue than they should because relevant ministries and regulatory bodies lack capacity. Companies also exploit weakness in government oversight due either to regulatory gaps and poor coordination. SAIs can help to overcome these weaknesses by adopting a holistic approach to auditing cross-governmental revenue generation efforts.

[Resources for Development Consulting](#) assists resource-rich countries to secure a fair share of the revenue generated from mineral and petroleum projects. We developed a risk assessment methodology to help governments identify pathways to revenue loss. An overview, along with an extensive collection of “real-world” case studies, is published in [Many Ways to Lose a Billion](#) (PWYP-Canada, 2017). The report is available in [English](#), [French](#) and [Spanish](#).

The framework starts with the basic distinction between setting the tax rates that apply to a project, and protecting the tax base (the revenues) against which those taxes will be applied.

Most developing countries set out the fiscal terms that will apply to EI projects in a contract. Governments often offer significant tax breaks during contract negotiations without fully understanding their revenue implications. Sometimes these are part of the headlines terms, such as corporate tax holidays, but often they are buried in the fine print, such as the deductions allowed for the calculation of taxable income.

Pathways to Revenue Loss		
<b>Tax Rate</b>	Tax Breaks	Tax Incentives
	Treaty Shopping	Tax Holidays
		Withholding tax
<b>Tax Base</b>	Under-Reported Project Revenues	Capital Gains Tax
		Production volumes
	Over-Reported Project Costs	Sale price
		Ineligible costs/misallocated costs
		Inflated goods and Services
		Debt Financing

Once the terms of the contract have been agreed, companies often seek to improve those terms by engaging in “treaty shopping,” taking advantage of the network of Double Taxation Treaties. By creating subsidiaries in third countries, companies secure reductions, and in some cases complete exemptions, in capital gains and withholding taxes.

The package of fiscal terms establishes the revenues the government should receive in “theory.” Governments often find that actual receipts fall far short of expectations. This can be the result of a slump in commodity prices, but it is often the result of company strategies to erode the tax base.

In some cases, the company under-reports projects revenue, thereby reducing payments to government on both production and profits. This can be done by under-reporting the quantity and quality of the commodity, and by selling the commodity to an affiliated company at below fair-market value.

In other cases, the company over-reports project costs, thereby reducing profit-based taxes. This can be done by claiming ineligible or misallocated costs and by inflating the costs of goods and services provided by an affiliated company.

Unfortunately, there are many pathways to government revenue loss. But they are not unlimited. There are clear patterns repeated over-and-over, country-by-country. SAIs can contribute to revenue protection by applying a comprehensive revenue risk assessment to their national context. The assessment should be adapted based on four Cs: the *country* legislation, the specific *commodity*, the *company* and its structure of subsidiaries and affiliates, and potential loopholes in the *contract*.

In most countries, there is a profound imbalance in expertise between the lawyers and accountants representing companies and the officials representing their country. The case studies in *Many Ways to Lose a Billion* reveal that developed countries with strong tax administration also struggle to collect a fair share of revenues. The issues that need to be addressed are technical and, in some cases, very complex. SAIs need a high level of expertise in order to protect their country’s revenue interests.

**Bio:** Don Hubert is the founder and President of Resources for Development Consulting ([www.res4dev.com](http://www.res4dev.com)), a policy research firm that seeks to assist citizens in resource-rich developing countries in securing a fair share of natural resource wealth. His work focuses on analyzing EI contracts and fiscal regimes, modeling plausible past and potential government revenues, assessing vulnerability to company tax avoidance and identifying risks of corruption. He has conducted economic analyses of extractive sector projects in Belize, Cambodia, Chad, Kenya, Malawi, Mozambique, Tanzania, Uganda and Zimbabwe. He was previously a Canadian diplomat and

university professor. He holds a PhD from the University of Cambridge, UK.

## How the Resource Governance Index Can Be Used to Audit Extractives (Dana Wilkins - NRG)



As I have argued in a previous [blog](#), [supreme audit institutions](#) are natural guardians of resource governance. They have both the legal mandate and the access—at least in theory—to be an independent check on the management of extractives all along the industry [decision chain](#).

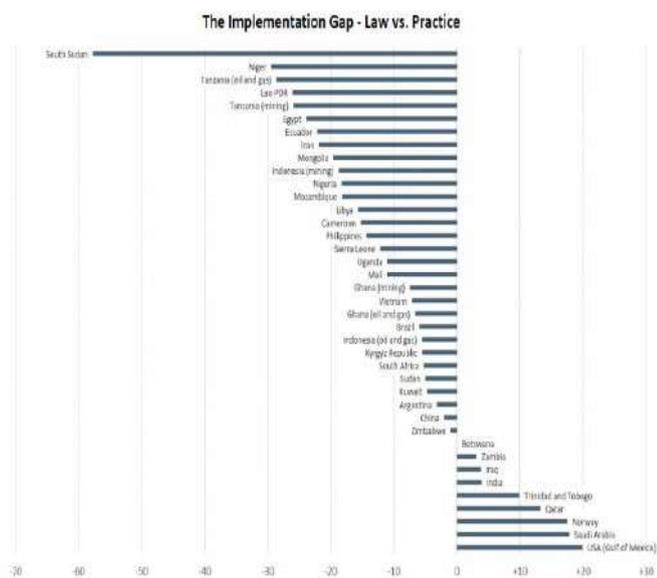
In Uganda, for example, the Office of the Auditor General has proven adept at responding to the unique challenges of resource extraction. The office’s most recent annual reports identified [significant underpayment of gold royalties](#), disallowed more than USD 70 million in [old oil company cost claims](#) and called out [dangerous weaknesses in the government’s management of oil data](#). In just the last few weeks, [article](#) after [article](#) has covered the shocking findings of the most recent report by South Africa’s auditor general, including serious failings in the [management of the state-owned oil company](#).

But supreme audit institutions, known as SAIs, aren’t always able to function so effectively in this space. They are often limited by insufficient funding and internal technical expertise, refused access to financial records and documentation, and even threatened over critical findings. It doesn’t help that audit reports can be intimidatingly long and complicated, or that SAIs tend to shy away from direct engagement with civil society and journalists. Luckily, there is a great group of SAI professionals committed to addressing these challenges: the [INTOSAI Working Group on the Audit of Extractive Industries](#) (WGEI).

I had the pleasure of joining the group’s annual meeting in September, when I presented the [2017 Resource Governance Index](#) and the implications of its findings. We also discussed how the index might be used to support SAIs’ oversight work.

SAls have a critical role to play in closing the “implementation gap” so well illustrated by the index. The 89 country/sector assessments included are each based on a 149-question survey completed by extractive sector and country experts, and supported by almost 10,000 documents. One of the most interesting features of this edition of the index is that it differentiates between the quality of the policies, laws, and regulations as written and the reality of implementation.

provide a good general sense of how well a country’s governance systems match up against other countries and against global standards. This snapshot can help SAls identify major risk areas, inform the objectives and scope of audits, put evidence in context and outline alternative approaches from other countries to include in the audit recommendations. The data explorer goes into much more detail on the documentation and explanations underlying the country assessments and offers many great options for examining, visualizing, and comparing the data.



Though still somewhat unknown in the extractives governance movement, SAls are increasingly recognized as critical actors in the accountability ecosystem. I look forward to spending more time with WGEI and supporting SAls directly to provide a robust check on the management of natural resources, using the RGI and any other tools we can come up with together.

*Dana Wilkins is a capacity development officer with the Natural Resource Governance Institute (NRGI). This article was originally posted as a blog on NRGI’s website. (<http://bit.ly/2yrhTOI>)*

Of the 39 assessments conducted in WGEI countries, 30 noted a significant failure by governments to implement their own legal frameworks. The chart above illustrates this failure through the differences between the points scored for law questions and those for practice, negative numbers indicating that laws are much stronger than practice. SAls can expose and make recommendations to help close these gaps through both regular and special audits. For example, a SAI can use its annual audit reports to highlight noncompliance with fiscal rules for the saving and spending of resource revenues. Or a SAI could conduct a special audit of the degree to which the government is adhering to its contract and fiscal transparency commitments.

Public Flashlight on Extractive industries: WGEI Enters Consortium with Civil Society Organizations (By Eli Wærum Rognerud – Norwegian Audit Office)

Networking with non-SAI stakeholders has been a priority for WGEI since the beginning. In October this year, the WGEI entered into a consortium with a group of non-SAI stakeholders to seek donor support for extractive industry audit and civil society dialogue.

A number of multilateral organization and initiatives, government bodies as well as civil society organizations are working to promote good governance within the extractive industries.



SAl’s engagement with external stakeholders is therefore of great importance, as it allows knowledge and experience sharing across the industry. It may help SAls identify and respond to emerging risks and challenges, and it may identify partnerships for resource mobilization. Moreover, the engagement of external stakeholders promotes awareness as well as increased understanding of SAls within a society at large, and may enhance SAls’ impact as their role and report findings are made available to a larger public. The WGEI has therefore made it one of its objectives to promote networking and stakeholder engagement within the WGEI community.

SAls can also use the Resource Governance Index [country profiles](#) and [downloadable data explorer](#) to inform their work. The country profiles

## Funding proposal for DFID

In October 2017, the WGEI Steering Committee was invited to join a consortium of civil society and media organizations working to ensure better resource governance. Apart from INTOSAI WGEI, the consortium is composed of Natural Resource Governance Institute (NRGI) as consortium lead, Publish What You Pay (PWYP), the African Centre for Media Excellence (ACME) and BudgIT, an organization working to make national budgets accessible to ordinary people.

The strength of this consortium is to amplify the role of each stakeholder, by improving the capacity of and building links between supreme audit institutions, the media, and civil society in target countries.

Together, the consortium of five partners submitted a project and funding proposal to the British development agency DFID under their “open societies” initiative. The consortium is seeking funding for both global and country-level activities that help increase access to information, public dialogue scrutiny of the extractive industries. In a first phase, Nigeria, Uganda and Zambia will be targeted. In a second phase, three additional countries will be added based on DFID’s selection criteria.

From WGEI’s side, a number of activities have been proposed – in line with the WGEI’s three year work plan:

1. Support to SAIs wishing to develop EI audit strategies, including strategies for report dissemination
  2. Guidelines development and haring of best practice and experiences from EI audit amongst members of WGEI Community of Practice
- INTOSAI WGEI toolkit produced for SAI engagement with external stakeholders

Initial feedback on the proposal is expected from DFID by the end of December 2017 and will be shared with WGEI members. If the consortium is successful in securing DFID support, the WGEI SC will appoint a project focal point whom members can contact with input and inquiries.

In the meanwhile, WGEI members are invited to share their own strategies, stories and best practice examples of external stakeholder engagement with through the WGEI newsletter and website.

## Trainings and events

WGEI Steering Committee meeting held in Washington D.C. 25th – 28th September 2017 (By SSali Edward, OAG-Uganda and Stefanie Grace G. Fernandez, Norwegian Audit Office)



Starting from 2014 the INTOSAI Working group on Audit of Extractive Industries (WGEI) organizes a yearly meeting with its members together with regional bodies and/or external speakers in the extractive industries (EI) sector. In exception, the annual meeting held this year is a working meeting for the WGEI Steering Committee (SC) members, where regional bodies and a range of external speakers were also invited.

The main objective of the Steering Committee meeting that took place from 25th- 28th September at the U.S. Government Accountability Office (GAO) in Washington D.C., is to chart the way forward regarding the implementation of WGEI’s three-year Activity plan for 2017-2019. The SC meeting had very fruitful discussions about the activity plan and identified specific goals and tasks to be implemented under different activities. During the meeting, several presentations and papers were presented by activity leaders. The external subject matter experts were also brought in to address the steering committee members on the key topical issues facing the extractive industries.

### Implementation of the three-year activity plan

Some of the points deliberated involved the Working group’s role in facilitating knowledge sharing for Supreme Audit Institutions (SAIs) regarding the audit of the extractive industries sector. This role includes organizing trainings and sharing published audit reports and guidelines for the audit of extractive industries. To promote knowledge and experience sharing in the audit of EI, there is still a need to increase the visibility of audit reports, map existing guidelines and organize capacity-building activities for the benefit

of the members. In organizing capacity building trainings and workshops, it is important to cover the different regional areas such that as many members as possible are engaged and included. In addition, the topics tackled in the trainings should be relevant for the SAIs and be based on their needs.

The annual meeting also reflected upon the need of engaging external stakeholders as well as WGEI members in the activities of the Working group. The objectives of the discussion was to identify relevant stakeholders that can support SAIs in the EI-audit, promote the role of SAIs and to define possible strategies for how the Working group can strengthen relations with these stakeholders and better utilize their knowledge, networks and resources in enhancing SAI impact.



### Topical issues discussed

Some of the topical issues discussed included among others Sustainable Development Goals (SDGs) and their linkage to extractive industries, and Illicit Financial Flows (IFFs) as a development challenge to many developing economies especially Africa. The meeting also discussed the Canadian practice audit guidelines for mining. This guide mainly helps performance auditors in planning and conducting the audit as well as reporting the results of the mining and petroleum audits effectively. This guide provides a list of questions that can be considered when planning an audit, and it has a useful tool that could also assist in risk analysis, in addition to key context information and useful references.

The steering committee members were also updated on extractive industries guidelines by AFROSAI-E. In this regard, AFROSAI-E introduced an updated conception of the value chain. This stresses the fact that legal frameworks are consulted at every stage of the value chain and that implementation of sustainable policies is considered at every stage of the chain.

The SAI of Uganda presented to the committee the cost recovery guidelines developed in conjunction with the

colleagues from the Norwegian audit office. This manual applies the requirements of the International Standards of Supreme Audit Institutions (ISSAIs) for compliance auditing: ISSAI 400 and ISSAI 4000. This was chosen because it allows for the interpretation of an authority (law, regulation or agreement) as the basis for criteria. The costs which are deemed as recoverable must be necessary, economical, appropriate and related to petroleum operations. In the case of SAI Uganda, once a certain figure is determined as recoverable, the recoverability is capped to 60% of production and the rest is carried forward to subsequent years.

### Key decisions

All in all, the discussions from the meeting resulted in further points of action to ensure a better implementation of the activity plan. Some of the key decisions made during the meeting are as follows. The SC members agreed that the current chair to continue until 2022 (term of nine years). In addition, the SC meeting decided to expand the steering committee membership from the current 5 to ten members. WGEI general meetings will take place every three years, which culminates with the completion and report of the work plan, as well as the work plan for the next three years and the working steering committee meetings to take place every year.

The steering committee also decided to elaborate a strategy for external stakeholder engagement and pursue funding opportunities with selected donors. Furthermore, to ease the implementation of the WGEI activities, the SC resolved to implement the Extractive Industry activities through the INTOSAI regional bodies. Notably, engaging WGEI members is crucial to better promote knowledge and experience sharing between SAIs pertaining the audit of extractive industries.

Extractive Industries (EI) Training from 11th – 15th September, 2017 (By SSali Edward – OAG-Uganda)



*The Office of the Auditor General of Uganda in collaboration with the INTOSAI working group on the audit of extractive industries (WGEI) Community of Practice and AFROSAI-E organized an extractive industries training workshop that took place in Kampala, Uganda*

This training helped participants to share knowledge and experiences regarding the topical issues affecting the extractive industries and the trends prevailing currently. Various papers and presentations were discussed including among others; the overview and characteristics of the extractive industries, The Petroleum and minerals value chains and key players (Industry, government), petroleum and minerals' Regulatory frameworks, Identification of Key Risks in the extractive industries sector along the petroleum and solid mineral value chain, the fiscal regimes that are adopted in petroleum and minerals sectors and their major terms.

The participants also shared their country experiences for the Illicit Financial Flows (IFFs) in the extractive industries sector. The participants discussed various ways in which the supreme audit institutions (SAIs) could respond to this vice in their respective countries. The training tackled how we as SAIs could link our work in extractive industries to the attainment of sustainable development goals (SDGs). The participants concluded the training by sharing experiences about how the Strategic Planning for the extractive industries sector audits with our SAIs could help to enhance the quality of these audits such that the citizens get value for money from these resources.

The training drew participants from several countries within the INTOSAI regional groups including; Botswana, Ghana, Kenya, Libya, Iraq, Saudi Arabia, South Africa, Sudan, Tanzania, Uganda, Vietnam and Zambia.

Course Announcement: Reversing the Resource Curse 15 – 26 April 2018 (By Dana Wilkins - NRG)

Applications are now open for the 2018 edition of NRG's *Reversing the Resource Curse*, which will be held from 15-26 April 2018 at the Central European University. Full information on the course can be found at: <http://bit.ly/2jgL1VV>; some highlights below.

We would love to have more SAI participants this year so please consider applying and/or sharing this notice with others who might be interested. NRG can also offer a few country-specific scholarships for individuals from Colombia, DRC, Ghana, Guinea, Indonesia, Mexico, Mongolia, Myanmar, Nigeria, Tanzania, Tunisia, and Uganda.

### **Reversing the Resource Curse 2018**

15-26 April 2018, School of Public Policy, Central European University, Budapest

<https://resourcegovernance.org/events/training/reversing-resource-curse-theory-and-practice-2018>

Applications close: 1 December 2017

### **Design**

This is an advanced-level, multi-stakeholder course for exceptional, committed actors in the resource governance sector. Over ten days, participants will equip themselves with the knowledge, tools and contacts needed to influence natural resource governance in their own contexts. Focusing on rigorous analysis and advanced techniques, the course is designed primarily for individuals who already have a solid understanding of the subject matter but are seeking to enhance their knowledge and skills to play a more prominent role in developing, monitoring, and/or evaluating the mining and petroleum sectors in specific countries or globally.

### **Eligibility**

This course is open to the following: civil society leaders, mid- to senior-level government officials, officials from state owned companies, members of parliament, parliamentary staffers and researchers, journalists, academics and doctoral students, professionals from development agencies and consultancies, representatives from extractive industry associations. Applicants are expected to be active in the resource governance sector. Further information

on eligibility can be found in our course brochure. Women are particularly encouraged to apply.

### **Scholarships**

Scholarships are available for eligible candidates from the following countries: Colombia, Democratic Republic of Congo, Ghana, Guinea, Indonesia, Mexico, Mongolia, Myanmar, Nigeria, Tanzania, Tunisia and Uganda. A restricted number of exceptions may be made from this list for outstanding applicants from other countries.

### **Application**

Applications for Reversing the Resource Curse 2018 can be submitted online at this link: <http://spp.ceu.edu/resource-curse-2018>.

Interested individuals will need to submit: 1) A current résumé/CV; 2) A letter of support from their employer; 3) Two essays that will be used to assess their suitability for the course; 4) A supporting statement for a bursary application (optional).

### **Deadlines**

Applications are due by **1st December 2017**. Longlisted candidates will receive a pre-course exercise on **15<sup>th</sup> December 2017**, which must be completed and submitted by **5<sup>th</sup> January 2018** (applicants must pass this exercise in order to be admitted to the course).

### **Contact**

Queries can be directed to: [gpa@spp.ceu.edu](mailto:gpa@spp.ceu.edu).



# INSIDE THIS ISSUE

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New Guidance on Auditing the Mining Sector by the Canadian Audit and Accountability Foundation

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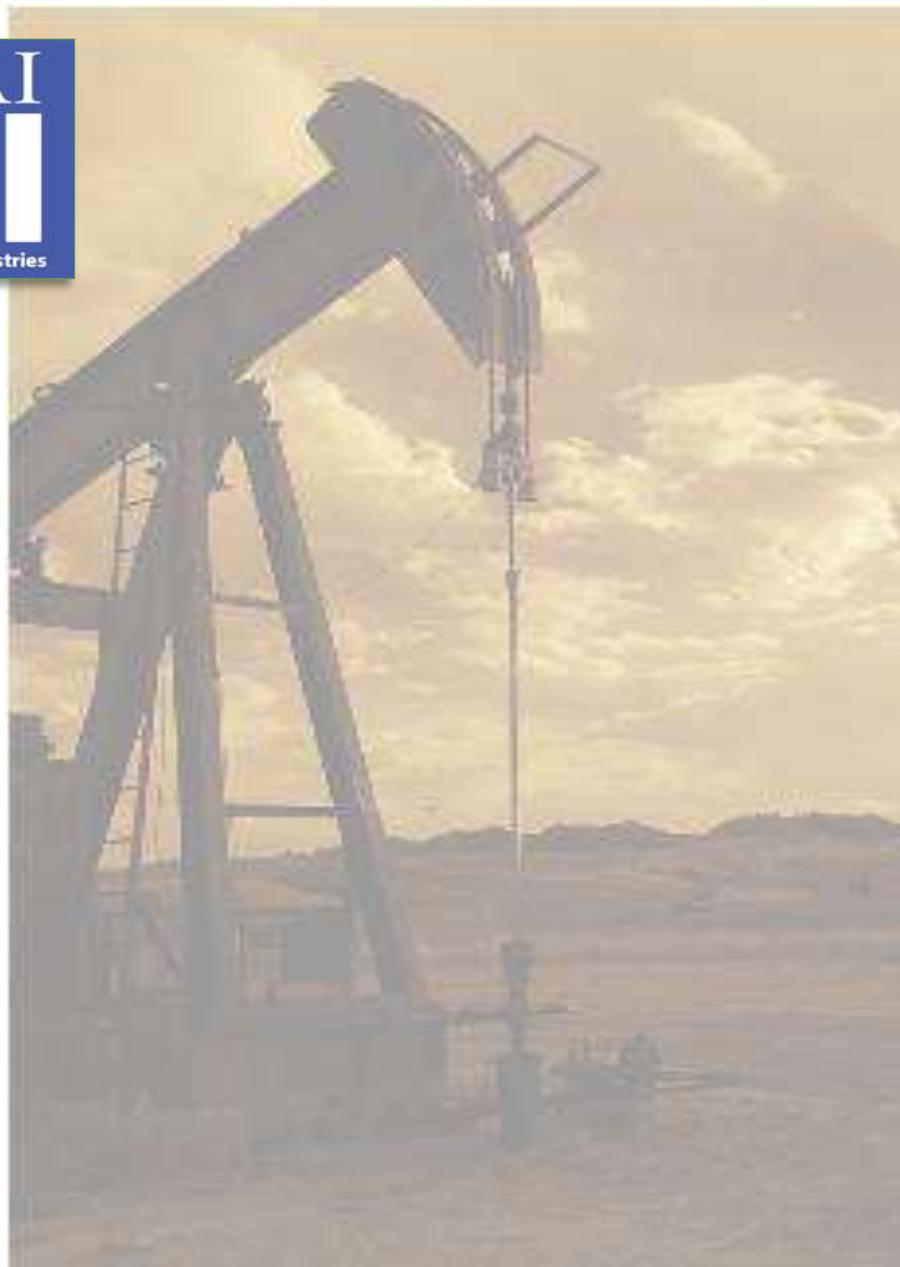
Who is Petropedia?

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Norwegian Audit Office conducts training in fiscal regimes

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Capacity Building Workshops and Exhibitions Conducted by AFROSAI-E and WGEI-CoP



ISSUE NO. 8 | JULY 2017

## About this issue:

Welcome to the eighth edition of the WGEI newsletter! In this edition of the newsletter you can read articles about New Guidance on Auditing the Mining Sector by the Canadian Audit and Accountability Foundation, Who is Petropedia?, Norwegian Audit Office conducts training in fiscal regimes, Capacity Building Workshops and Exhibitions Conducted by AFROSAI-E and WGEI-CoP.

Have a nice read!

## Foreword from the WGEI Chair:

Dear Colleagues, writers and our esteemed readers of this newsletter, I would like to thank you for your contributions towards this newsletter content which has been a valuable tool for sharing knowledge and experiences on various extractive industries topics and ideas.

I am delighted to inform you that the WGEI steering committee plans to meet from 25th – 28th September, 2017 at the U.S. Government Accountability Office (GAO) in Washington, D.C. This meeting will be conducted as a planning meeting of the steering committee members in conjunction with representatives of the INTOSAI Regional bodies. The meeting will review the work plan and identify specific tasks to be implemented under different activities. As you may have noticed I have already sent out a request to our WGEI members to identify the activities where each SAI is interested in providing input.

My humble reminder to you all is that you can get engaged in our activities any time by visiting the WGEI website at [www.wgei.org](http://www.wgei.org), by sharing your published audit reports, useful links and contributing articles to the WGEI newsletters. As a working group, we depend on your input and engagement to keep the community of practice alive.

Sincerely yours,

**John F.S. Muwanga**  
**Auditor General**  
**Republic of Uganda**  
**WGEI Chair**

## Need to know

[New Guidance on Auditing the Mining Sector by the Canadian Audit and Accountability Foundation \(By Glenn C. Fischer, Senior Analyst, Natural Resources and Environment, U.S. Government Accountability Office\)](#)



The [Canadian Audit and Accountability Foundation](#) (formerly known as CCAF) is a not-for-profit organization dedicated to promoting and strengthening public sector performance audit, oversight and accountability in Canada and abroad. In 2013, we initiated a program to develop new performance audit methodology tools in the form of a series of Practice Guides. In October 2016, we released our [Practice Guide to Auditing Oil and Gas Revenues and Financial Assurances for site remediation](#). This July, we are proud to publish a companion guide about the mining sector: [Practice Guide to Auditing Mining Revenues and Financial Assurances for site remediation](#).

This new Practice Guide is the result of recent research and consultations with experienced performance auditors from Canada and several WGEI member countries. It provides information and guidance that will help auditors to complete the successive steps involved in planning, conducting, and reporting the results of an audit of the mining sector. This guidance will be especially useful to auditors who wish to audit:

- mining revenues, including royalties, fees, bonuses and penalties; and
- the financial assurance systems put in place by governments to manage the potential liabilities that may arise from the remediation of mining sites.

In addition to examples of audit questions, audit objectives and audit criteria, the Practice Guide includes information on the following topics:

- the range of government responsibilities in the mining sector.
- the typical life cycle of mining projects;
- the different types of revenues that governments can derive from the extraction of minerals;

- how financial assurance requirements help governments to manage potential financial liability associated with the remediation of mining sites; and
- recent performance audits on the mining sector from different countries.

A printable version of our latest Practice Guide has been made available on the WGEI website and can be accessed by clicking [here](#). For any questions or comments on this document, please contact us at [info@caaf-fcar.ca](mailto:info@caaf-fcar.ca).

By making new guidance on auditing extractive industries available, the Foundation aims to help supreme audit institutions build their capacity in this regard and to contribute to WGEI's efforts to develop tools that address the common challenges involved in auditing extractive industries.

Who is Petropedia? *(By Noah Hammer, Petropedia)*



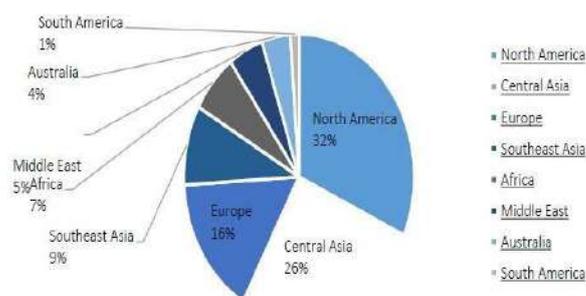
### Who is Petropedia?

Petropedia aims to be the largest collection of insights and inspiration for Petroleum Industry professionals, decision-makers and anyone else who is proud to be called an “expert”. From defining complex Upstream, Midstream and Downstream industry jargon in our dictionary, to exploring the latest trends in our articles, or providing in-depth coverage of various topics in our tutorials. Our goal is to help our readers better understand the “Oil Biz”, the technologies involved and, we hope, make better decisions as a result.

### Petropedia’s Audience

Petropedia is one of the most popular Oil & Gas websites on the Internet; as such, we measure the interests of our audience better than any other media platform in the market. As an Online publisher, Petropedia’s reach extends to a global audience of over 30,000 Energy professionals each month. Using modern Internet analytic tools, we have built a clear picture of our audience – both from a macro-level to track total users, and from a micro-level to measure the geographical data for each article and topic.

Audience Location



Audience Location

We’re your energy encyclopedia, so we want to hear from you. Visit our site at [www.petropedia.com](http://www.petropedia.com) or contact us with questions, comments or suggestions at: [webmaster@petropedia.com](mailto:webmaster@petropedia.com)

### Trainings and events

Extractive Industries (EI) Workshop 11th – 15th September 2017 to be held in Kampala, Uganda *(By WGEI)*

#### Introduction

Strong and effective Supreme Audit Institutions can contribute to better and more transparent oversight of Extractive Industries (EI) and help to ensure that governments manage natural resources in the best interest of the public. The INTOSAI working group on the audit of extractive industries (WGEI) is undertaking a number of initiatives to strengthen SAI’s ability to fulfil this function. At the same time, several stakeholders have made a strong call for more systematic compilation of the many experiences, tools and lessons held by different SAIs and partners, and a more formal platform for advancing this field of work in a coordinated way.

A survey conducted by WGEI among its members confirmed that knowledge and experience sharing and networking are paramount in enhancing the capability of SAIs in audits of this sector.

In line with the above, SAI Uganda in collaboration with WGEI Community of practice and AFROSAI-E has organized an extractive industries workshop scheduled to take place in Kampala Uganda from 11th -15th September 2017.

The theme of this workshop is; “Enhancing the audit of Extractive Industries: Risks and Mitigation”. The main objective of this workshop is to build capacity and deliver valuable tools to help SAIs effectively audit

extractive industries (EI). In particular the course will provide an insight for SAIs to undertake strategic planning for the EI sector audits, identify risks in the value chain and how SAIs respond to those risks, examination and benchmarking of different Fiscal regimes.

#### EXPECTED RESULTS:

At the end of the course participants will be able to:

- Strategically plan for the audits in their SAIs at an institutional level, to develop long term plans (3-5yrs), identify staff and other resource needs for the SAI to effectively undertake audits in EI,
- Identify and assess various risks along the EI value chain, key players, their roles and map out the different types of audits to be conducted to respond to the assessed risks,
- Gain skills to evaluate and compare different fiscal regimes, forecast government revenues and assess risks of any leakages,
- Provide better oversight to the EI sector through informed reports and recommendations

#### Norwegian Audit Office conducts training in fiscal regimes (By Eli Wærum Rognerud, Norwegian Audit Office)

At the end of May, a group of colleagues at the Office of the Auditor General of Norway gathered for a 2-day workshop in fiscal regimes. The course drew on experience from Norway as well as Sierra Leone, Uganda, Zambia and Myanmar, and covered different models for calculating revenue from the extractives sector. Through interactive sessions and exercises, participants learnt to calculate government take, effective royalty rate, contractor entitlement and the rate-of-return-factor.

For Stefanie Grace Fernandez, compliance auditor and WGEI focal point at OAG Norway, the course was an eye-opener:

“This course gives you a great basis for analyzing the tax system in different countries. It allows you to assess whether the system is “fair”, and how one country compares with another”, she says. “With this knowledge, you can also gauge whether developments such as changes in the price of raw material benefits the government or the oil companies”, Fernandez noted.

The course builds on a longer course conducted by [David Johnston](#), who works to design fiscal regimes for developing countries. Facilitators were Trygve Christiansen and Ole Husebø Schøyen from the OAG Norway.

If you are interested in receiving copies of any of this training material, please contact ([trygve.christiansen\[at\]riksrevisjonen.no](mailto:trygve.christiansen@riksrevisjonen.no))

#### Capacity Building Workshops and Exhibitions Conducted by AFROSAI-E and WGEI-CoP (By Edward Ssali, WGEI CoP/OAG-Uganda)

The AFROSAI-E in collaboration with working group on the audit of extractive industries (WGEI) community of practice (CoP) has so far conducted 3 extractive industry training workshops. The first training workshop held in Johannesburg South Africa from 25th to 29th April 2016. The major objective of this workshop was to build capacity and provide valuable tools to support SAIs in auditing extractive industries (EI). The workshop drew participants from several countries organizations including: South Africa, Sierra Leone, Zambia, Uganda, Botswana, Namibia, Norway, Kenya, GIZ, and African Tax Administration Forum (ATAF).



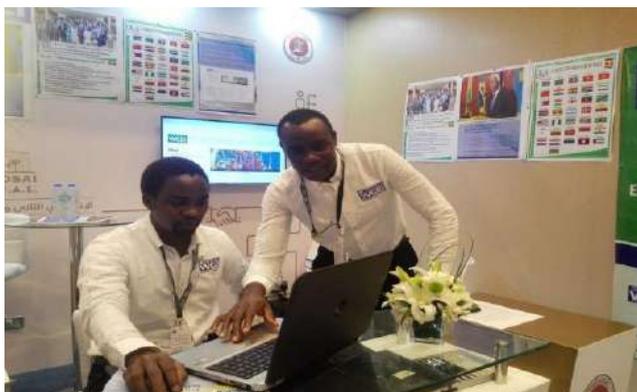
Participants in the April 2016 Extractive Industry capacity building workshop in Johannesburg

The workshop evaluated the key risks and major challenges in the extractive industries, the generic extractive industries value chains, the fiscal regimes and their major terms, risk assessment along the value chain and a high level introduction to transfer pricing.

After this workshop, participants were able to map out key extractive industries audit risks and audit considerations in extractive industries. The participating SAIs were encouraged to use the acquired knowledge to plan and execute at least one audit in extractive industry. As a result, a follow up workshop was organized and held from 21st -23rd September, 2016. During this workshop, participants from different SAIs shared knowledge and experiences of the audits they were individually undertaking. Due to increased interest from SAIs regarding EI capacity building workshops, AFROSAI-E together with the WGEI-CoP, organized a third workshop from 29th May-2nd June, 2017 where SAIs presented and shared their country experiences and common observations.

In order to continue with our networking drive with external stakeholders, WGEI-CoP participated in the Extractive Industry Transparency Initiative (EITI), global conference that was held in Lima, Peru in February 2016. During this event a permanent stand to present the activities of WGEI was managed by the secretariat staff. The secretariat has been in constant collaboration with the EITI secretariat in Oslo and together will continue to elaborate on the role of SAI in the audit of EI.

Additionally, the WGEI-CoP exhibited their activities during the XXII INCOSAI that was held in Abu Dhabi National Exhibition Centre from 5th-11th December, 2016.



*WGEI - CoP staff at the WGEI booth in Abu Dhabi*

Over 85 participants visited our exhibition stand and this had a great impact on membership. After this exhibition, 6 new SAIs joined the working group.



# INSIDE THIS ISSUE

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A Proposed Framework on How to approach Extractive Industry (EI) Audits

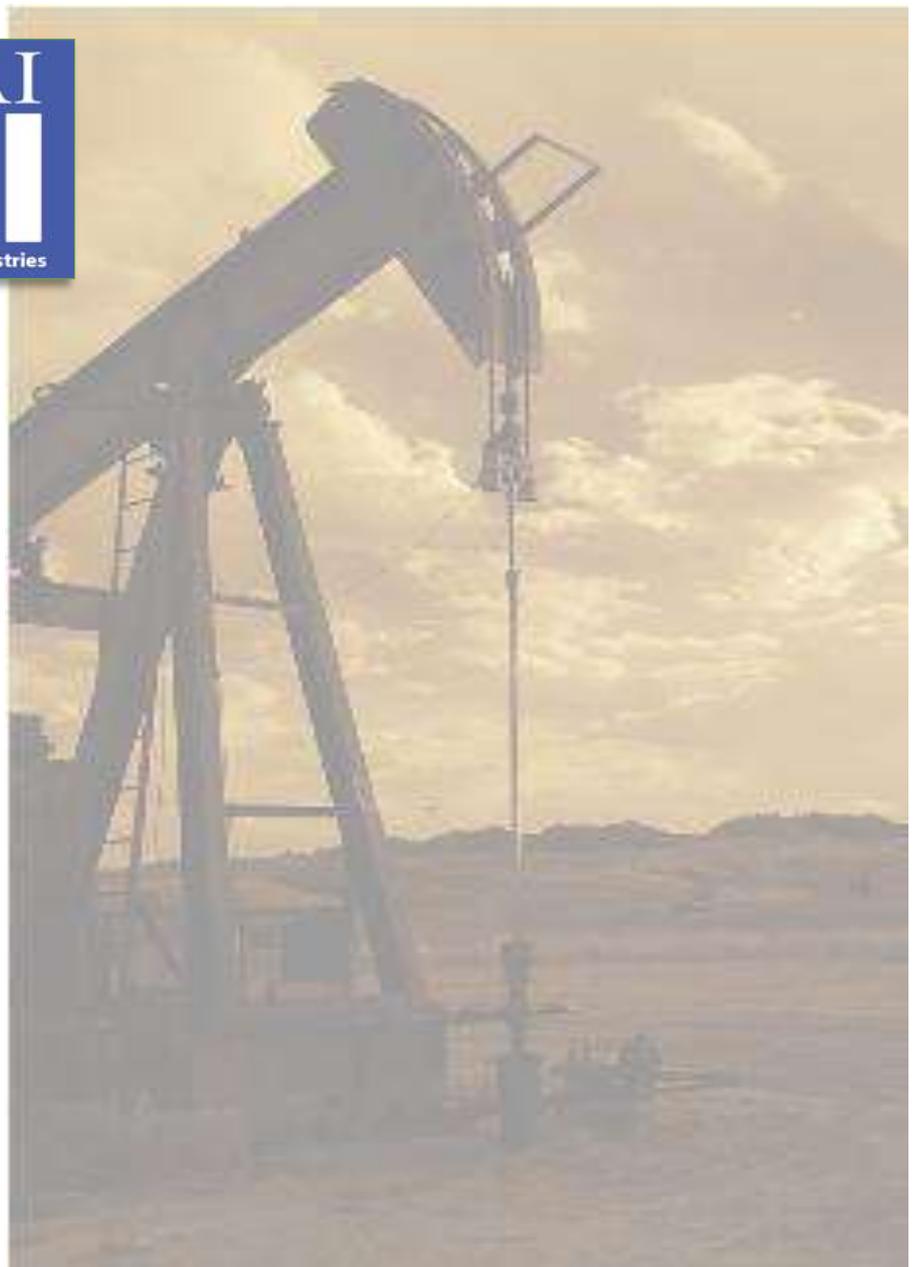
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Mineral resources in Uganda – Tin

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The role of Supreme Audit Institutions (SAIs) in the Oil and Gas Sector

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ISSUE NO. 7 | FEBRUARY 2017

## About this issue:

Welcome to the seventh edition of the WGEI newsletter! In this edition of the newsletter you can read articles about A Proposed Framework on How to approach Extractive Industry (EI) Audits, Mineral resources in Uganda – Tin, The role of Supreme Audit Institutions (SAIs) in the Oil and Gas Sector (Integrating the EI value chain with the Oil and Gas activity chain), Three-day annual WGEI meeting held in Mombasa (24th-26th August 2016).

Have a nice read!

## A Proposed Framework on How to approach Extractive Industry (EI) Audits *(By Glenn C. Fischer, Senior Analyst, Natural Resources and Environment, U.S. Government Accountability Office)*

At the 3rd Annual WGEI Conference in Mombasa, the United States Government Accountability Office (GAO) presented a proposed framework for developing guidance on how to approach Extractive Industry (EI) audits. The idea behind this guidance was to create an accessible starting point for someone unfamiliar with extractive industry audits. GAO is proposing to develop a web-based entry point—to be available on WGEI’s website—that would provide information on considerations of extractive industries.

It is thought that this would be the first place someone unfamiliar to audits of extractive industries would begin learning about the key issues. The proposed framework has 5 sections. First, it would define the purpose for the extractive industry guidance. Second, it would provide the background information necessary to understand extractive industries. Third, it would include the considerations and resources for audits related to extractive industries. Fourth, it would identify existing extractive industry guidance. And fifth, it would include additional related resources.

At the conclusion of GAO’s presentation at the conference, members were placed into three groups to discuss the proposed framework and identify areas where additional audit guidelines could be developed. In general, members supported the developing the guidance. Additionally, members suggested several areas where extractive industry specific audit guidelines could be developed. GAO is planning to conduct follow-up with WGEI members via email to better gauge interest in additional guidelines with the goal of prioritizing their development.

## Mineral Resources in Uganda – Tin *(Henry Luwemba, Senior Auditor - OAG-Uganda)*

Tin in Uganda is found in its ore known as cassiterite. It has a number of uses that include coating other metals to avoid rusting. It is used with lead to make solder and when it is mixed with copper it makes bronze. Tin was the first mineral to be mined in Uganda in 1927. During the period between 1927- 1960 Uganda exported 9,518 tons of tin concentrate worth 2,179,890 pounds. Tin exports by Uganda from 1937-1960 brought in revenue close to 1.5 million pounds (Alaba, 1997).

## Brief Geology

Tin is found in a series of schists, argillites and arenites of the Karagwe-Ankolean system that spans as far as Zimbabwe and eastern Democratic republic of Congo. The rocks are considered about 1300-1400 million years old according to age dating. As the cassiterite is mainly found in hydrothermal and pegmatitic vein, it is estimated that the formation of the veins was around 900-600 million years. Systematic evaluation of the cassiterite in Uganda has not taken place however, Byamugisha and Alaba place the quantity of cassiterite at Mwerasandu at 120,000-135,000 tons of coarse tailings and 195,000-210,000 fine tailings (Alaba, 1997).

## Occurrences

Tin in Uganda occurs in the following places Kikagati, Mwerasandu, Rwemikoma, Nyamaherere, Kitezo, Kyamugashe, Kaina, Ngoma, Burama ridge, Ruhuma, Byasa, Ndaniyankoko (Katto, 1997).

## Tin Production

Currently there are 3 companies with mining leases for tin with one location license. In 2016 41 tons of tin were mined while in 2015, 180.3 tons were mined. The reason why there was a drop in production is not explained. Most of the tin produced in Uganda is exported and the royalty paid for export is 5% of the gross value of the mineral produced in cognizance of its purity as according to the Mining Act 2003 and Mining Regulations 2004.

## Current trends

The systematic evaluation of tin in Uganda has not been undertaken and as a result, it is difficult to have a reliable estimate of the total resource. It is expected that with the evaluation, tin beneficiation will be easy to achieve rather than export the cassiterite. This is expected to improve the livelihoods of all those involved in the process if tin mining.

## Role of the Office of the Auditor General in Mining

The Office of the Auditor General does not directly audit the mining in Uganda. The mining Industry in Uganda is regulated under the Mining Act 2003 and the Mining regulations 2004. The Directorate of Geological surveys and Mining under the Ministry of Energy and Mineral development regulates the mining sector in Uganda.

The Office of the Auditor General undertakes financial and VFM audits on the Ministry and in the process it audits the activities of the Directorate. The Mining act requires the mining company to submit monthly reports of all activities to the directorate. The OAG acquires this information and this is what is used during the audits.

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### **The role of Supreme Audit Institutions (SAIs) in the Oil and Gas Sector (Integrating the EI value chain with the Oil and Gas activity chain) (By Lindah Nalubanga - OAG-Uganda)**

Building strong Institutions is vital to Natural Resource Management. Citizens are excited about the benefits that come along with oil discoveries at the same time elites are worried about the so called resource curse as it has been witnessed in some resource rich countries. This article, therefore demonstrates the role of the Supreme Audit institutions basing on the Extractive Industry Value Chain (EIVC) and the Oil Activity Chain as a basis for auditing.

Many studies put emphasis on good governance that entails transparency and accountability as the solution to the oil curse. However, few experts examine the role of SAIs yet a SAI has a critical role to play in the entire Oil and Gas value chain. They go beyond assessing resource revenues, Specifically, SAIs, aid in promoting sound financial management thereby enabling an accountable and transparent governments which give priority to service delivery for their citizens.

This can also be achieved if SAIs exercises properly their mandates of assessing public institutions operations through carrying out financial, performance, compliance and environmental audits. This will finally give ultimate assurance that extractive industry related activities have been carried out as planned.

In that regard, to assess transparency and accountability, SAIs make use of the World Bank illustrated model of the EIVC which includes; Award of contracts and licences, regulation and monitoring of operations, collection of taxes and royalties, revenue management and allocation and implementation of sustainable development policies.

SAIs are cautioned to take note of the type of fiscal regime in place when planning for an extractive industry audit. Cost recovery and compliance audits would be very vital under a Production Sharing Agreements regime and service contracts, whereas, Value for money and financial audits may be critical under the concessionary arrangements. Environmental audits should be cross cutting through the entire value chain.

Often SAIs wait until the end of the petroleum cycle i.e. the termination stage to carry out an environmental audit however this should be done at all stages especially regarding waste management, pollution and the process of Environmental Impact Assessments. This may be explored along with issues like occupational health and safety. Similarly, when auditing the value chains all the key players should be involved, for example while auditing the volumes of oil produced and revenue, the ministry responsible for the resource, Revenue Authority and Ministry of Finance should form part of the audited entities. Correspondingly, SAIs are challenged with the capacity and capability issues to carry out these audits in addition to the confidentiality clauses which are common in extractive industry sector.

### **Trainings and events**

#### **Three-day Annual WGEI meeting held in Mombasa (24th-26th August 2016)**



Over 80 delegates from 20 member countries gathered in Mombasa-Kenya to attend the three day annual meeting event of WGEI whose main objective was to chart a way forward in auditing oil, gas and minerals.

The Auditor General of Kenya Mr Edward Ouko who hosted the conference welcomed participants to Mombasa and appreciated the Chairperson of the Working Group on the Audit of extractive industries and also the Auditor General of Uganda Mr. John F.S Muwanga for entrusting SAI Kenya with the role of hosting such a major event.

Mr. Muwanga appreciated members for heeding to the call to attend this important meeting. He emphasised the need for members to look for ways of effectively auditing extractive industries to ensure good governance and promotion of sustainable development.

He noted that due to the fact that the audit of extractive industries (oil, gas and minerals) is a new field which faces several challenges the Working Group faces a key task of addressing these shortfalls. He expressed pleasure towards members' efforts thus far.

Delegates at the Conference centred their deliberations around the theme: "The role of Supreme Audit Institutions in ensuring sustainable growth from extractive industries" development of extractive industry guideline and future trainings.



*The Chairperson of INTOSAI WGEI Mr. John F.S Muwanga (left) with his Kenyan and South Sudan counterparts Mr. Edward Ouko and Stephen Wonda during the WGEI Conference*

Mr Muwanga noted some of the challenges as; limited technical capacity of Supreme Audit Institutions (SAIs) in the audit of extractive industries, lack of enabling legislation that can allow SAIs access the needed oil and gas information for audit, and inability to retain well-trained specialized staff in SAIs to continue audit of oil and gas sector arising from competing opportunities for them out in the economy

Members discussed strategies of how to promote audit of extractive industries within the International Organization of Supreme Audit Institutions (INTOSAI) community in order to support good governance and promote sustainable development for the UN post 2015 agenda, now Sustainable Development Goals. These were agreed upon in 2015 in New York to be achieved by 2030. They consist of 17 goals, mainly their aim was to achieve: Poverty eradication, infrastructure development, environment Protection and equality

This was the third annual conference since the working group on Audit of Extractive Industries was established by INTOSAI in 2013. The first meeting was held in Uganda while Norway hosted the second meeting last year.



# INSIDE THIS ISSUE

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SAls Have a Critical Part in  
Extractives Revenue Oversight

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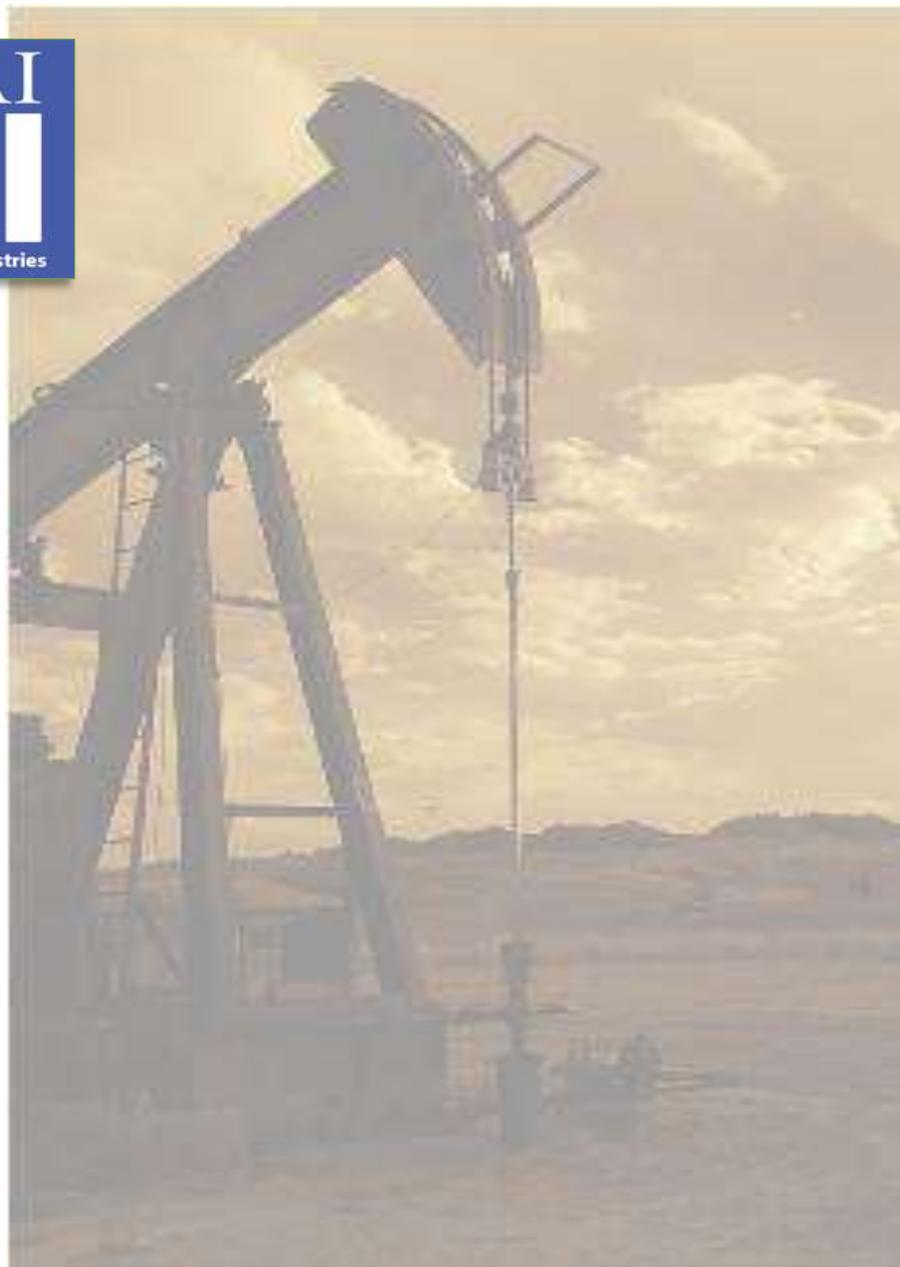
Effectiveness of SAls and how  
AFROSAI-E is working to increase  
capacity in relation to audit of the  
Extractive Industry sector

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Highlights of the AFROSAI-E Annual  
Extractive Industries Workshop  
2019

## Need to know

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ISSUE NO. 6 | AUGUST 2016

### About this issue:

Welcome to the sixth edition of the WGEI newsletter! In this edition of the newsletter you can read articles about the effectiveness of SAls and how AFROSAI-E is working to increase capacity in relation to audit of the Extractive Industry sector. As the annual WGEI meeting is about to start (from 24<sup>th</sup> to 26<sup>th</sup> August) in Mombasa, Kenya you will also see interesting information on this event. We have also added some tips on an upcoming online training.

Have a nice read!

## SAIs Have a Critical Part in Extractives Revenue Oversight (By Dana Wilkins, Natural Resource Governance Institute)

Supreme audit institutions are the unsung heroes of natural resource governance—or they have the potential to be, at least.

SAIs are the first, and in some cases only, independent check on the accuracy of government accounts. They measure the degree to which officials comply with legislation and budgets, and the effectiveness and efficiency of government programs. When things go wrong in public resource management or officials abuse their power to line their own pockets, SAIs are there to identify and expose the problem.

Though such a check holds universal value, the potential of SAIs as watchdogs is particularly relevant for resource-rich countries. Despite their natural wealth, many of these countries top the world's worst development, governance, and fragility indices. Their citizens seem to miss out entirely on the funds that should be used to improve things like healthcare, education, and infrastructure.

The huge and in some cases very sudden rents that natural resources can bring are difficult to manage and oversee even in the most sophisticated public financial management systems. And the highly-complex decision chain and financial flows of the oil, gas, and mining sectors are particularly susceptible to corruption. It is critical that SAIs of resource-rich countries are able to operate effectively and hold governments accountable.

### Research

There is a large and ever-growing body of literature on natural resource governance and SAIs are becoming a topic of choice for academics writing on accountability and corruption. However, despite obvious overlap of the research areas and the potential for game-changing policy implications, few if any scholars have yet conducted a joined-up analysis. My research seeks to help fill this gap, examining the legal and administrative determinants of SAI functional effectiveness in resource revenue oversight. In this instance, I focus on Sub-Saharan Africa.

For the purpose of this research, I limited my scope to the 'functional' effectiveness of SAIs only. This means their ability to access information and publish credible reports, rather than overall effectiveness in fighting corruption or mismanagement. I also focused on legal and administrative variables, rather than external

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relationships and the wider political economy; and on revenue collection and management oversight, rather than contract allocation or public spending outcomes.

### Overall Findings

Though the existing literature typically emphasizes de jure factors such as constitutional grounding, sanctioning powers, and appointment and budget control as the key determinants, my analysis suggests that de facto conditions such as quality of leadership and presentation of reports may be equally—if not more—significant. Technical sector expertise and technology are also central in the ability of a SAI to deal with the complexity of natural resource revenue oversight and to take advantage of the increasing amount of open data available. These conclusions demand further study and have important implications for the way in which domestic and externally-sponsored efforts to improve natural resource governance engage with SAIs.

### A Few Highlights

#### *Leadership*

The degree to which SAI leaders are willing to challenge executive authority varies significantly. However, such efforts can be necessary to secure access to sensitive documents and the freedom to publish uncensored reports. In Liberia, for example, the former Auditor General was a vocal critic of government opacity and mismanagement. For a few years, this allowed his office to produce high-quality and widely-lauded reports on mining and other sectors, despite a particularly sensitive post-conflict context. In Uganda, the Auditor General's willingness to speak out on limited access to information and gaps in accounts has led to the exposure of significant corruption cases. Importantly, his leadership on extractive industry auditing has better prepared Uganda's government for petroleum production and helped build a global network of SAI partners. Even the most technically capable institution might fall short if its leader is not willing to actively manage political, bureaucratic, and other blockages.

#### *Report Presentation*

Given the sensitive nature of resource governance in some countries (and allegations of corruption abound), publishing findings in a timely manner can be a significant challenge. SAIs' inability to simply present reports can undermine all preceding efforts. The act of report presentation relies on the parliamentary calendar (and in some cases, sign-off by the executive)

and those in power are not always keen to see mismanagement or corruption brought to light. In South Sudan, for example, the most recent annual audit report is from 2008. Even prior to the current conflict, repeated requests from the Auditor General to present his reports faced years of delays and pushback. This was despite the oil sector bringing in almost all government revenues, and previous audit reports (and many individuals in and outside of the government) citing specific and repeated concerns over how the sector was being managed.

I was also recently told that in pre-revolution Tunisia, the Cour des Comptes produced consistently good reports detailing the diversion of public funds. However, it was only allowed to publish a short (and unsurprisingly unproductive) newspaper blurb once a year. Happily, it seems the preceding efforts were not in vain: the courts are now using those reports in corruption cases against former officials.

### More

There are many critical factors affecting SAIs' ability to access information and publish credible reports on resource revenue management. Though it is of course necessary to have a strong constitutional mandate, committed resources, and technical expertise, the gap between de jure and de facto abilities deserves more in-depth scrutiny. We may learn that personalities and parliamentary maneuvering have a much larger effect than previously thought.

This article is a synopsis of research I will be presenting at the 3rd Annual INTOSAI WGEI Meeting later this month in Mombasa. For those of you unable to attend, my presentation will be shared on the WGEI site and I am always very happy to discuss this work.

### Recommended Reading

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### Building Extractive Industry Audit Capacity in AFROSAI-E (By Esther Thomas, AFROSAI-E)

The audit of extractive industries is a priority area for AFROSAI-E. We are therefore focused on building the capacity of auditors in the region to enable them to gain an understanding of the sector and guide them on how to conduct risk assessments of the sector in order to focus their audits where the risk is high. These training workshops and initiatives are also open for WGEI members.

### Extractive Industries Training Workshop conducted in Johannesburg April 2016

AFROSAI-E arranged an Extractive Industries Training Workshop from 25 to 29 April 2016. The workshop was held in Johannesburg and subject matter experts were invited from WGEI CoP, SAI South Africa, SAI Zambia, SAI Norway, the GIZ and the African Tax Administrative Forum (ATAF). Participants from seven AFROSAI-E member SAIs, namely Botswana, Kenya, Namibia, Sierra Leone, South Africa, Uganda and Zambia attended this workshop. Participants included both regularity and performance auditors and they had ample opportunity to share their country experiences on the audit of extractive industries. The participants were provided with valuable tools to support their SAIs with the development of this critical focus area.



Extractive Industries Training Workshop in Johannesburg, 25th April 2016

ATAF was invited to give a keynote address to share the outcomes from their special meeting on extractive industries (held in Johannesburg 11-13 April 2016) and; to share the challenges the tax administrations are facing in this area. The keynote address provided a valuable perspective about that the necessity for tax administrators and auditors in the SAIs to have the same knowledge and understanding of the industry. After all, the SAIs are auditing extractive industry revenues that are collected mainly by tax administrations in the region.

Participants were first provided with an introduction of the generic value chain and its seven steps as mentioned in AFROSAI-E's guidelines on extractive industries. Then, subject matter experts from South Africa, Zambia and Uganda (WGEI) shared the specific value chain for diamonds, copper, oil and gas respectively. Several exercises were included in the workshop, both general and SAI specific ones, that provided a foundation for the SAIs to start a process of identifying the key risks in their respective extractive industry along the value chains seven steps. In addition, sessions were conducted, with the support of SAI Norway, WGEI (CoP) and the GIZ, on the major contract types and terms; transfer pricing and; Illicit Financial Flows (IFF). The discussions on IFFs were focused on providing participants with an understanding on the causes that enable IFF, and specifically on the major part that is derived from extractive industries. Poorly negotiated contracts were identified as one of the problem areas and awarding of contracts and licences were identified as step 3 in the value chain.

This workshop was very successful and an eye-opener for the participants, who were encouraged to share this knowledge with other colleagues in their SAIs and contribute to capacity building. They were also encouraged to carry out risk assessments along value chain for their extractive industries. A follow-up workshop is scheduled to take place in South Africa from 21 – 23 September 2016.

### **Governing Board Meeting in Abuja**

AFROSAI-E's 13th Governing Board Meeting took place in Abuja, Nigeria from 9 to 13 May. Extractive Industries emerged as a very significant topic during the various breakaway sessions which focused on topics such as the sustainable development goals and fraud-risk.

### **Fiscal Governance Workshop in Pretoria**

AFROSAI-E also held a session on the extractive industries value chain in the Fiscal Governance workshop which took place in South Africa from 25-29 July 2016. Extractive industries are part of the fiscal system that the SAIs need to gain an understanding of and pay more attention to.

### **Impact of Illicit Financial Flows on Extractive Industries and Sustainable Development Goals**

Most of the SAI's have the mandate and responsibility to audit the revenues from extractive industries. The SAIs can and should raise questions about the revenues received and not received, i.e. are all the revenues collected? What is the cause of leakage of the revenues? The collection of taxes and royalties is identified as step five in AFROSAI-E's value chain for extractive industries.

Resources have the potential to fund sustainable human and economic development. Lack of engagement around resources can impede accountability and effective governance. If the revenues are not appropriately accounted for it is difficult for the region to achieve the Sustainable Development Goals such as, "No poverty", "No hunger", "Good health" and "Good Education". These first four SDGs relate strongly to the revenues the countries generate through various taxations. It is also important for the SAIs to focus on other effects of extractive industries, such as the impact on the environment which links to the SDGs on "Clean Water and Sanitation", "Clean Energy", "Life Below Water" and "Life on Land".

AFROSAI-E will continue to integrate extractive industries focus area in training workshops and guidance material, but it is of great importance that SAIs take the responsibility to build their capacity to better understand this complex sector, in order to raise the relevant issues in their audits.

### **Trainings and events**

[The 3rd annual WGEI meeting to take place in Mombasa, Kenya from 24th to 26th August 2016.](#)

The theme of the annual meeting this year is "The role of Supreme Audit Institutions in ensuring sustainable growth from extractive industries". The program this year consists of a technical program linked to the theme as well as a few activities that will hopefully

contribute to the continued development of this important working group. The speakers come from government, UN Agencies, the SAI community as well as academia. We are sure that this diverse range of speakers and themes will make this event dynamic, spark discussion and inspire.

Of special interest may be that we this year have a session on guideline development. We know that many of our members are interested in this topic and we hope to give an overview of ongoing guideline projects and receive feedback on how these can be further developed or integrated to benefit the work done at the respective SAIs. Among the presenters for this session will be GAO (SAI U.S.), CCAF, SAI India and AFROSAI-E.

The technical program will touch upon issues such as EI and price volatility, Revenue Management in EI rich countries, Artisanal and Small scale mining and EI and Public Private Partnerships. The full program can be found on the WGEI homepage.

As for last year's event all presentation will be uploaded to the WGEI homepage so that also members who did not have the opportunity to join in this year can get a taste of what was going on. We are also going to upload a brief summary of the day each evening. These updates can be accessed by clicking on the "WGEI Activities" banner and then "3rd WGEI meeting".

### **Useful Resources**

[Free online course \(starts this September\)](#)

For our members interested in expanding their knowledge regarding EI governance we suggest enrolling for the free online course "Natural Resources for Sustainable Development: The Fundamentals of Oil, Gas, and Mining Governance". This is a joint initiative by Natural Resource Governance Institute (NRGI), the Columbia Center on Sustainable Investment, and the World Bank and the aim is to give an understanding of the key challenges and opportunities that come with managing extractive industry investments for sustainable development. The course starts in September 2016 and you can enroll using the following link: <https://www.sdsnedu.org/learn/natural-resources-for-sustainable-development-september-2016>



# INSIDE THIS ISSUE

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The link between the Paris climate agreement and the work of SAIs

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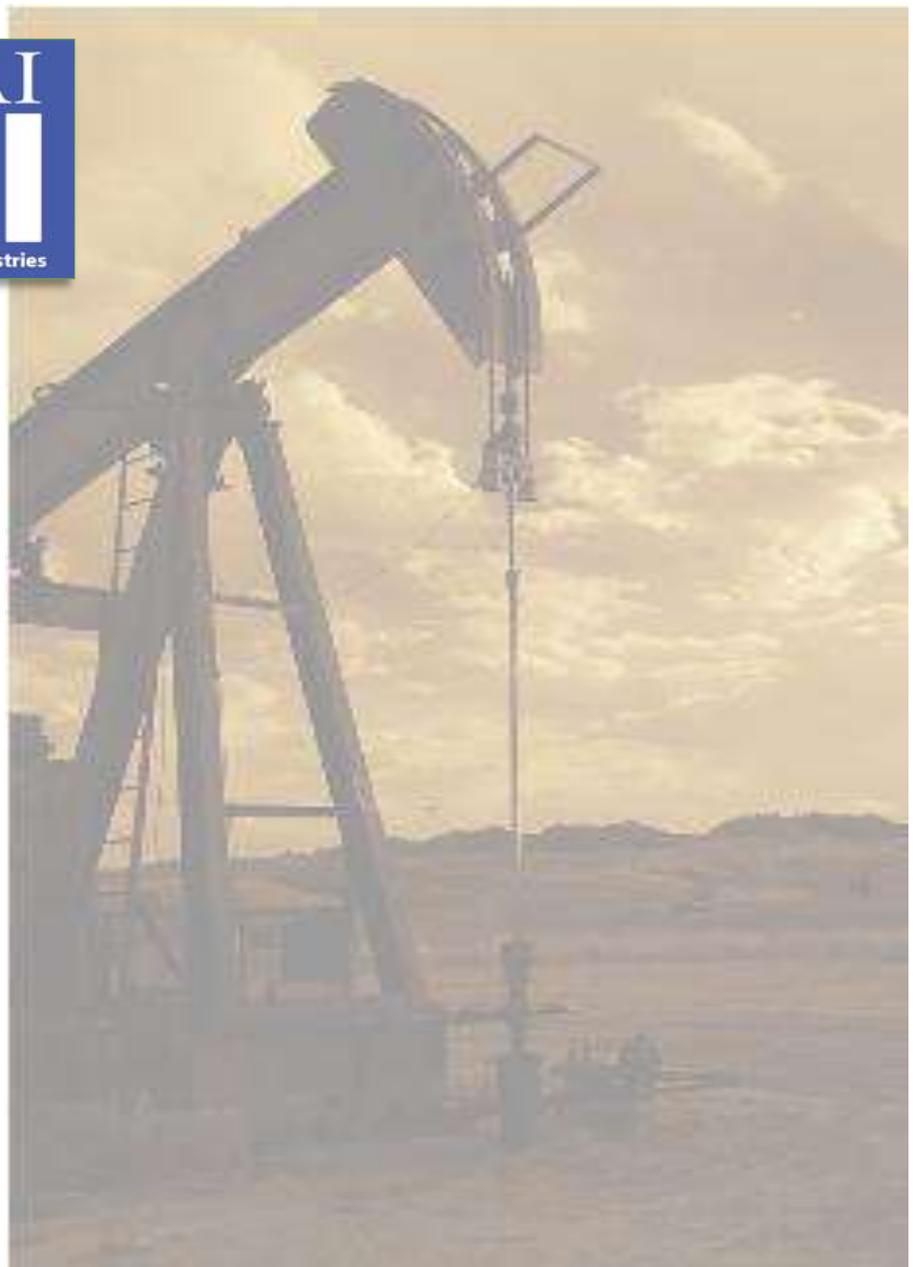
A new contractual model used in the Ecuadorian oil & gas industry

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Highlights from the Global Accountability Conference on Oil and Gas in Dar-es-Salaam

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El field trip by top management at SAI Uganda



ISSUE NO. 5 | MAY 2016

## About this issue:

Welcome to the fifth edition of the WGEI newsletter! In this edition of the newsletter you can read about the link between the Paris climate agreement and the work of SAIs, a new contractual model used in the Ecuadorian oil & gas industry, get highlights from the Global Accountability Conference on Oil and Gas in Dar-es-Salaam as well as read about an El field trip by top management at SAI Uganda.

Have a nice read!

## Need to know

What does the Paris Agreement mean for the future of Extractive Industries? (By Marcoen Roelofs & Jeroen Doornbos, Netherlands Court of Audit)

***With last December's Paris Agreement, the world community agreed on reducing the emission of greenhouse gases severely with the aim to limit global warming. What exactly is agreed on? And even more important from the WGEI perspective: how does it affect the extractive industries?***

After many years of preparation and two weeks of negotiations, 195 countries plus the European Union adopted the Paris Agreement under the United Framework Convention on Climate Change (12 December 2015). It was largely seen as a success, compared to the modest expectations and the almost complete failure of the preceding climate conference in Copenhagen. At the same time, it is clear (and even mentioned in the text itself) that the sum of all intended measures is far below what's needed to realise the main aim: keeping climate change well below 2 Degrees Celsius, if possible even below 1.5 degree.

### ***Main elements of the Paris Agreement***

The parties (countries and regional collaborative organisations like the European Union) that negotiated the Agreement emit more than 90% of all CO<sub>2</sub> (and equivalents) in the world. With the Agreement, its parties promised to strive to limiting global warming at the end of this century to well below 2 degrees Celsius compared with pre-industrial levels, and to try to keep it below 1.5 degree.

Moreover, the developed countries will support developing countries with large financial contributions for mitigation, and adaptation to the climate change that takes place in spite of the mitigation. The financial flows from the developed countries should reach a value of 100 billion dollar a year by 2020, the side letter makes clear (probably public as well as private funding are meant). The Agreement is due to enter into force in 2020. In a side letter, several considerations are formulated to stimulate climate action before 2020.

The Agreement creates quite a few mechanisms to monitor progress and to develop a kind of peer pressure among the parties. To give an example: each country has to formulate how it intends to contribute to the above-mentioned aims and these "intended nationally determined contributions" will be recorded

in a public registry. And each country will have to account for its results.

That there is a large gap between the aims and the sum of the intended nationally determined contributions is clearly stated in the side letter to the agreement. Filling this gap is expected to be stimulated by a new report of the International Panel on Climate Change in 2018, on scenarios limiting global warming to 1.5 degree. Afterwards a 'facilitative dialogue' is planned in the same year to help finding solutions. This facilitative dialogue is hoped to produce a dynamic towards significant reductions of CO<sub>2</sub> emissions, already before the Agreement enters into force.

Under the Agreement itself, a similar process of 'stocktaking' will take place every five years from 2023 on: evaluating if the sum of the obtained results and the intended nationally determined contributions will be enough to realise the aim of keeping global warming well below 2 degrees; if not, revising the intended contributions.

### ***A significant step forward...***

It is said that the agreement enhances the chances of really mitigating the climate change, giving a clear orientation to governmental and EU action, and to private investments.

Beyond this consensus important differences are present, most of all concerning the urgency and needed pace of climate action. Several NGO's and think tanks like the Dutch Environmental Agency stress how enormous and urgent the task is to keep global warming well below 2 degrees and call for much quicker action. There might be a gap between the urgency documented in all IPCC reports and the reality of politicians, not eager to defend far-reaching and in the short term possibly costly transformations.

### ***...but what does it mean for extractive industries ?***

A small project team in our office is currently assessing the significance of this Agreement and the consequences for the Dutch Government and society. However, we have no reason to believe that the agreement will affect our national oil and gas production. Within a decade the Netherlands has almost depleted its major reserves of natural gas and our national oil production is not significant.

This is quite different for a lot of WGEI member countries. This becomes clear when we consider the carbon potential of global fossil fuel reserves and the concept of 'the carbon budget'.

## The carbon potential of fossil fuels...

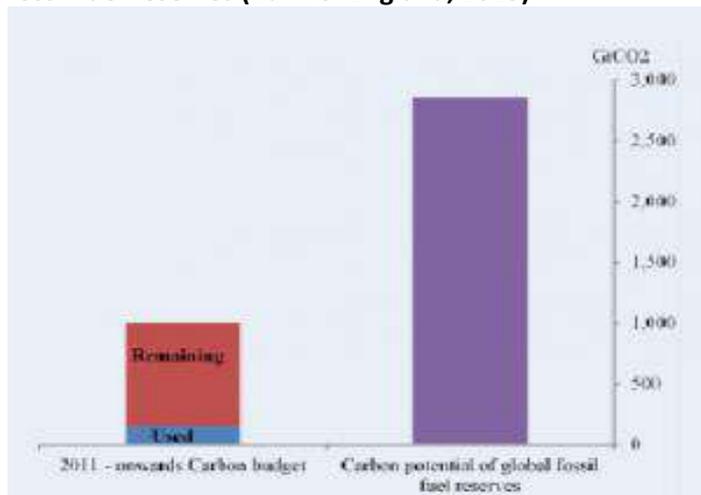
The world has still major reserves of fossil fuels. Those fossil fuels emit CO<sub>2</sub> when burned. Carbon Tracker, a not for profit financial think tank, estimated in 2012 the carbon potential of the earth's total reserves of fossil fuels at 2,860 GtCO<sub>2</sub>.

### ...is restricted by the carbon budget

However, to limit global warming to 2 degrees we cannot 'burn' the full carbon potential, but only a part of it: the so-called carbon budget. That is the amount of CO<sub>2</sub> that can be emitted before we reach a global warming level of 2 degrees. In 2011 this budget was estimated to be approximately 1000Gt of CO<sub>2</sub>; just one third (!) of the total carbon potential. In other words: just one third of the fossil fuel reserves could be burned. The remaining part could be burned using innovative but still immature technologies like carbon capture and storage. Alternatively, those reserves should not be extracted at all. In particular, Ekins and McGlade (2014) estimate about 30% of oil reserves, half of gas reserves and around 80% of coal reserves globally would need to remain below the ground in order to keep within the 2°C goal.

And matters are urgent: end-2014 the world already consumed 15% of its carbon budget (see figure below). It is expected that the 1.5°C carbon budget will be consumed by 2021 and the 2.0°C carbon budget will be finished by 2036.

### Global carbon budget vs carbon potential of global fossil fuel reserves (Bank of England, 2015)



Global carbon budget vs carbon potential of global fossil fuel reserves (Bank of England, 2015)

## The question for the WGEI countries

Of course, one could raise some critical remarks whether the Paris Agreement will be effective and will be enforced. However, there is a sense of urgency and it is reasonable to expect that the global community will take additional action if needed.

This raises questions for the countries that are heavily dependent on their extractive industries. Especially the countries standing on the brink of exploiting their natural reserves and currently investing heavily in their extractive industry sector, should ask themselves whether the investment is futureproof. Is it not 'an investment in yesterday's opportunities' like it is an army's nightmare to invest in the technologies of the last war? This assessment should be part of the government's 'business case' before deciding to invest significantly in the extractive industry sector in order to boost economic development. Could that be something a supreme audit office should consider when auditing government's investment plans for extractive industries?

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A new contractual model is used in the Ecuadorian oil & gas industry for the development of crude fields through private investment (By Carla Fiallos, specialist of the Strategic Sector Audit Direction of the Office of the Comptroller General of the State, Ecuador)

With the ongoing oil crisis, the Ecuadorian State has developed new ways to get financing from exploration and exploitation of crude blocks in the Amazon; resulting in a new type of contract which has raised criticism for its legality. However, with the General State Budget depending mainly of that resource, it is important to describe and analyse carefully this new deal; being the role of the Office of the General Comptroller the supervision of the State resources.

By the end of 2015, the Ecuadorian State, through one of its public companies, subscribed a “Contract for the Provision of Specific Integrated Services”, with enterprise related to a private company. This new type of contract meant that the Contractor finance the execution, optimization, production activities and operation support in a block of the Ecuadorian Amazon Region, for an approximate investment of 4,100 million dollars to be disbursed over 20 years.

The normative for procurement of the Public Company allows it to make direct contracts that tend to obtain economic benefits from intangibles arising from legal or contractual rights.

Under this model the state pays the private company a fee per barrel regarding all block fields production, unlike previous “Contracts of Specific Integrated Services” with funding from the contractor, signed in 2014, for the execution of optimization activities, improved recovery activities and exploration activities, under which the payment of the fee was limited only to the incremental production generated by private investment.

One of the main reasons that motivated the subscription of this “Contract of Specific Integrated Services” with funding from the Contractor is the lack of resources to perform CAPEX and OPEX investments expected in the Development Plans and therefore maintain or increase the production. Currently, the block production is approximately 70.000 BOPD<sup>1</sup>; however, 1 Barrels of oil per day according to the Public Company’s estimated production, in case that it does not have the resources to execute the planned investments from 2016 and onwards, the production would decline 25% per year, decreasing by the year 2021 to 10.000 BOPD<sup>1</sup>.

In order to increase and sustain the block’s crude production for the last 3 years, the Public Company required an annual average of USD 320 million for capital expenditures and \$ 180 million for expenses and operating costs. Due to the low WTI<sup>2</sup> crude price and the export price of Ecuadorian crude, the state reduced the budget allocation to the Public Company in recent years.

The interpretation of the Ecuadorian State with the signing of this contract is that the Ecuadorian Public Company continues as owner and operator of the block, even though the private company is responsible for the investment (CAPEX) and operating expenditures (OPEX) in the subsoil as a percentage, so that another percentage corresponding to surface OPEX is assumed by the State through its public company. This new business proposed model states that the Contractor assumes investment costs, freeing up that item from the General State Budget and from the Government.

Previous specific integrated services contracts with funding by the Contractor for optimization activities, improved crude recovery and exploration – commonly called “Contracts for Mature Fields” – were signed as a result of the crude rounds carried out in 2011 and 2013, in which the area of activities was limited only to one field, the contract term was agreed in 15 years and the payment of the fee per barrel only corresponded to the incremental production calculated over a contractually agreed Referential Production Line and generated as a result of the investments made by the Contractor.

Meanwhile, in the recently subscribed contract, the activities area corresponds to a whole block, within which there are several fields in production; the term has been agreed in 20 years; and the payment is done through a fee per barrel of total production of the Block, ergo, there is no Referential Production Line. The legality of the signing of this contract is still on debate. Since, the Public Company hired a specialized international legal consultancy, which indicates that this contractual mode is provided in Article No. 2 of the Hydrocarbons Law. This article states that the works or specific services that Public Enterprise has to execute can be performed by itself or entering into contracts for works or services; but this refers specifically to the mature fields.

Another important stipulation is contained in the article 16 of the Reformed Regulation to the Hydrocarbons Law issued in 2010, indicating that the fields in production by public companies will not be delegated through contractual arrangements

(association, participation, providing services for hydrocarbons exploration and exploitation contracts) provided in article No. 2 of the hydrocarbons Law to private initiative, without prejudice to enable them to perform specific service contracts in accordance with Article No. 17 of the hydrocarbons Law, which refers to works or specific services contracts in marginal fields. As all the fields that are part of the area of Contract activities are mature and non-marginal fields, it would not apply the exception provided in Article No. 16 of Reforms Regulation to the Hydrocarbons Law, mentioned above.

The analysis of this new contractual model must be thorough, especially all the matters related to the resources that the Public Enterprise received by concept of an intangible asset that was listed as “Contract Right”; the “Carry Forward Clause” without interests for cases where available income is not sufficient to cover the amount of the fee; the scope of services to be rendered by the Contractor in favor of the public company, ergo, if the services are limited to activities of production optimization, or whether on the contrary investments in improved crude recovery are contemplated; which part reserves itself the right to take decisions regarding the management of the reservoir; among others.

Regarding to the new legal figure “Intangible Right”, that comes from the specific integrated services contract with funding by the Contractor, the Budget Classifier of Public Sector Incomes and Expenditures allows annotating revenues from the value of the prestige that the company of state-or sectional property has in monetary terms; and other intangibles. The Contractor amortizes the intangible during the contract term and the Public Company records it as a deferred tax liability.

The established fees in the contract for the three phases of the Activities Plan include the amount of productive investments (CAPEX), operating costs (OPEX), taxes, and a fee for contract law and the Contractor utility, which is paid in money for each barrel produced. Furthermore, according to the payment mechanism established in the contract, if the funds from crude exports become insufficient, the fee may be funded with market resources for the payment of the domestic price of derivatives or the budget of the Public Company.

One of the main problems of the Ecuadorian Public Enterprise is that resources received for this contract were transferred to the General State Budget, because of the agreement for their liquidity management signed with the Ministry of Finance; therefore this does

not work as a company that manages its own resources, but depends on the state budget allocations.

Consequently with the statements above, the challenge for the Office of the Comptroller General of Ecuador, which is currently auditing this new type of contract, is to understand and analyze the environment that led to its subscription in order to determine its legality, to verify compliance with the Activities Plan foreseen in the contract, and the destination of the provided resources to ensure that these are not used for other purposes other than investments in the hydrocarbon sector to increase national crude production.

[1 Barrels of oil per day](#)

[2 West Texas Intermediate](#)

### **Trainings and events**

[Global Accountability Conference on Oil and Gas in Dar-es-Salam \(By Trygve Christiansen, Norwegian Audit Office\)](#)

The Global Accountability Conference on Oil and Gas was held in Dar-es Salaam 11-12 April. The conference was arranged by the Wajibu Institute of Public Accountability, which was co-founded by former Tanzania Controller and Auditor General, and former AFROSAI-E Chair, Mr. Ludovick Utouh. Wajibu shall focus on accountability on a number of policy areas, and at the moment oil and gas is the emerging area in Tanzania.

### **Managing Expectations**

Managing expectations was one of the important topics. Mr. Aidan Eyakuze from the respected NGO Twaweza said that the myth saying that Tanzania will swim in money because of the natural gas discovery is false. Tanzania’s gas reserve constitutes 0,83 % of the world’s gas reserves. The development of shale gas in e.g. USA makes Tanzania’s share increasingly irrelevant. The low gas price makes commercial investment decisions increasingly unlikely. Also, the result of the recent UN conference on climate change in Paris was to keep global warming below 2 degrees Celsius. This will draw attention to other sources of energy outside natural gas. Such forces may lead to expectations of the public in Tanzania not being met.

However, Mr. Thomas Baunsgaard from IMF wanted to balance the story from Mr. Eyakuze saying that natural gas is likely to give lasting benefit if managed correctly. Although the expected revenue may be modest, it will constitute an important supplement to the economy of

Tanzania and also supply the domestic market will much sought after energy.

Twaweza later explained about its experience with working with ordinary citizens and their recommendations to how natural gas revenue should be used. The citizens had three recommendations:

1. Oil and gas revenue should not be used on fuel subsidies. Fuel subsidies in countries such as Nigeria and Venezuela have crippled their economies. Also, such subsidies have a tendency to favor the rich which possess cars. Instead, the oil and gas revenue should go into the state budget to fund public service goods.
2. Revenue should not be saved, but used to address immediate needs such as infrastructure, school and health needs.
3. Revenue should not be used as guarantee for taking up significant foreign debt. This is a type of financial speculation that pose a significant risk to the economy.

Although, not all these bottom-up recommendations are based on oil and gas best practice, they may serve as input to policy decisions. They are also a reminder of that although some public expectations may be unrealistic; they also represent a share of wisdom which we can learn from.

### **The Readiness of Tanzania**

Mr. Farouk al-Kasim shared many of his experiences as one of the key figures in developing sound and effective management of the oil and gas industry in Norway. For more information about the utterly fascinating story of Mr. al-Kasim, read his Financial Times Interview from 2009: <http://www.ft.com/intl/cms/s/0/99680a04-92a0-11de-b63b-00144feabdc0.html>

al-Kasim stressed the importance on developing the sector *gradually*. The legal framework should be developed in the following order: 1. Petroleum policy, 2. Petroleum Act, 3. Regulations, 4. Strategies and preparations for concession rounds, 5. Commercial contracts (Production sharing agreements and/or licenses). After developing the legal framework, competent government institutions must be established. Mr. Deo Kirama from National Audit Office Tanzania also stressed this point. Tanzanians must think less about the output of its natural gas reserves, and more on the input. What does Tanzania have to invest in competencies, education, local content, infrastructure etc. to make sure that it can turn the natural gas reserves into cash which will benefit the economic development of Tanzania?

Professor Patrick Lumumba said that Tanzanians are more prepared to spend the resource revenue than spending the effort needed to make sure that this revenue is generated. He iterated the need for African countries to have more control of the sector and made reference to Norway, Qatar and Botswana as countries which are in effective control of their sector. In Africa too much control is exercised by the foreign oil and gas companies. This is among others shown in the oil pipeline dispute between Kenya, Tanzania and Uganda. The French oil company Total, as a powerful industry player, is using its weight to favour one of the proposed alternatives. According to Lumumba there is little benefit of having beautiful policies and laws as long as implementation fails because of rent-seeking, low competence and resignation towards the big industry players.

### **The New Petroleum Laws**

The conference ended with a revision of the newly enacted petroleum laws in Tanzania in July 2015. These are the Petroleum Act, The Petroleum Revenue Management Act and the Extractive Industries (Transparency and Accountability) Act. It was generally agreed that these new acts meet most of the internationally accepted best practice criteria. However, it was revealed that these acts were tabled in Parliament in express speed without any proper hearing rounds which included civil society, companies and also parliamentarians. The result is a number of discrepancies in the acts. There are examples of government entities being tasked to do the same task. Also, some legal requirements in the acts conflict with existing requirements in the already approved government policies.

It was generally felt that the process of enacting these laws was flawed and not to be emulated by others. In retrospect, many of the inconsistencies could have been rectified if a proper debate had been facilitated by the government.

### **Summing Up**

The Oil and Gas conference in Dar-es Salaam was a good example of how to bring different stakeholders together to discuss an emerging issue, which oil and gas extraction in Tanzania represents. The role of the National Audit Office of Tanzania is also highly commendable. They were active participants and performed different roles with ease, such as chairing sessions, making though-provoking presentations, take part in panel debates and asking questions. SAIs should lead by example in stimulating public debate on emerging issues. Too often SAIs refrain from providing

foresight, and only restrict themselves to oversight and ex ante controls. By contributing to the public debate SAIs can use its wisdom and knowledge to ensure that informed decisions are being made.

A similar case of a proactiveness was demonstrated by the Office of the Auditor General of Uganda in 2013 when they hosted a Petroleum conference, with participation of parliamentarians, companies, government institutions, development partners etc. The objective of the conference was to discuss how increased transparency and accountability in the emerging petroleum sector in Uganda could help foster effective and sustainable resource exploitation, and to demonstrate the role of the Office of the Auditor General in the emerging petroleum sector.

Let us hope there will be many more examples of these initiatives. Policy decisions on the extractive industries are too important to take place behind closed doors, but should instead undergo a rigorous public debate.

### The 3rd Annual WGEI meeting to take place in Mombasa, Kenya from 24th to 26th August 2016

The WGEI secretariat has the pleasure to inform you that the 3rd annual WGEI meeting is scheduled to take place in Mombasa in Kenya from 24th to 26th August this year. SAI Kenya will host the event and a first preparatory meeting in Nairobi has already been undertaken with the WGEI secretariat. The details of the program has not yet been finalized but the theme that will serve as a red line throughout the event will be linked to The role of Supreme Audit Institutions in ensuring sustainable growth from extractive industries. Apart from introductions and discussions related to this theme there will be sessions aimed at driving forward the development and future activities of WGEI. Invitations with a preliminary agenda will be sent out shortly.

#### Members in Action

### Top management of the Office of the Auditor General of Uganda & WGEI visits the Albertine Graben and Karuma Hydro Electric Power Project

Recently the Energy Sector team of the OAGU, in collaboration with the INTOSAI Working Group on Audit of Extractive Industries (WGEI), organized a visit to some of the areas of the Albertine Graben Region where Petroleum activities are taking place as well as to the Karuma site, in Northern Uganda, where a major Hydro-electric project is under construction. The WGEI Newsletter Journal | September 2019

objective of this mission was to familiarize top management at the Office of the Auditor General (OAG) with these significant projects in the Extractive Industries (EI) and energy sectors in Uganda. The two project sites represent initiatives that will impact heavily on Uganda for decades to come. The Kingfisher installation in the Albertine Graben petroleum field was visited Monday 11<sup>th</sup> April while the Karuma hydroelectric project site was visited Tuesday 12<sup>th</sup> April.



AG and three members of top management.

Some 6.5 billion barrels of oil have so far been discovered in Uganda and several licenses, both exploration and production, have been granted. The main private actors involved in petroleum activities in Uganda are Total E&P, Tullow Uganda oil Pty and CNOOC (China National Offshore Oil Corporation). The Kingfisher block is operated by CNOOC which formally received the production license in 2013. During the mission the team observed several drilling pads as well as an airfield which would facilitate logistical needs when production starts as well as several stretches of road that have been constructed or upgraded to facilitate access to the area.



Petroleum installations on the shore of Lake Albert

In addition the team visited the site which has been acquired for the proposed refinery measuring 29km<sup>2</sup> .

The works to construct the Karuma hydroelectric power plant started in 2013 with Sinohydro Group Ltd as the main contractor. This project, which is estimated to cost about 1.7 billion USD, is located at the Karuma Falls on the River Nile. It is estimated that the project is today at about 30% completion rate and when work is scheduled to end in 2018 the total capacity of the plant will be 600 MW. The OAGU team visited, among other installations, the power house excavations which is about 80 meters below the ground and represents a major part of the large underground installations of the dam project.

WGEI Community of Practice discussed the implications of such large EI and energy projects on the SAI with the Energy Sector audit team of the OAGU and the head of the WGEI Secretariat.

**WGEI CoP:** What role does a SAI play in general when such huge energy projects are undertaken by the government, and how do we ensure that revenues from the EI sector finally benefits the population?

**OAGU Energy Sector:** The role of the SAI will depend on its particular mandate. For the case of SAI Uganda, the mandate is to audit and report on the public accounts of Uganda. This is to ensure that public resources are spent efficiently so that the population of the country gets value for public money. OAGU will thus look at all the stages of implementation of these energy projects and consider if public money has been used according to relevant standards, rules and regulations. We will for example look at the procurement process conducted, the financing of the projects, and the overall progress of the projects. We can also go in and look at whether the relevant government monitoring entities are handling data from seismic surveys according to rules and regulations, if the licensing rounds and contract awarding is done in compliance with relevant rules and regulations, if the government revenues from the sector is used in compliance with relevant legislation etc. In Uganda, unlike many other countries we are also directly reviewing the petroleum recoverable cost to see if they are correctly reported.

**Head of the WGEI secretariat:** I would like to add that the role of a SAI is to give an objective assessment of the performance of such huge projects whose completion span over several years and has long term implication on citizens. The objective assessment can only be based on the SAI's capacity to appreciate and have adequate understanding of the project right from

the beginning through the various stages. This understanding requires being able to keep track of the project process outputs and if possible, design audits based on the key project process outputs. Understanding the project right from inception and visiting such project during implementation at sites provides SAI top management this important opportunity to understand the project better and be able to adequately guide audit planning in order to provide objective assessment.

For projects with long completion timeline, it is appropriate for SAIs to break the project into key auditable stages so that SAI's can provide recommendation at the appropriate process outputs in order that the utilization of the recommendations can be implemented to improve the next project process rather than wait to provide recommendations only relevant for future such projects when the existing one is beyond correction.

**WGEI CoP:** What are the main characteristics of the EI sector in relation to public auditing?

**OAGU Energy Sector:** It is important to understand that the energy sector is a complex sector and this needs to be matched by adequate skills and resources of any particular SAI. Another characteristic of the sector is the high value of the financial flows on the investment side as well as inflows in form of revenues (for both government and the private sector). The projects are most often long term and can last over several decades, something that also requires SAIs to think long term in relation to auditing strategies. Due to the fact that the projects in the EI and energy sector often gets a lot of media attention there is also an interest in the general population to understand if the government is doing what it is supposed to do. The SAI therefore has to provide assurance to the public on the government's role.

**WGEI CoP:** What are some of the approaches that public auditors can use when faced with challenges of auditing the EI sector?

**OAGU Energy Sector:** Long term planning is essential for a SAI to undertake audits in EI. It is important that a strategic plan (say 5 year) is formulated to guide the office. This plan should be aligned to the office strategy and also in line with the major trends of the nation's extractive industry.

Auditing of the EI sector requires specialized skills as well as adequate resources in form of HR, finances etc. At the OAG, initially in the absence of such skill, we outsourced to private audit firms, where a team of OAG

staff is attached to understudy. We are presently moving away from this strategy as the capacity is being improved. OAG has also improved its internal capacity through collaborations with experienced SAIs. Such collaborations consist of experts joining audit projects to undertake on job training, benchmarking trips and joint audits. We have also initiated drafting of guidelines on topics such as transfer pricing which are good for ensuring uniform approaches and documentation of organizational knowledge on complex areas.

We are also beginning to draw benefits from the information sharing that is happening within the Community of Practice of the WGEI.

**WGEI CoP:** What are the main challenges related to the impact of public audits in the EI sector in Uganda?

**OAGU Energy Sector:** As you may be aware, the Parliament of Uganda is the primary recipient of our audit reports, so in relation to the impact a lot depends on how the reports are dealt with at that level. In that context there may be a challenge that some of the reports are only discussed after a significant delay depending on Parliamentary timetable. At the same time, it is true that some of our reports may be of quite a technical nature, making them less assimilated by non-technical persons and subject to various interpretation. There is also an issue that some reports contain confidential information and will therefore only be accessed by restricted/authorized individuals. In addition, long term contracts used in the sector between Companies and Government may be hard to change even if it is discovered that they are not optimal for the country.

**WGEI CoP:** What do you think other Supreme Audit Institutions could learn from SAI Uganda?

**OAGU Energy Sector:** One of the advantages we have at the OAGU is the dedicated Energy Sector team. This team consists of experts from both financial and value for money directorates with particular knowledge and experience in auditing the energy sector. The energy sector covers everything related to the EI sector in addition to electricity.

We are also developing a new 5-year strategic plan for the sector to take us to 2021, the first one coming to an end in 2016. As EI projects are long term projects it is important that also the SAI has a long horizon.

The sector has also initiated capacity building initiatives to ensure that the staff have sufficient knowledge about the EI sector. Several of our staff have, for example, been supported to graduate with specialized

master degrees in EI audits abroad. We have also developed partnerships with other SAIs such as SAI Norway and SAI Sweden.

In addition to these site visits, The SAI is also undertaking training of Top Management in short courses to understand and appreciate the sector.

It is also important to have a cordial working relationship with the implementing government agencies to enhance information and document flow during audits and also implementation of audit recommendations.

**WGEI CoP:** What kind of initiatives would you like to see taken by WGEI to help the OAGU and other SAIs meet challenges that rapid changes in the energy sector constitutes?

**OAGU Energy Sector:** The WGEI network could be used to suggest and organize benchmarking activities between SAIs that have a need – expertise match. We would also like to see more documentation on uniform approaches such as shared guidelines and manuals related to the audit of the Extractive Industries sector developed and shared among the members. Collaborative or joint audit in the EI sector is another element that we would like to see developed further, as this is a practical approach for SAIs to learn from each other. The WGEI CoP should also continue to share resources on the WGEI webpage as it does today and continue to upload relevant documentation, and it could be a good idea to think of using blogs.

**Head of the WGEI secretariat:** WGEI should be able to gather challenges from various SAIs and consolidate them to group them into various specific crosscutting challenges thus bringing together SAIs with similar challenges and engage them in efforts to address the challenge. If challenges could be addressed through designing joint training programs or identifying existing training which can address the problem WGEI can interest itself to do this. If the matter requires developing guidelines then WGEI can help bring the SAIs together to develop one. If joint or collaborative audit approach can address the challenge then WGEI could assist in coordinating the SAIs in initiating such joint or collaborative audits.



# INSIDE THIS ISSUE

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Fiscal regimes in the petroleum sector

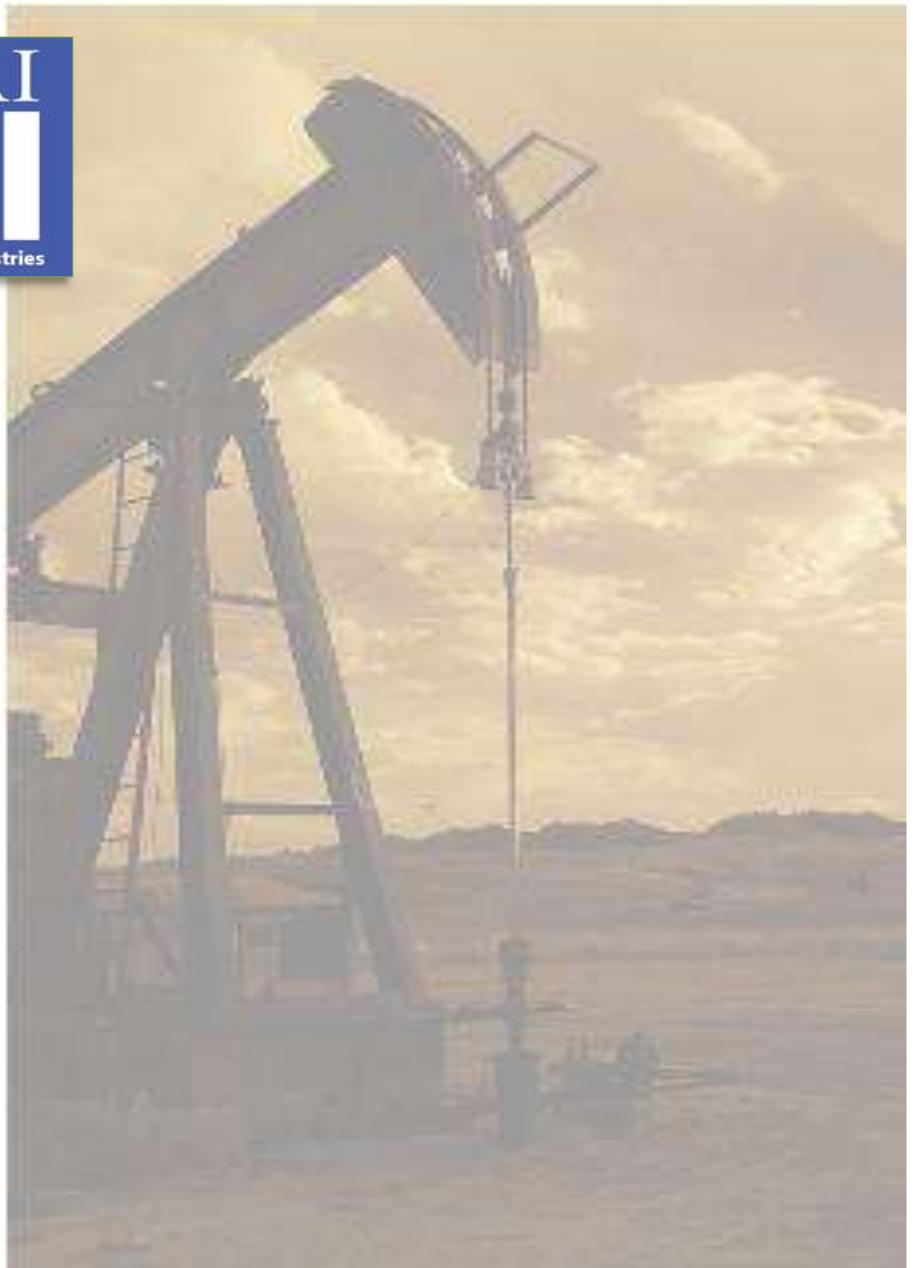
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SAI Uganda's experience with auditing petroleum activities

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WGEI participation in an extractive industry audit strategy workshop

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ISSUE NO. 4 | FEBRUARY 2016

**About this issue:**

Welcome to the fourth edition of the WGEI newsletter! In this edition of the newsletter you can read about fiscal regimes in the petroleum sector and learn about SAI Uganda's experience with auditing petroleum activities. You will also learn about WGEI participation in an extractive industry audit strategy workshop and be reminded of some important tools that could be relevant for your work in auditing the extractive industry sector.

Have a nice read!

## Announcement on changes within the CoP/WGEI Secretariat

We would like to take this opportunity to inform you that Mr. Edward Ssali is now officially the Coordinator of the WGEI Community of Practice. The Previous Coordinator, Mr Ingvald Heldal, will continue to work for the CoP and WGEI as an advisor. All requests should from now be directed to Mr. Ssali (Edward.ssali@oag.go.ug, +256793344663).

### Need to know

#### Fiscal Regimes in the Petroleum Sector (By Trygve Christiansen, Norwegian Audit Office)

Countries that are blessed with petroleum resources must try to manage their wealth in the best way possible. Doing so often means allowing international oil companies (IOCs) to explore, develop and operate oil fields, because they have the technical know-how to extract the resource more efficiently and effectively than the government can do on its own.

When IOCs are involved, the government must set up a system for sharing profits that allows it to maximize the benefit its citizens receive from the oil wealth whilst making the country an attractive place for the IOCs to invest. How you organize the fiscal regime depends on whether the government needs revenue immediately, its ability to cover risks and how it wants to attract investors. These factors will all affect the final government take. Government take is government's share of the net profit (gross production value – costs = net profit). This article will present some basic features of the three most common fiscal regimes: royalty/tax systems, production sharing contracts and service agreements, and how they affect government take.

#### Royalty/Tax systems

These are systems that apply a tax rate and/or a royalty percentage. Normally, royalties are deducted on gross production value. Thereafter costs are deducted, and what is left is subjected to taxation. Royalties are useful for governments that are in dire need of revenue. Theoretically, costs may be equal to 100% of gross production value, which leaves nothing left for taxation. By imposing e.g. a 10% royalty tax the government will get some revenue regardless of the cost level. Another advantage is that royalties are relatively easy to administer. A production of 100 000 barrels per day means that, with a 10% royalty rate, 10

000 barrels will automatically be allocated to the government.

While royalties are fairly common, some countries, such as Norway, have abandoned this tax. The downsides of royalties are at least three depending on whether you have the government or the company perspective. By having a high royalty rate, the government will actually get a lesser take of the total profit when costs are reduced over time. This is shown in the table below:

	HIGH COST	LOW COST
<b>GROSS REVENUE</b>	100 USD	100 USD
<b>ROYALTIES (20 %)</b>	20 USD	20 USD
<b>COSTS</b>	30 USD	10 USD
<b>TAX BASE</b>	50 USD	70 USD
<b>PROFIT TAX (30%)</b>	15 USD	21
	35	USD 41
<b>TOTAL GOVT. REVENUE</b>	(royalties + profit tax)	+(royalties + profit tax)
<b>GOVERNMENT TAKE (GOVT.REVENUE/GROSS REVENUE-COSTS)</b>	<b>50 %</b>	<b>45,6 %</b>

When costs are reduced from 30 USD to 10 USD, government revenue (in absolute figures) increases. Government take however is reduced, and this is attributed to the high royalty rate. When costs decrease, more profit is subjected to taxation. It would be better for the government if the amount subjected to 20 % royalty tax was subjected to the 30 % profit tax instead.

Another disadvantage is that royalties do not take into account the profitability of an oil and gas field. If companies are making losses, they will still have to pay royalties. This may lead to shut-down of production and scare off potential investors. Profit tax is better correlated to the profitability of the oil and gas field, and is therefore regarded as more popular by the companies. From the company perspective it is also a disadvantage that royalties effectively block companies from booking all their costs and get them recovered. Therefore, government gets a greater share of the initial cash flow, and extends time lapsed before “break even” – the time when company cash flow exceeds costs and the company starts making profit.

Royalty/tax systems are usually found in Western Europe, with UK, Norway and the Netherlands as typical examples. Further reading on disadvantages of royalty systems can be found in the 2008 report by the US Government Accountability Office which concludes that “...the inflexibility of royalty rates to changing oil

and gas prices has cost the federal government billions of dollars in foregone revenues”.

### **Production Sharing Contracts/Agreements**

Production sharing contracts (also called agreements in some countries) (PSC) emerged in the 1960s and are seen as a tool of controlling cost-levels in oil and gas projects. This fiscal regime is most commonly found in South-East Asia and Africa.

PSCs are quite similar to royalty/tax systems except for one feature; cost recovery limits. Cost recovery limits mean that costs can only be recovered up to a certain limit, e.g. 50 %. Such limits ensure that government will always get a minimum share of the profit. The downside for the government is that it will take a much longer time to recover all costs because of the limit. Theoretically, an oil and gas field without a cost recovery limit may take five years to cover all investment costs, while a cost recovery limit of 50 % may extend this period to ten years.

After costs are deducted up to cost recovery limit, typically referred to as cost oil, the remaining profit is shared between government and the contractor. Such profit sharing can be done in many ways, but it usually involves a set of tranches/sliding scales. Profits may be shared differently based on production volume, profitability of the project (R-factor), oil and gas price etc. The general rule is that government's share of profit increases with increase of production volume increases, profitability and oil and gas prices.

Unlike royalty tax/systems, PSCs are fiscal regimes that are usually ring-fenced. This means that within a country there are different tax levels for each negotiated PSC. In Norway all oil and gas companies have to pay the same profit tax, but in countries such as Indonesia, Myanmar, Tanzania and Nigeria government's share of profit (which behaves like a tax) will differ between different oil and gas fields. Taxes and cost recovery limit are negotiable, which means that government take is also negotiable.

Countries that apply PSCs, typically, also use royalties and taxes. Taxes are applied on contractor's share of profit. While this may potentially generate substantial government take, it also has some disadvantages. The system becomes very complex because of different fiscal terms for each PSC, which increases the need for competent tax authorities. PSCs, however, may be useful if there are uncertainties regarding potential oil and gas reserves. If the contractor does not make discoveries, no costs will be recovered. The average success rate of drilling is between 20-25 %. If the risk is

considered to be high, and the contractor makes a discovery, the government take is likely to be less.

### **Service Agreements**

Service agreements use a simple formula: the contractor is paid a cash fee for performing the service of producing oil and gas resources. What is produced belongs entirely to the government. In some cases, the fee also includes a certain percentage of costs. Service agreements are usually applied in countries with a high discovery rate and low costs. When companies are awarded service agreements, both government and the companies are sure of success. Such contracts are typically found in the Middle East where oil and gas resources are easily accessible. Service agreements lead to a very high government take, but this is generally accepted by companies because of low risks and relatively low costs.

### **Designing Fiscal Regimes for the Future**

The three main categories of oil and gas fiscal regimes all have their pros and cons. In a world with volatile oil and gas prices governments need to choose fiscal regimes that do not scare off potential investors. The number and quality of bidders in a licensing round is usually an indicator of the success of a fiscal regime. In licensing rounds, such as the recent onshore oil and gas bidding round in Mexico, companies compete in offering the biggest share of pre-tax profits to the government via a weighted formula that also includes an investment commitment. While companies may offer a very favorable government take, the bid may be unrealistic when it comes to investment commitments.

Today, the world is experiencing low oil and gas prices, which lead to companies postponing their planned investments. Companies may have offered high royalty rates, a high cost oil limit and big government share, but the government's ultimate interest is that oil and gas projects move from exploration phase to development phase. Therefore, a work programme detailing investment is also an important bid item.

As mentioned, exploration and development activities have been halted in many countries because of the drop in oil and gas prices. This has become a particular challenge in developing countries which have seen a big rise in expectations after major oil and gas discoveries. While companies are crying out for better fiscal terms for investments to take place, the countries are cautious about reducing government take. Fiscal regimes should however not only be designed for today's low prices, but also for a future increase in oil and gas prices.

## Two “useful links”: WB contract monitoring roadmap and OECD transfer-pricing library

For each issue of the WGEI Newsletter we are going to present one or two essential “useful links” that can be found under the “tools and resources” banner on the WGEI home page ([www.wgei.org](http://www.wgei.org)). The aim is to remind of and draw attention to external resources that we think could be useful in the daily work of auditors at the various Supreme Audit Institutions involved in audit of the extractive industries sector.

World Bank Institute has a very interesting tool related to monitoring of contracts in the extractive industries sector that can be reached through the following link: <http://contractroadmap.azurewebsites.net/> or through the “external resources” section of the WGEI homepage.

For those who are interested in documents related to transfer pricing OECD has a nice online library on this topic that can be reached through this link: <http://www.oecd.org/ctp/transfer-pricing/> or by visiting the WGEI homepage “useful links” section. This page has compiled important documents such as existing guidelines, country profiles and various statistics related to transfer pricing.

### Trainings and events

#### Extractive industries audit strategy: WGEI involvement in the Zambia Workshop

In December 2015 the advisor of the WGEI Community of Practice travelled to Zambia to co-facilitate an EI audit strategy workshop along with three auditors from SAI Norway. The workshop lasted five days, from December 14th to December 18th, and the whole team of SAI Zambia auditors involved in audit of the extractive industries area participated. The result was a participant driven draft strategy that will be finalized by SAI Zambia in the months to come. Elaboration of strategies for audit of the Extractive Industries has been identified as one of the focus areas in the WGEI activity plan for 2016 and 2017. The WGEI secretariat would therefore be interested in hearing from SAIs planning to elaborate such strategies to see how the Zambia experience can benefit other SAIs in this area.

### Members in Action

#### The Ugandan experience in the audit of petroleum activities. *(OAG-Uganda)*

Uganda is endowed with a variety of natural resources that include copper, cobalt, gold, tin, and most recently petroleum. This article will concentrate on audit of petroleum activities conducted by the international oil companies (IOCs). Ever since the first commercial discovery in 2006, exploration work in Uganda has increased to the point of having over 116 wells drilled with over 80% success rate. Currently, 6.5 billion barrels of stock tank oil initially in place (STOIIP) have been discovered. The increased exploration activity goes yardarm to yardarm with a rise in the exploration costs.

Uganda adopted the Production Sharing Agreement (PSA) system which requires the (IOC) to invest in the exploration, development and production and later recover their costs from the proceeds of the oil and gas produced. This is done through a series of sliding scales and R factor formulas applied as stipulated in the PSAs. It is the role of the Government to undertake audits to ensure that all the amounts that are to be recovered were necessary, appropriate and incurred in accordance to the applicable laws and regulations. The role of undertaking the above audits is a responsibility of the Office of the Auditor General as mandated by the 1995 Constitutions of Uganda (as amended) and the National Audit Act 2008. The audit provides government with the assurance that the costs incurred were necessary appropriate and in accordance to the applicable regulations.

#### The Budget Review/Approval Process

Cost control in Uganda starts at the budget review process. While this is not part of the audit process, it is important as a cost control mechanism. Before the start of the year, the companies submit detailed work programs and budgets to the Petroleum Authority of Uganda formerly the Petroleum Exploration and Production Department for approval. During this process, a number of meetings are held where discussions are held on the work programs and budgets. This in itself is a process of cost control before the activities are undertaken. It is important that before any work is undertaken, the budget is approved.

## **The audit review Process**

The audit is not a financial audit and the standard that has been applied during the audit is ISSAI 4100. This standard deals with compliance audits with its objectives being;

- Gather sufficient appropriate audit evidence to conclude whether the information on a particular subject matter is in compliance, in all material respects, with a particular set of criteria, and
- Report the findings and conclusions to the legislature and/or other bodies as appropriate

As a result of the above, no opinion is given however a conclusion is made based on the audit findings. Initially, the OAG was outsourcing the audits. Currently they are being undertaken by a dedicated team within the Office of the Auditor General. The team is composed of multi-disciplinary staff including; accountants, lawyers, geologists. Due to the fact the costs involved are large and the supporting documentations are voluminous, the sampling method to be applied has to be appropriately representative.

The recovery expenditure is typically made up of 3 parts. These include the following; exploration and production costs, general and administrative costs and geological/geophysical/geochemical costs. License costs are costs incurred as stipulated in the law. General and administrative costs include the operator's day to day operational costs. Geological and geophysical involve costs to do with studies and the costs related to exploration and drilling. Each of these parts has different procedures and tests carried out at the transaction level. Currently the audit team in collaboration with the Office of the Auditor General of Norway is in the process of developing a customised audit manual to be used in the audits of petroleum.

Currently 11 audits have been completed by the Office of the Auditor General. While 8 were outsourced earlier, 3 have been completed in-house.

## **Challenges**

- Need for additional technical expertise (Transfer Pricing reviews, oil refinery operations, geological data analysis, specialized accounting software).
- Need for technical capacity for the Oversight committees.



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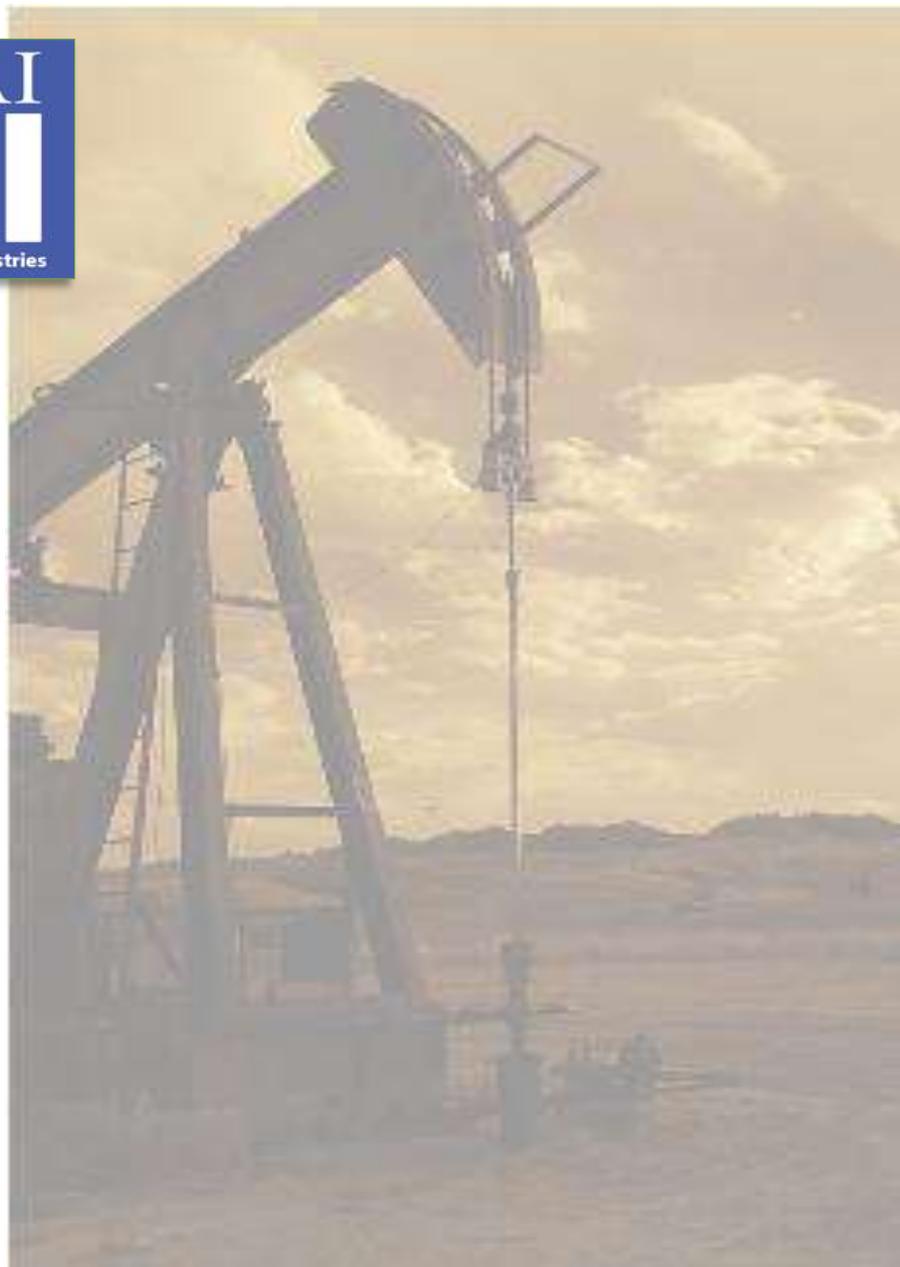
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The Shale Gas Boom – How Does It Affect Current and Aspiring Gas Producers?

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ISSUE NO. 3 | NOVEMBER 2015

## About this issue:

Welcome to the third edition of the WGEI newsletter! In this edition of the newsletter you can read about the Base Erosion and Profit Shifting (BEPS) project of OECD and how this is important for the SAI community. EITI gives us a brief introduction into the important EITI standard and you will see examples from audits of the extractive industry sector from SAI Vietnam. We will also give you a quick summary of the 2<sup>nd</sup> WGEI meeting that took place in Oslo from 21<sup>st</sup> to 23<sup>rd</sup> September and how you can access the resources that was shared during the event.

Have a nice read!

## Introducing two new members of the Community of Practice and the WGEI Secretariat

We are happy to announce that the Community of Practice and the WGEI Secretariat has now been reinforced by two new full-time members contributed by the WGEI Chair, SAI Uganda.

**Edward Ssali** has recently arrived as deputy coordinator of the WGEI Community of Practice. Edward is a certified public accountant of Uganda and presently senior auditor at the office of the Auditor General of Uganda where he has been for over 14 years. During the last 5 years he has been involved in audit of extractive industries under the energy sector. He recently arrived back to Uganda after completing a MSc. in Oil and Gas Accounting with a distinction from Robert Gordon University in Aberdeen, Scotland. He already holds a master's degree in management studies (Business Administration) from Uganda management institute. With the WGEI secretariat Edward is going to follow up the implementation of activities in the WGEI activity plan linked to capacity building, resource development and networking.

**Emmanuel Angole** has recently arrived as the Information Technology Officer of the WGEI Community of Practice, where he is in charge of the WGEI website and Information Technology resources. Emmanuel has been an Information Technology Officer with the Office of the Auditor General of Uganda for over 4 years and his main duties involved the day to day management of the OAGU systems and applications development for the various departments. He holds a BSc. in Information Technology and is currently pursuing further studies in Information and Computer Systems Security, Information Systems Audit and E-Governance.

## Need to know

### The case for collaboration between Supreme Audit Institutions and the Extractive Industries Transparency Initiative (EITI) *(By Bady Balde - EITI)*

The EITI International Secretariat welcomes the opportunity to present the Extractive Industries Transparency Initiative (EITI) in the newsletter of INTOSAI's Working Group on Audit of Extractive Industries (WGEI). This article provides a brief introduction to the EITI, the reporting process in the 49 implementing countries, and the common interests and opportunities for collaboration with Supreme Audit Institutions.

The goal of the EITI is to promote the good use of natural resources for the benefit of a country's citizens. The EITI Principles – agreed by government, industry and civil society stakeholders in 2003 – emphasize the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability. To achieve this, countries that implement the EITI Standard are required to publish timely EITI reports that reconcile government disclosures on revenues with companies' disclosures on tax payments. The process is overseen at the national level by a multi-stakeholder group comprising government, industry and civil society representatives. While these stakeholders are often at odds, there is a shared commitment that "a public understanding of government revenues and expenditure over time can enhance public debate and inform choice of appropriate and realistic options for sustainable development".

### **A broader Standard that covers the governance value chain of extractive revenues**

The EITI's practices and procedures have evolved in several steps to the current EITI Standard (2013), which goes well beyond the EITI's original focus on revenue transparency. EITI Reports now include details on licensing, license allocation, production and exports. There are disclosures on oil sales by National Oil Companies (NOCs), voluntary and mandatory social payments by oil, gas and mining companies, and details on budgetary allocations and transfers. EITI countries are also encouraged to adopt contract transparency and disclose beneficial ownership information. As a result, EITI Reports have become more comprehensive, dynamic and influential. 49 countries are implementing the EITI, from across the developing, middle income, emerging market, and OECD countries. EITI Reports as

a whole have already covered over US \$1.7 trillion of government revenues, accompanied by increasingly rich contextual information on the extractive sector.

### **Embedding the EITI in government systems instead of replicating them**

Achieving compliance with the EITI Standard often hinges on the quality of the information disclosed by implementing countries. In the past, poor quality assurance of government and government data has been one of the main causes of non-compliance with the EITI requirements.

Well-functioning oversight institutions, such as Supreme Audit Institutions, play a key role in holding both companies and government agencies accountable. The EITI builds on existing audit and assurance systems in government and industry and promotes adherence to international standards.

The EITI Standard makes a direct reference to INTOSAI: “The multi-stakeholder group, in consultation with the Independent Administrator, is required to examine the audit and assurance procedures in companies and government entities participating in the EITI reporting process, including the relevant laws and regulations, any reforms that are planned or underway, and whether these procedures are in line with international standards...for public entities: the International Standards of Supreme Audit Institutions (ISSAI) issued by the International Organization of Supreme Audit Institutions (INTOSAI).”

### **EITI as a diagnostic tool**

In many cases, the EITI acts as a diagnostic tool that identifies weakness in audit and assurance standards and compliance. The EITI can help identify areas of risks where further investigation is needed. In **Albania, Azerbaijan, Côte d’Ivoire, DRC, Ghana, Mali, Mauritania, Mongolia, Nigeria and the Philippines** EITI reports identified weaknesses in the quality assurance of government data and made recommendations how these weaknesses can be addressed.

But there are greater opportunities. A key area of debate on the EITI community is the question of “mainstreaming”. Ideally, extractive industry transparency should not be confined to EITI Reports, but rather become an integral part of how governments manage their sector. Rather than simply relying on the EITI reporting mechanism to bring about transparency, governments implementing the EITI could to a greater extent make the information required by the EITI Standard available through

government and corporate reporting systems such as databases, websites, annual reports, portals etc. In **Burkina Faso, Ghana, Kazakhstan, and Zambia**, for example, SAIs certify accounts and reporting templates of government agencies disclosing information in EITI reports.

### **Looking ahead**

A mutual understanding of requirements and constraints should be the beginning of a process of harmonising accounting, reporting and auditing schedules. In addition to contributing in the reliability of data disclosed in EITI Reports, SAIs could also use these reports to identify areas of risk and conduct further investigations. It is recognized that the availability of audited government accounts depends not only on the SAI concerned but also involves the government accountant and the parliamentary body, which reviews SAI’s audit reports. In a collaborative effort, based on mutual understanding, it should be possible to work toward a progressive harmonization of schedules for the auditing of government accounts and the production of EITI Reports. The EITI International Secretariat is presently working with interested countries on mainstreaming EITI reporting in this manner. This will no doubt afford additional opportunities for collaboration between the EITI and INTOSAI, especially its Working Group on Audit of Extractive Industries.

### **How and why Base Erosion and Profit Shifting (BEPS) is relevant for the SAI community (By August Schneider, Norwegian Audit Office)**

Conservative estimates on loss of revenues due to BEPS, indicates a severe obstacle in financing development and maintenance of public services and deficiency in the assessment and collection of revenues in surprisingly many countries. BEPS is possible due to multinational group’s shift of profit between its entities through cross-border transactions, especially through Transfer Pricing. The fact that some states permit low tax/tax exemptions, opaque registers on ownership and low quality company registration, enhances MNE’s economic incentives to establish a branch etc. in such jurisdictions (tax havens) for profit shifting purposes.

Deficiency in assessment and collection of revenues and taxes is in many cases likely caused by lack of experience, knowledge and competence within tax/revenue authorities to mitigate BEPS through (tax) audits, often combined with lack of/faulty prioritizing of necessary resources to survey MNE’s.

SAIs are the most important institutions to mitigate such deficiencies within tax/revenue authorities in preventing illicit profit shifting. SAIs that are given the task of, and authority to audit cost statements according to Production Sharing Agreement/Contract (PSA/C), will have to mitigate BEPS directly through their contractual audit (of the entity of the MNE).

Hence, BEPS is directly relevant for SAIs. Either through audit of companies according to PSA/Cs, and/or through compliance/performance audit of revenue authorities.

The OECD/G20 Base Erosion and Profit Shifting Project has resulted in what will prove to be better tools for both SAI's and tax authorities which will enable enhancement of BEPS-mitigation.

### [The OECD/G20 Base Erosion and Profit Shifting Project Has Delivered Stronger Transfer Pricing Rules](#) (By Dan Devlin, OECD)

Over several decades and in step with the globalisation of the economy, world-wide intra-group trade has grown exponentially. Transfer pricing rules, which are used for tax purposes, are concerned with determining the conditions, including the price, for transactions within a Multinational Enterprise (MNE) group resulting in the allocation of profits to group companies in different countries. The impact of these rules has become more significant for business and tax administrations with the growth in the volume and value of intragroup trade.

#### **A significant step in combating Base Erosion and Profit Shifting**

On 5 October 2015, the OECD presented the final package of measures for a comprehensive, coherent and co-ordinated reform of the international tax rules, and these were endorsed by G20 Finance Ministers at their meeting on 8 October, in Lima, Peru. The OECD/G20 Base Erosion and Profit Shifting (BEPS) Project provides governments with solutions for closing the gaps in existing international rules that allow corporate profits to disappear or be artificially shifted to low/no tax environments, where little or no economic activity takes place. Revenue losses from BEPS are conservatively estimated at USD 100-240 billion annually, or anywhere from 4-10% of global corporate income tax (CIT) revenues. Given developing countries' greater reliance on CIT revenues as a percentage of tax revenue, the impact of BEPS on these countries is particularly significant.

#### **The Need for Change**

As the 2013 Action Plan on BEPS identified, the existing international standards for transfer pricing rules needed to change to ensure that transfer pricing outcomes are aligned with value creation and not merely the legal arrangements companies have put in place.

The arm's length principle is used by countries as the cornerstone of transfer pricing rules. A shared interpretation of the principle by many of those countries is set out in the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter: "Transfer Pricing Guidelines"). The principle requires that transactions between associated enterprises are priced as if the enterprises were independent, operating at arm's length and engaging in comparable transactions under similar conditions and economic circumstances. Where the conditions of the transaction are different to those between third parties in comparable circumstances, adjustments to the profits may be needed for tax purposes.

The arm's length principle has proven useful as a practical and balanced standard for tax administrations and taxpayers to evaluate transfer prices between associated enterprises, and to prevent double taxation. However, with its perceived emphasis on contractual allocations of functions, assets and risks, the existing guidance on the application of the principle has also proven vulnerable to manipulation. This manipulation can lead to outcomes which do not correspond to the value created through the underlying economic activity carried out by the members of an MNE group.

#### **The BEPS Actions on Transfer Pricing**

In the area of transfer pricing, the guidance on the arm's length principle has been upgraded to ensure that what dictates results is the economic rather than the paper reality. These are BEPS Actions 8-10.

- Work under **Action 8** looked at transfer pricing issues relating to transactions involving intangibles, since misallocation of the profits generated by valuable intangibles has contributed to base erosion and profit shifting.
- Work under **Action 9** considered the contractual allocation of risks, and the resulting allocation of profits to those risks, which may not correspond with the activities actually carried out. Work under Action 9 also addressed the level of returns to funding provided by a capital-rich MNE group member, where those returns do not correspond to the

level of activity undertaken by the funding company.

- Work under **Action 10** focused on other high-risk areas, including the scope for addressing profit allocations resulting from transactions which are not commercially rational for the individual enterprises concerned (re-characterisation), the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and neutralising the use of certain types of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with value creation.

The OECD Transfer Pricing Guidelines now contain a clear framework indicating that while contractual arrangements are important and serve as the starting point of any transfer pricing analysis, the arm's length principle does not and cannot rely on self-serving contracts which do not reflect the conduct of the parties on the ground. The revised guidance provides a framework for analysing risks within a group of companies, clarifies how returns from the exploitation of intangibles or intellectual property (IP) shall be allocated, and contains detailed guidance on the transfer pricing treatment of group synergies, location-savings and local market features, as well as assembled workforce. Recognising that tax administrations are often faced with information asymmetries which exacerbate the difficulties of evaluating transactions involving IP, an approach for hard-to-value intangibles has been devised which, in specific circumstances, would allow tax administrations to use actual outcomes as presumptive evidence about the appropriateness of the pricing arrangements. The guidance also ensures a consistent approach is applied to Cost Contribution Arrangements.

The guidance on transfer pricing is linked in a holistic way with other BEPS Actions. Together, they will ensure that so-called "cash boxes" without any relevant economic activities will not be entitled to any excess profits.

Furthermore, a simplification mechanism has been developed for low-value adding services, and there is new guidance in respect of commodity transactions, two areas of particular relevance to developing countries, and for which their contribution was paramount to understand the concerns and identify the best way to address them. The scope for new and more detailed guidance on the application of transactional profit-split methods for global value

chains has been agreed and such guidance will be finalised soon.

### **Additional Action for Greater Transparency of MNE Operations**

In a major step toward greater transparency on MNE operations, the requirements for transfer pricing documentation have also been substantially revised (**Action 13**). MNEs will be required to submit information regarding their global business operations and transfer pricing policies in a "Master File," as well as more detailed information regarding relevant related party transactions and the amounts involved in such operations in a "Local file."

Country-by-country reporting will provide a clear overview of where profits, sales, employees and assets are located and where taxes are paid and accrued. Guidance and tools to ensure a swift and consistent implementation of country-by-country reporting across countries have been developed, to ensure the widest possible dissemination of information among tax administrations, while respecting the agreed safeguards on confidentiality, appropriate use and consistency. The first country-by-country reports are expected to be filed and exchanged in 2017.

Further Information is at the OECD Website: <http://www.oecd.org/tax/beps-2015-final-reports.htm>

*The Shale Gas Boom – How does it affect current and aspiring gas producers? (By Trygve Christiansen and Eli Wærum Rognerud, Norwegian Audit Office)*

(See full paper on the shale gas revolution, including policy, geopolitical and environmental effects here: [link](#))

Shale gas has been described as a "revolution", our "bridge to a low carbon future" and indeed "the biggest thing that happened to America", yet others have branded it an "environmental disaster". There is little dispute however that the commercial exploitation of shale gas has been, and continues to be, a major game changer in the global energy sector. This article briefly explains the nature of the shale gas boom, its effect on gas markets and prices, and the potential impact on current and aspiring gas and oil producers in developing nations.

## What is shale gas?

Shale gas, along with tight sands and coal bed methane constitutes so-called unconventional gas resources. These are natural gas resources trapped in deep, underground rocks such as shale rock or coal beds (Carbonbrief 2015). The resources are harder and more expensive to access than for example conventional gas, but can be extracted using hydraulic fracturing, or “fracking”; a method whereby a mixture of water, sand and chemicals are injected into the rock formation under high pressure, fracturing the low-permeability shale to release natural gas. The method has been used in the industry since the nineteenth century and in the US since the mid twentieth century, but has recently become much easier and much cheaper as a result of improved techniques and technologies. (Marey and Koopman 2013, 2; Carbonbrief 2015)

Shale rock is common in many parts of the world, and makes up an estimated 35% of the world’s surface rocks. Technically recoverable shale gas resources exist in a number of countries, however it is the USA that has piloted the “revolution” and today by far dominates the industry. US shale gas production in 2012 stood at some 460 billion cubic meters (bcm) gas, followed by Canada (80 bcm), Poland (0,66 bcm) and China (13,4 bcm) (IEA 2015b).

## The nature of the boom

The development has been rapid. Between 2007 and 2014, US shale gas production grew more than 50 percent, with a five-fold increase in proven national reserves in the same period. Though not the main focus of this article, it should also be noted that oil production from shale deposits, so-called “tight oil” is growing even faster than shale gas, bringing US oil production to a level not experienced since 1970. Of total marketed gas production in the US, 60% are now unconventional gas resources. (IEA 2014; Statoil 2015). Though there is considerable uncertainty still surrounding production forecasts, the IAE estimates that global natural gas reserves, including shale gas, will last 250 years with current consumption levels, compared with 120 years when only including conventional recoverable resources (IEA 2011, 7).

When launching the IEA Energy Outlook Report in 2012, **Executive Director Maria van der Hoeven** left little doubt about the significance of the shale gas revolution: “North America is at the forefront of a sweeping transformation in oil and gas production that will affect all regions of the world”, she stated to the press (IEA 2013a). The key to this transformation is first and foremost the sheer volume of gas production, but

also the -at least longer term – possible flexibility with which US gas can be traded.

Natural gas made up 21% of the world’s energy supply in 2011 (IEA 2014), and demand is rising. According to the IEA, gas is especially attractive to developing regions in Asia, most notably China and India, and the Middle East, which face rapid urbanization and growing energy demand. In its special report on gas in 2011, “The golden age of gas?” IEA outlines a scenario where the share of natural gas in the global energy mix rises to 25% by 2035. This assumes a gas demand of 5,1 trillion cubic meters (tcm), 1,8 tcm more than current levels.

Unconventional natural gas resources are now estimated to be as large as conventional ones (IEA 2011), and the portion of shale gas of total production is expected to grow significantly, as illustrated in figure one.

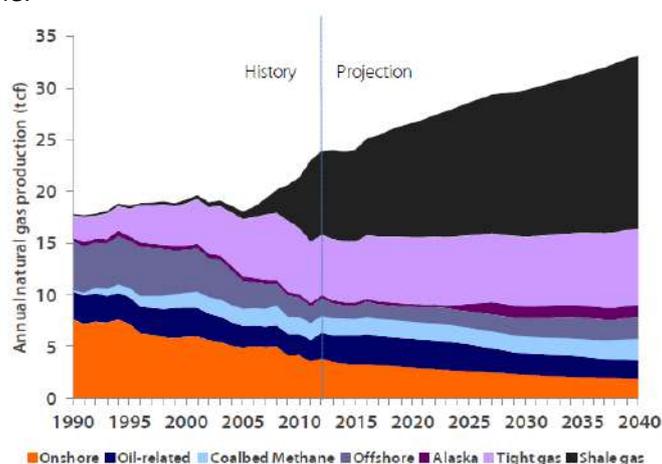


Figure 1: Projections for increased shale gas production. Source: IEA 2013a; Marey & Koopmann 2013

## Effect on prices and markets

So far, the most important effects of the shale gas boom are observed in the US, where a positive supply shock has fuelled demand and at the same time a significant downward pressure on natural gas prices 2010-2014 (Fatouh, Rogers and Stewart, 2015, 24; IEA 2015, EAI 2015a).

US gas prices are quoted by the Henry Hub index, reflecting the pricing point of natural gas futures contracts traded on the NY Mercantile Exchange, NYMEX. Spot prices are given in USD/MMBtu, or million British thermal units. From peaks well above 10USD/MMBtu in 2006-08, prices on the Henry Hub for a period dropped below USD2/MMBtu but have now stabilized between USD3 and USD4/MMBtu. In terms of market position, this development has moved the US from a major gas importer to a position of energy

self-sufficiency and potential net export within few years (IEA, 2012a).

The US supply boom has further broken the historically stable relationship between the price of oil and Henry Hub Natural gas. Most importantly, it has increased the price differential or spread of gas prices between the US on the one hand and Europe and Asia and Japan on the other, resulting in geographically divided, three-tier gas pricing structure. This means Henry Hub is selling at a fourth of European prices and a fifth of Japanese, as illustrated in Figure 4 (Maroy and Koopman 2013, 2).



Figure 2: Broken link between energy sources. Source: WB, EIA, presented in Maroy and Koopman 2013, 2

These developments have in turn affected the global trading pattern of gas, and to some extent the energy mix in different regions.

As indicated above, virtually all US gas is currently traded in the domestic market as there are no natural gas export facilities in operation yet, though several are underway. Overseas export is expensive, requiring either a gas pipeline or LNG production facilities. As a result, LNG imports that had been expected to reach 70 Bcm in 2010, were in fact reduced from 18 Bcm in 2005 to 4,2 Bcm in 2012. This has meant that volumes from other gas producers originally intended for the US market has had to find new buyers. Qatar, as the world's largest LNG exporter, whose record-size LNG compressors (megatrains) launched in 2009 expanded capacity in a low-demand period, were able to divert volumes to both Europe and Asia. Declining demand in Europe and readily available Qatari LNG led to a drop in pipeline imports in Europe, mainly from Russia. Russia in the period proved itself as a "shock absorber" of an increasingly integrated market, reducing its pipeline exports (Fattouh, Rogers and Stewart 2015, 22). Asian demand had suffered from the financial crisis of 2008, but rapidly recovered and soared in the

2010-11, partly due to the Fukushima disaster, after which Japan used gas to replace its nuclear power (BP, 2014; OPEC 2014a). The Asian demand was then in part met by the Gulf surplus created in the wake of increasing US self-sufficiency.

Notwithstanding these important supply shifts, the perhaps most important impact is possibly still to be seen, when the US position itself as an exporter. Whilst the US prohibits exports of crude oil and condensate, there are much fewer restrictions on natural gas. Export is already approved to countries with which US has a free trade agreement (Irwin 2013), and in May this year, US president Obama gave green light for another milestone LGN export project. Cheniere Energy's proposed liquefaction terminal in Corpus Christie bay, Texas, became the sixth LNG to win approval for global gas export. Over the next 20 years, Cheniere will be allowed to export up to 2.1 billion cubic feet of LNG per day to countries with which the United States does not have free trade agreements (Dlouhy, 2015). With more than half a dozen such terminals planned, Cheniere is positioned to become one of the world's most important gas exporters in the global energy market. Many more investors have sought approval for similar export projects as federal policy on the issue is expected to relax further. License to export unrestricted of destination and a strategic geographic position means that not only export volume, but flexibility, may pave the way for the US as the new global "swing supplier" in gas. However, uncertainty surrounding the technical as well as financial viability of many of these projects, political resistance and industry lobby fighting to keep the "cheap gas at home" leaves forecasts uncertain (Blackwill and O'Sullivan 2014).

Since oil, gas and coal are to some extent substitutes, shale supply also has had an impact on the market of other energy sources. In the US, low gas prices has made it competitive to coal and helped reduce consumption, though the US also has the world's largest reserves of coal. US Coal output dropped from some 160 million MWh in 2002 to nearly 120 million MWh in 2012. Coal exports soared in the same period, from a quarterly figure of just over 20 million MWh in 2002, to a peak over 160 million MWh in 2012 (IAE, 2013). The US shift from coal to gas is further helped by government policy to reduce coal, and increasing shares of renewable source in electricity generation (OPEC 2014b). Consequently, according to OPEC (2014a, 8) "US coal has found its way into European markets, where its relative low price coupled with low carbon prices has made it more competitive in power generation than gas." In fact, 50% of US coal exports was absorbed by Europe in 2012 (Maroy and Koopman

2013, 3). Also in Asia, coal is still far cheaper than natural gas, and demand outlook depends as much on Co2 prices and government policies as the volume of shale gas on the global market. Analysts at Rabobank also found a strong negative price relationship between oil and gas prices when relative supply of gas over oil increased 2000-2013 (IEA 2014; Maroy and Koopman 2013).

### Developing country effects

The recent drop in oil and gas prices, largely tributed to the shale oil and gas boom, has a negative effect on oil and gas companies' willingness to invest in developing countries, especially in Africa. PwC[1] carries out an annual survey among these companies asking them to rank factors that are likely to impact their oil and gas business in Africa. In 2014 the oil and gas prices were ranked as fourth, but in 2015 in jumped to number one. The price is regarded as more important than "protectionist governments" and "inadequacy of basic infrastructure". This means that African countries with oil and gas reserves are feeling the effects of an external price factor which they cannot influence. This coincides with a drop in Africa's share in world's total oil production, going down from 10,1 % in 2013 to 9,6 % in 2014. Given that Africa is seen as an upcoming oil and gas region, this trend is not positive.

Several countries in Africa are affected by the shale oil and gas revolution. The drop in oil prices has contributed to delays in investments in some countries. In Uganda several workers in the oil industry has been laid off this year and in Tanzania the decision on whether to develop the discovered gas fields and build a much needed LNG plant is regularly delayed. Kenya[2] has been seen as a country with great potential for extraction of petroleum resources, but the exploration activities has slowed down lately. Recent studies conclude that for projects in Kenya to make profit, oil price needs to be at a minimum of 70 USD per barrel. Currently, the oil price sits at approximately 50 USD per barrel. In Ghana, the 2015 government budget was based on an estimated oil price of 99,38 USD. With the sharp drop in oil price, the government experienced a big budget deficit. This deficit was covered by withdrawing funds from the Ghana Stabilization Fund, which contains petroleum revenue[3].

While the drop in oil and gas prices may be hurting the industry and potential revenue, it may be good news for those buying refined products such as petrol and kerosene. It may also be good news for countries that spend a lot of money on subsidizing such refined products for its citizens, such as Nigeria and Venezuela.

The problem however is that countries that apply big fuel subsidies also rely heavily on petroleum revenue. The development in the shale industry and potential effects on global oil and gas prices will be closely watched by developing country leaders, investors and companies alike.

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## Two “useful links”: Open Oil and Goxi

For each issue of the WGEI Newsletter we are going to present one or two essential “useful links” that can be found under the “tools and resources” banner on the WGEI home page ([www.wgei.org](http://www.wgei.org)). The aim is to remind of and draw attention to external resources that we think could be useful in the daily work of auditors at the various Supreme Audit Institutions involved in audit of the extractive industries sector.

[www.goxi.org](http://www.goxi.org) is a World Bank and UNDP initiative that the members of the WGEI secretariat use almost at daily basis to keep up to date with the latest events in the extractive industry sector. From the Goxi page we can read that “GOXI is a space for dialogue and platform for innovation and collaboration serving those actively working on governance issues in the extractive industries”. The blog posts, which are frequently updated, gives a nice overview of the latest updates in the sector. There is also a list of upcoming events and links to relevant job postings.

<http://openoil.net> is a site with the aim to enhance transparency in the oil sector. On their page you will find material on how to understand oil contracts, with publication for free download. The most interesting feature of the site is possibly that you can download most of the worlds published oil contracts. They also have an interesting map of oil concessions.

### New resources uploaded to the WGEI webpage

Since the last newsletter, 34 new audit reports on both oil & gas and mineral audits, have been uploaded to the “tools and resources” section of the WGEI page. We have also included 8 new resources under the banner “external resources” (such as examples of legislation and an OECD guideline) as well as a 4 useful links. I hope you will find the new resources useful. Do not hesitate to let us know in case your SAI has some resources to share.

## Trainings and events

### A recap of the 2<sup>nd</sup> WGEI meeting held in Oslo, Norway 21-23 September

The 2<sup>nd</sup> WGEI meeting took place in Oslo, Norway, from 21<sup>st</sup> to 23<sup>rd</sup> September with participants from 19 of the WGEI member countries. The meeting consisted of both a technical program and more strategic sessions with the development of the WGEI as an aim. The participants could follow presentations and panel discussion on important themes such as transfer pricing and local content. The presenters for this year’s meeting came from organizations such as OECD, EITI, Publish What You Pay, Industry interest groups and of course from the SAIs themselves.

The second day of the meeting a session was organized in order to update the WGEI activity plan. Input from this session was collected and has served as a base for the new plan that is presently being elaborated.

Those WGEI members who did not have the pleasure of attending the meeting, or those who would simply like to recap on some of the content, will find all the presentations available on the WGEI site through this [link](#). On the same page you can also find the [minutes](#) of the meeting as well as the [annual report](#).

### The EITI Global Conference

The 7<sup>th</sup> EITI Global Conference is scheduled to take place on 24<sup>th</sup> and 25<sup>th</sup> of February 2016 in Lima, Peru. The conference, which is organized every 2-3 years, brings together participating countries, industry and civil society representatives to discuss important policy issues related to EI governance.

From the EITI website: “The 2016 EITI Conference will focus on highlighting the results from implementing the EITI Standard, informing policy dialogue, and integrating the EITI into how governments and companies operate. Speakers and participants include high-level representatives from governments, extractive companies, investors, civil society and international organisations. The 49 implementing countries will present progress and innovations in a National Expo alongside the Conference.”

More information on the EITI global conference can be found through this link: <http://www.lima2016.eiti.org/>

## Members in Action

SAI Vietnam: Evaluating the environmental management and rehabilitation on mining industry in Thai Nguyen Province, Vietnam (By SAI Vietnam)

On 15 October 2015 the State audit office of Vietnam (SAV) launched a performance audit that aims to evaluate the environmental management and rehabilitation on mining industry in Thai Nguyen Province. The audit was performed as results of a survey that gathered initial information and data of environmental rehabilitation on mining industry in Thai Nguyen Province for the period 2012-2015.



Iron ore mining in Thai Nguyen Province, Vietnam

## The Audit Purpose and Objectives

The primary purpose of the audit is to evaluate the efficiency and effectiveness of the environmental management and rehabilitation on mining industry in Thai Nguyen Province. Based on this purpose, the SAV has determined five specific objectives of the audit as follows:

*Objective 1:* To assess the compliance of the environmental management and rehabilitation with Vietnamese regulations and laws.

*Objective 2:* To assess the efficiency and effectiveness of regulations related to raising and using environmental rehabilitation fund on mining industry.

*Objective 3:* To assess the efficiency and effectiveness of projects which are implemented in order to ensure that all mining activities must comply with requirements of environmental protection.

*Objective 4:* To assess the efficiency and effectiveness of governmental inspection activities related to the environmental management and rehabilitation on mining industry in Thai Nguyen Province.

*Objective 5:* To assess the efficiency and effectiveness of allocating and using revenue collected from environmental protection fees.

## The Audit Scope

The audit plans to conduct field works at 20 entities in Thai Nguyen Province including Department of Natural Resources and Environment, Environmental Protection Fund, People's Committee, Department of Finance and 13 Mining Companies for the period from 2012 to 2015.

## Further information

When the audit is completed, all audit findings will be discussed with the Chairman of Thai Nguyen People's Committee in order to ensure that all audit recommendations will be implemented in the future.

It is expected that the audit report will be issued early next year and then SAV's WGEI will share some experiences as well as findings on the above audit for WGEI members.



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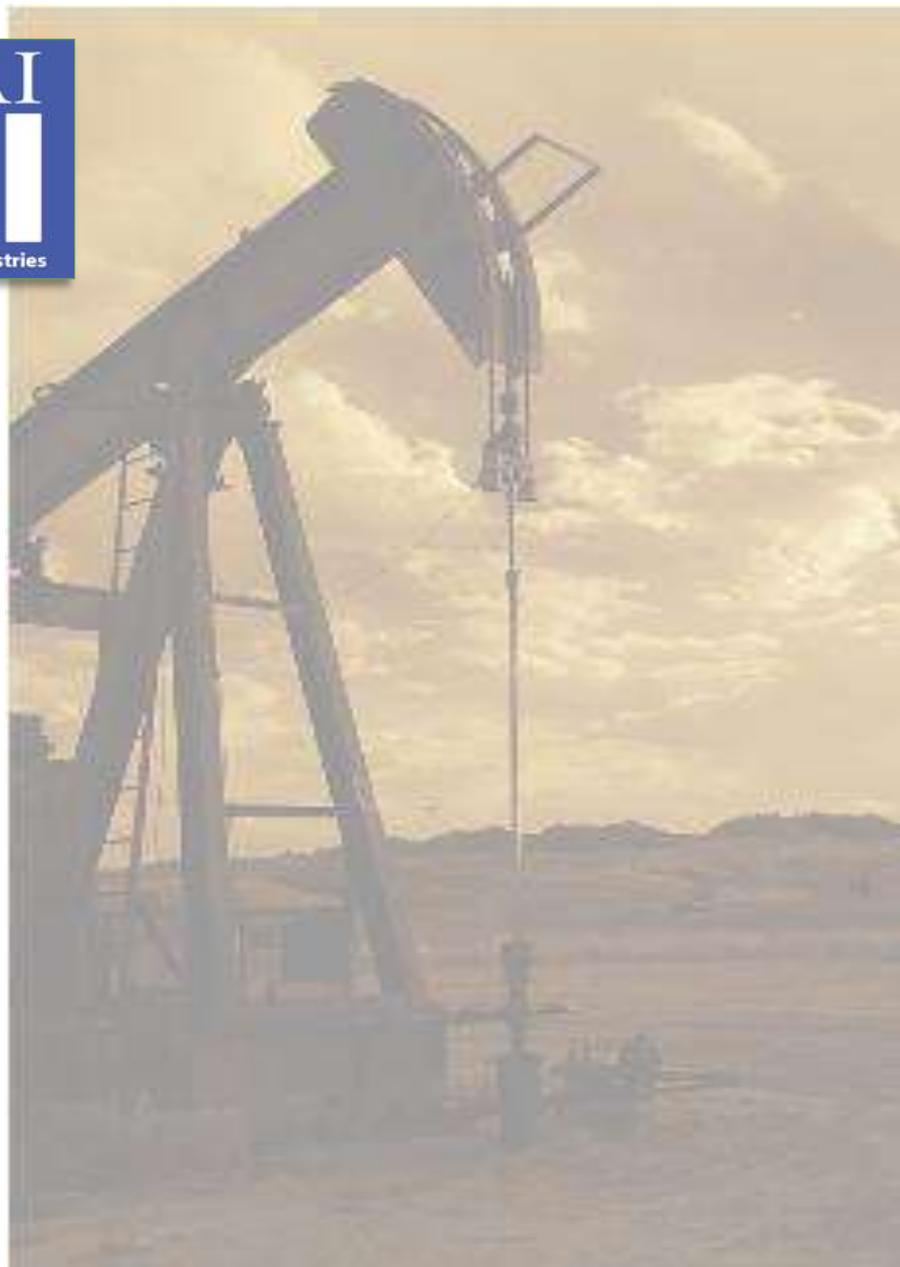
Community of Practice: A WGEI Initiative

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2<sup>nd</sup> WGEI Meeting

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GIZ Workshop: Enhancing SAI Capacity in Auditing the Extractive Industry Sector; Kampala 10-12 September 2015



ISSUE NO. 2 | SEPTEMBER 2015

## About this issue:

Welcome to the 2<sup>nd</sup> edition of the WGEI newsletter. The purpose of this issue is primarily to inform you about the second annual WGEI meeting that will take place in Oslo, Norway between 21<sup>st</sup> and 23<sup>rd</sup> September. We also take this opportunity to update you on the status of the WGEI Community of Practice, which is now equipped with a full-time coordinator. In this issue, you will also find information about a recent workshop organized by GIZ in Kampala.

Have a nice read!

## Introducing the CoP Coordinator

The Working Group on audit on Extractive Industries is pleased to let you know the newly initiated Community of Practice (CoP) now has a full-time coordinator working to set-up its functions. His name is Mr. Ingvald Heldal and he is based at the office of the Auditor General of Uganda in Kampala, for the next three months. Mr. Heldal is a Norwegian citizen with broad experience in coordination from various international organizations. He holds a master's degree in law and an MBA.

The main tasks for the coordinator will be to establish the CoP platform for sharing resources and networking as well as strategy development and outreach. You will find his TOR on the website [here](#).

In the following weeks Mr. Heldal will be in touch with several WGEI members and contact points with request for input and material for the CoP. The WGEI secretariat encourages you to give him your support so that together we can create an efficient community of practice for improved knowledge sharing. Do not hesitate to contact Mr. Heldal in case you have questions or recommendations regarding the CoP (his email: [ingvald.heldal@oag.go.ug](mailto:ingvald.heldal@oag.go.ug) and [cop@wgei.org](mailto:cop@wgei.org))

### Need to know

#### Community of Practice: A WGEI Initiative

The Community of Practice (CoP) is an initiative from the WGEI where the aim is to facilitate knowledge sharing on audit of the extractive industries sector. The general objective of the CoP is to strengthen SAIs' role in fostering accountability and transparency in the Extractive Industries, in line with the overall objective of the WGEI. The CoP shall facilitate information sharing between SAIs, but also link it with the extractive industry community outside INTOSAI.

The CoP is international and open to all interested SAIs and SAI colleagues in all INTOSAI regions. It will also invite participation by other institutions and individuals working in and with the Extractive Industries. Read more about the various functions of the CoP [here](#)

#### New resources uploaded to the WGEI home page

Within a few days there will be 16 new audit reports uploaded to the "Tools and Resources" section of the WGEI web page. The new reports will be classified by value chain segment to make it easier to identify relevant reports.

## Trainings and events

### 2nd WGEI meeting to be held in Oslo 21-23 September

On invitation by the Auditor General of Uganda and Chair of the INTOSAI Working Group on audit of Extractive Industries, the 2nd WGEI meeting will take place in Oslo, Norway, from 21<sup>st</sup> to 23<sup>rd</sup> September. The event is hosted by the Auditor General of Norway, and draws participants from 23 of the 34 WGEI member countries. The meeting comprises sessions on update and planning for the WGEI as well as a technical program. Contributors include SAI colleagues, industry experts, government- and civil society representatives.

The event is a yearly opportunity to jointly take stock of the activities and achievements since the last meeting that took place in Kampala in 2014.

During the three days of the meeting the participants will have the opportunity to be updated on the status on WGEI activities and the newly established Community of Practice. There is also planned a group work session where aim is to share ideas on the way forward and decide on future activities and planning.

Apart from these strategically important sessions, the meeting also includes an interesting technical program with topics such as illicit financial flows, EI risks and multinational EI audits. The speakers come from members SAIs, international organizations, government and the private sector. The technical program comprises presentations as well as panel discussions.

The WGEI secretariat wants to offer member SAIs that do not have the opportunity to participate at this event an opportunity to keep up to date. The WGEI website (<http://www.wgei.org/>) will therefore feature various information on the meeting and continuous updates as the event proceeds.

**Before** the meeting, the agenda can be viewed [here](#) and a link to the speakers profile can be found [here](#).

**During** the meeting, brief daily updates will be posted [here](#).

**After** the meeting, a more comprehensive summary of the meeting as well as all presentation will be shared [here](#).

The meeting will have daily presentation on a variety of topics, all related to the audit of the extractive industries sector. The agenda includes parallel sessions on day three (Wednesday), if you are participating at the meeting and have not yet signed up for the sessions, you can do so [here](#).

### GIZ Workshop: Enhancing SAI Capacity in Auditing the Extractive Industry Sector; Kampala 10-12 September 2015

The German Government through GIZ (Gesellschaft für internationale Zusammenarbeit) is working on improving public financial management and good government in Africa. GIZ recognises the importance and value of developing SAI capacity and effective work with Parliaments, particularly in resource-rich African countries. In seeking to develop and share good practice, GIZ collaborated with seven African SAIs to host the 'Workshop: Enhancing SAI Capacity in Auditing the Extractive Industry Sector,' in Uganda. This Uganda workshop was a follow-up to an eight-day training event in Extractive Industry audit held in Germany during June 2015.

- Shared knowledge and experiences as a result of their respective financial and performance audits in the Extractive Industry sector;
- Discussed the challenges and risks in auditing the sector from an auditor's perspective; and
- Considered what more SAIs can do to enhance their oversight and control of the sector and contribute to enhancing the accountability of its key actors.

The workshop was invaluable in bringing together a regional group of SAIs committed to sharing diverse experiences, increasing understanding and learning lessons in auditing the Extractive Industry sector. Positive outputs from the workshop included the participant SAIs developing strategic alternatives, objectives and activities that will enhance sector control and oversight in individual countries. This is the first time that a group of SAIs have worked with a range of key partners including GIZ, AFROSAI-E and OAG Norway in developing in-country Extractive Industry strategies and audit practices.



*GIZ Workshop: Enhancing SAI Capacity in Auditing the Extractive Industry Sector; Kampala, 10th-12th September 2015*

The workshop took place in Uganda with participants from the SAIs in Ghana, Kenya, Malawi, Mozambique, Tanzania, Uganda and Zambia. The aim of the workshop was to share technical knowledge and challenges in applying revised audit practices in Africa.

During his opening remarks, Mr. John F. S. Muwanga, the Auditor General of Uganda and Chair of the INTOSAI Working Group on audit of Extractive Industries, emphasised the key role of SAIs in the good governance of the Extractive Industries sector, the challenges faced by SAIs, and the importance of continuing capacity initiatives to enhance SAI capacity. During the workshop in Uganda, the participant SAIs, GIZ experts and facilitators:



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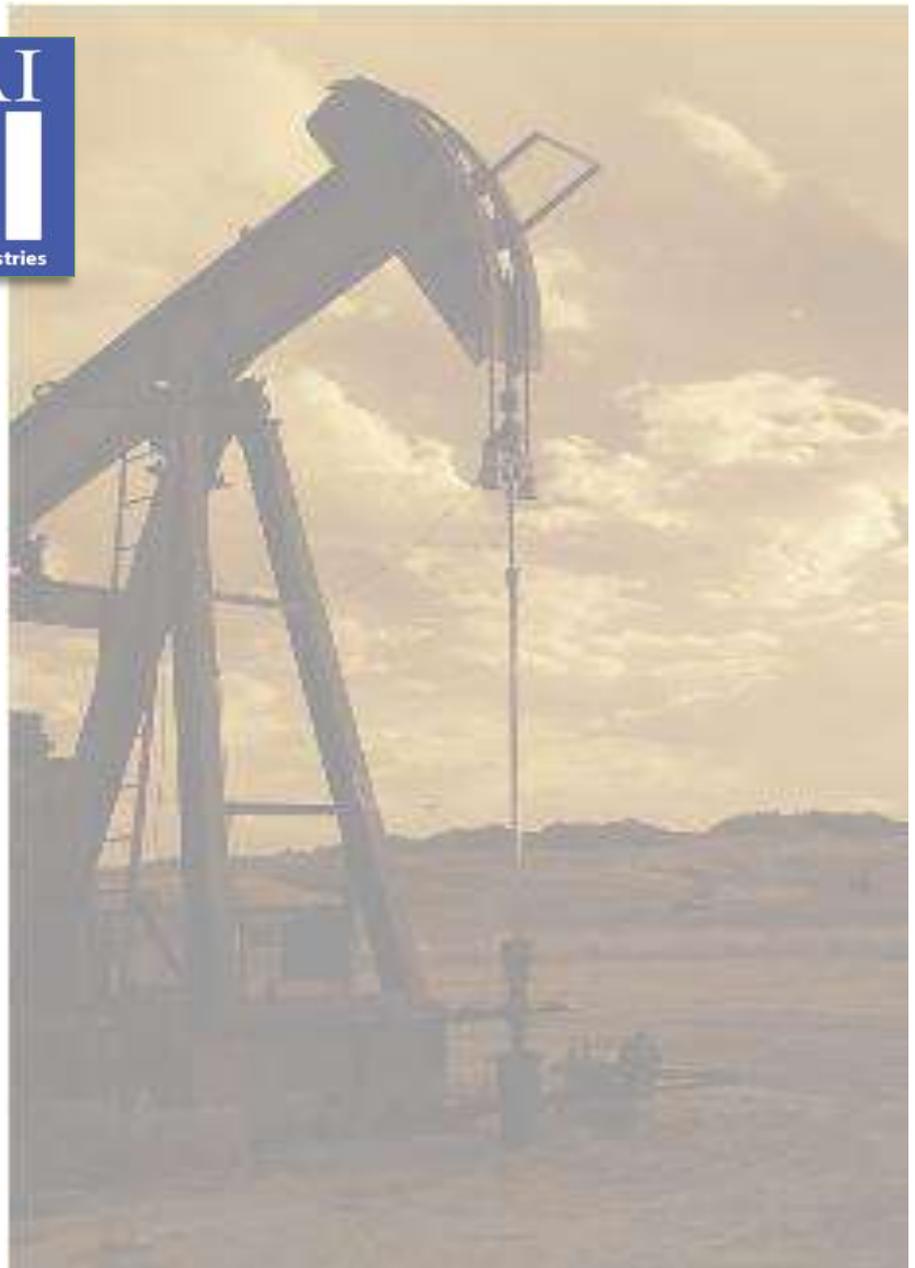
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SAIs and the audit of Extractive Industries

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Netherlands Court of Audit reviews spending of gas field revenues

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ISSUE NO. 1 | AUGUST 2015

**About this issue:**

Welcome from WGEI Chair, WGEI website re-launch, The Extractive Industries value chain: possible audit topics, What is transfer pricing, and why should SAIs care about it?, SAIs and the audit of Extractive Industries, The 2nd WGEI meeting to be held in Oslo 21-23 September, Seven African SAIs gather for regional EI training, Netherlands Court of Audit reviews spending of gas field revenues, Coordinated EI audit in OLACEFs

Have a nice read!

## Introductions

### Welcome from WGEI Chair!

As Chair of the [INTOSAI Working Group on Audit of Extractive Industries](#), I am very pleased to present to you the first WGEI newsletter. We aim to send you monthly updates with news about the activities of WGEI, recent sector audits around the world, trainings and events as well as feature articles on topics of particular relevance. We hope you will find the newsletter an interesting read. Please feel free to share your feedback with the WGEI Secretariat. Note that our newsletter, as our website, is dependent on contributions from group members. Please be in touch if you have news, articles or relevant updates you think can be shared on the WGEI website, or if you can write an article for the next newsletter. Contributions can be emailed to the WGEI secretariat: [wgei@oag.go.ug](mailto:wgei@oag.go.ug)  
*John F. S. Muwanga Auditor General of Uganda and Chair of INTOSAI Working Group on Audit of Extractive Industries*

### WGEI website re-launch

The WGEI website was launched after the first WGEI meeting in Kampala in August 2014, but has recently received a facelift and a number of new resources. Check out the website and review a number of audit reports from around the world on <http://www.wgei.org/>

## Need to know

### The Extractive Industries value chain: Possible Audit Topics *(By Trygve Christiansen, Norwegian Audit Office)*

*Supreme Audit Institutions (SAIs) can play a role in ensuring that countries reap maximum benefits from the EI sector and keep negative effects to a minimum. The type of audit to be carried out will depend on the competency level at SAI, their audit mandate, access to relevant data, the maturity of government institutions and the lifespan of extractive industries in the country. This presents a selection of possible risks and audit topics to be considered within the different phases of the EI value chain, and give examples of recent EI sector audits from around the world.*

Audit of the management of extractive industries (EI) is gaining more significance for SAIs. For many countries their EI play a vital role in generating government revenue, ensuring employment, attracting investors and developing new technology. Notwithstanding these benefits are possible negative effects such as environmental damages, affected local communities, too much dependency on EI revenue, tax evasion and corruption. Supreme Audit Institutions (SAIs) can play a role in ensuring that countries reap maximum benefits from the industry and keep negative effects to a minimum.

The decision of what to audit should be based on an assessment of sector risks, but will often depend on the competency level at SAI, the audit mandate, access to relevant data, the maturity of government institutions and the lifespan of the extractive industries in the country. Audit topics however can usefully be categorized within the different phases of the EI value chain. The value chain describes from a governance perspective the different steps or phases to be undertaken, from discovery, through extraction to lasting value creation for society. The group of English-speaking African SAIs (AFROSAI-E) had in 2013 developed an EI value chain, based on the World Bank classification. The EI value chain shows the role of government in managing the extractive industries in the following areas:

1. Legal framework
2. Exploration, including seismic and magnetic surveys and drilling
3. Award of contracts and licenses
4. Monitoring of operations
5. Collection of revenue
6. Revenue management and allocation
7. Implementation of sustainable policies

This article will focus on audits which may be carried out within each phase of the EI value chain, including some examples of audits which have been carried out in the last years.

### **Legal framework**

A common risk is lack of operationalization of overall legal framework. Petroleum and/or mining acts may not be supported by regulations and guidelines, which may lead to government not exercising their oversight role in an effective way. The Office of the Auditor General of Uganda (OAGU) reported in 2014 that the government failed to complete relevant environmental guidelines on time, which reduced government's ability to manage waste from oil and gas activities in a proper and efficient way. By this OAGU referred to government's responsibility to ensure that overall legislation by Parliament is understood and implemented.

### **Exploration**

If Parliament decides that certain areas shall be open for exploration, government must ensure that exploration activities are taking place and that data gathered are kept in systematic and secure way. The Comptroller and Auditor General of India conducted a performance audit (report no 11 of 2012-13) of how India's government owned Oil and Natural Gas Corporation Limited (ONGC) carried out exploration activities. It showed that ONGC failed to complete its work commitments in a majority of the exploration blocks, that monetizing of offshore discoveries were almost non-existent, and that exploration costs were unnecessary high.

### **Award of contracts and licenses**

Contracts and licenses should normally be awarded to competent companies through a competitive and transparent bidding process. A number of audits have been carried out on this area, e.g. by the Brazilian Court of Audit[1], TCU, which has audited every single bidding round. In 2007 it reported lack of transparency, publicity and openness regarding dialogue between government and bidders. The Office of the Auditor General of Norway did a similar audit in 2010 which concluded that Government issued petroleum licenses based on clearly defined criteria which were in compliance with relevant acts and regulations[2].

### **Monitoring of operations**

When production commences, it is important that government has measures in place to ensure that activities on the ground are carried out in accordance with relevant laws and regulations, e.g. that health and safety regulations are met and that equipment used for measurement of production is correct. The Government Accountability Office of USA concluded in 2008[3] that relevant government agencies did not carry out sufficient inspections of metering equipment, which raised uncertainty about accuracy of oil and gas measurement.

### **Collection of revenue**

An effective taxation system which brings in a fair share of the economic rent, which is easy to administer and facilitates investment should be implemented. Also, the system should enable realistic revenue projections to be made. The New South Wales Audit Office in Australia did an audit of collection of coal mining royalties in 2010[4]. The audit showed that the relevant government agency responsible for collecting the royalties cannot assess from the royalty returns whether the royalty being paid is likely to be correct. In 2013 the National Audit Office of China reported that the China National Petroleum Company was crediting substantial current period natural gas sales revenues to the following year, which resulted in significant understatement of profits[5].

### **Revenue management and allocation**

Revenue streams from EI are significant and it is therefore common to have specific procedures for how these shall be handled in a way which does not damage the economy, but secure lasting positive effects for the country. The Netherlands Court of Audit[6] did recently an investigation of how much money had been earned from its biggest natural gas field Groningen since production began in 1960, and how it was spent. They discovered that the designated gas revenue fund, which was supposed to be used for "additional projects", was used to finance projects which were part of the annual state budget. Spending policies were changed numerous times which made long term investments difficult. The report concluded that the precise use of natural gas revenues cannot be identified.

### **Implementation of sustainable policies**

Extractive Industries should create lasting benefits for the country and negative impacts, e.g. environmental degradation, should be reduced to a minimum. It is important that a country with an emerging extractive

industry benefits from investments by increased participation from local staff and services, and through engagement of local suppliers of goods and services. The Office of the Auditor General of Uganda (OAGU) discovered in 2014 that a substantial number of supposedly local suppliers to the oil and gas industry in Uganda were in fact wholly foreign owned[7]. The local supplier companies it was suspected had been set up just to fulfil legal requirements without effecting local value addition. In the same year OAGU reported that the government environmental authority did not systematically verify self-monitoring reports submitted by oil and gas companies operating in highly vulnerable areas with rich biodiversity[8].

There are many more examples of audits that have been carried out within the different phases of the value chain. The above mentioned audits may serve as inspiration for SAIs that want to expand their audit scope and identify risks which have led to audits in other countries.

#### References

[1] [http://portal3.tcu.gov.br/portal/page/portal/TCU/Rio20/fichas/en\\_07\\_oil.pdf](http://portal3.tcu.gov.br/portal/page/portal/TCU/Rio20/fichas/en_07_oil.pdf)

[2] <https://www.riksrevisjonen.no/rapporter/Sider/utvinningsstillatelse.aspx>

[3] <http://www.gao.gov/assets/100/95735.html>

[4] [http://www.audit.nsw.gov.au/ArticleDocuments/142/208\\_Coal\\_Mining\\_Royalties.pdf.aspx?Embed=Y](http://www.audit.nsw.gov.au/ArticleDocuments/142/208_Coal_Mining_Royalties.pdf.aspx?Embed=Y)

[5] [http://www.cnao.gov.cn/main/articleshow\\_ArtID\\_1374.htm](http://www.cnao.gov.cn/main/articleshow_ArtID_1374.htm)

[6] [http://www.courtsofaudit.nl/english/Publications/Audits/Introductions/2014/10/Use\\_of\\_natural\\_gas\\_revenues\\_facts\\_figures\\_and\\_scenarios](http://www.courtsofaudit.nl/english/Publications/Audits/Introductions/2014/10/Use_of_natural_gas_revenues_facts_figures_and_scenarios)

[7] <http://www.oag.go.ug/implementation-of-national-content-in-the-oil-and-gas-sector-by-the-ministry-of-energy-and-mineral-development/>

[8] <http://www.oag.go.ug/value-for-money-reports/>

What is transfer pricing, and why should SAIs care about it? (By August Schneider and Anders Pilskog, Norwegian Audit Office)

*An estimated 60 % of world trade is transactions between branches and subsidiaries of multinational enterprises (MNE). The way prices are set for these transactions (transfer prices) can greatly influence the overall taxes paid by the enterprise, as costs are shifted*  
WGEI Newsletter Journal | September 2019

*to high tax jurisdictions, and profits move to jurisdiction with less or no profit tax. This article explains what is meant by transfer pricing, and why it should be high on the agenda of SAIs looking to audit the extractive industries.*

#### What is transfer pricing (TP)?

Transfer prices are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises (subsidiaries and other related/affiliated companies). Transfer prices are important for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions.

An estimated 60 % of world trade is transactions between subsidiaries within multinational enterprises (MNE).[1] In principle, the prices charged for these transactions should equal those of the free market. This means that the transfer price within the company should correspond to the price a seller would charge an independent, “arm’s length” customer, or what the buyer would pay an independent, “arm’s length supplier”. In practice however, it can be hard to determine the market price, and multinational entities often set internal transfer prices that differ from free market prices (arm’s length). This ability opens for profit shifting between countries and thus tax base erosion in any particular country, commonly known as aggressive tax planning or corporate tax evasion.

When working with transfer pricing, we are looking for commonly accepted methodologies to determine market prices (arm’s length), or acceptable deviation from those prices. Use of the methodology is applicable for both authorities and private companies. For tax authorities these methods can help in their effort to reduce tax base erosion. For multinational entities (MNE), appropriate transfer pricing can help avoiding double taxation. It will also help the MNE leadership establish the accurate level of costs in different parts of the company and in this way determine which are performing well and not so well. The arm’s length principle is set forth in [Article 9 of the OECD Model Tax Convention](#), and basically states that any additional profits gained as a result from “favorable” transfer pricing between related enterprises should indeed be taxed:

Where “conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits

which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly".[\[2\]](#)

### **Why is Transfer Pricing within extractive industries important for SAIs?**

As some jurisdictions in the world have low or no income tax for companies (tax havens), there are economic incentives for MNEs to shift profit between their companies: Moving costs to high tax jurisdictions and profits to low tax jurisdictions respectively. Such profit shifting can be done by letting the subsidiary in the low tax jurisdiction charge another subsidiary or the mother company in a normal tax-rate country a price that is higher than market price on services and goods, captives (insurance) or intangibles. The abnormal high price can then be deducted for tax purposes in the latter country and thus reduce the legal tax base in this particular country. This is commonplace, and not necessarily illegal.

A survey of 10 of the world's most powerful extractive industries giants showed that 34 % of their 6 038 subsidiaries were situated in tax havens[\[3\]](#), giving an indication of the opportunities that exist for profit shifting within the sector. Audit has also revealed some rather stunning examples of creative transfer pricing: A company charging USD 973 USD for a plastic bucket[\[4\]](#), but only USD 52 for a rocket launcher[\[5\]](#) or USD 13 for a camera recorder[\[6\]](#) for example.

It is important to note that the invoicing country do not have to be a tax haven to play a part in transfer pricing or an aggressive tax planning scheme. Some seemingly normal tax-rate jurisdictions have special regulations that allow cash flow through their jurisdiction without taxation, and the profit might eventually end up in a tax haven, making it attractive for companies to shift profits here.

Transfer pricing is a high risk area in countries with extractive industries due to the nature of the business. The industry is characterized by several multinational entities, advanced technical expertise and knowledge, large investments, valuable assets and much intangible property for which prices are hard to determine. Within Production Sharing Agreements (PSA's), transfer pricing will play a key role in the calculation of a company's recoverable costs, and considerations of ring fencing[\[7\]](#). Cost recovery statements, that is the amounts the companies intend to deduct from revenues before calculating profit, will normally contain costs incurred through services performed by an associated enterprise. Since the associated

enterprise and the company have the same owner, the companies have incentives to exaggerate the cost incurred as to be able to deduct more costs through the cost recovery. For other than tax purposes, it should make little difference to the company as a whole where income and costs are placed.

### **How to audit TP or What do auditors need to know?**

Tax authorities and SAIs play a key role in preventing illicit profit shifting. SAIs in some countries have direct authority to audit cost statements according to Production Sharing Agreements (PSA), and therefore have tasks similar to a tax authority. Tax authorities and SAIs can for example prevent illicit profit shifting through TP risk assessments, comparability analysis, function analysis and tax audits. They may challenge the prices set by the companies through dedicated Appeals Board or Advisory Committees, or through the ordinary judiciary and/or application for prosecution in cases of tax evasion and fraud.

Where a SAI has no direct authority to audit cost statements, the SAIs could still play an important role in monitoring and auditing the tax authorities on their accomplishment on TP performance. This is normally done as a compliance audit.

There are different transfer pricing rules and regulations across the globe. Common for them all is that they contain rules on what kind of information companies should present to governmental bodies, in order to enable them to control the price set between affiliated parties. Further, they contain pre-approved methods of calculating an arm's length price. For OECD countries there are five such pre-approved methods. Other jurisdictions may have more pre-approved methods as for example USA, which has seven pre-approved methods. Some countries oblige companies to use one of these methods to prove arm's length, whilst other countries allow companies to also present alternative methods to prove arm's length. Either way, the rationale behind all the methods used is to substantiate that the agreement is economically sound and could have been entered into by unaffiliated parties.

In order to do this, extensive amounts of documentation must be examined. The documentation should disclose the nature of the transaction, the amounts paid and a comparable price which can justify that the price agreed upon does not significantly diverge from what two unrelated parties could have agreed upon. Note that it is not necessarily the "market price" that should be identified, but the unexplained difference from the market price. It is still

allowed to cut costs by streamlining services throughout the company, but again any divergence from the market price must be justified.

### Examples of what audit has revealed

As mentioned before, audit has revealed several examples of illicit TP practice and profit shifting:

- Reluctance or unwillingness to provide mandatory transfer pricing documents for audit
- Restrictions to audit transfer pricing in clauses in PSA (terms in PSA)
- Indiscriminate rate of services/consultancy fee charged regardless of staff experience or merit
- Duplication of costs (often hard to detect in transfer pricing arrangements)
- Insurance/captives overpriced from subsidiary in tax haven
- Use of intangibles overpriced from subsidiary in tax haven
- Loans and financing/funding from related companies/affiliates significantly above or below market rates
- A mother company invoicing an affiliate for general assistance costs in a way that mixes the actual service costs with for example shareholder costs. Shareholder costs accumulate regardless of the affiliates and should therefore be included in general assistance costs.

### Where to learn more – tools and resources

[https://en.wikipedia.org/wiki/Transfer\\_pricing](https://en.wikipedia.org/wiki/Transfer_pricing)  
[OECD Transfer Pricing Guidelines. \(needs Log In\)](https://www.oecd.org/ctp/transfer-pricing/)  
<http://www.oecd.org/ctp/transfer-pricing/>  
<http://www.taxjustice.net/topics/corporate-tax/transfer-pricing/>  
<http://www.pwc.com/gx/en/international-transfer-pricing/requirements.jhtml>  
[http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/transfer\\_pricing/forum/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/forum/index_en.htm)  
<http://www.ey.com/GL/en/Services/Tax/International-Tax/Transfer-Pricing-and-Tax-Effective-Supply-Chain-Management/Worldwide-Transfer-Pricing-Reference-Guide—Country-list>  
<http://www.royaltyrange.com/home/royalty-rate-database/transfer-pricing?gclid=CN77hvyh3cYCFUTecgodDZAL4A>  
[1] Neighbour, J. (2002). *Transfer pricing: Keeping it at arm's length*. OCED Observer. [http://www.oecdobserver.org/news/fullstory.php/aid/670/Transfer\\_pricing:\\_Keeping\\_it\\_at\\_arms\\_length.html](http://www.oecdobserver.org/news/fullstory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html)  
[2] OECD (2014) *Model Tax Convention on Income and capital: Condensed version*. <http://www.oecd->

[ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version\\_20745419](http://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version_20745419)

[3] Mathiason, N. (2011). *Piping Profits. Mapping the 6,038 subsidiaries owned by ten of the world's most powerful Extractive Industry giants and the quest by Latin American journalists to find out more*. Oslo: Publish What You Pay Norway. <http://www.publishwhatyoupay.no/pipingprofits>

[4] Pak, S. J., Zdanowicz, J. S. (2002). *U.S. Trade with the World*. Malvern/Miami: Trade Research Institute: [http://www.oss.net/dynamaster/file\\_archive/040318/50b167ce2bb58f256cf8c2225aa4da82/OSS\\_2003-01-09.pdf](http://www.oss.net/dynamaster/file_archive/040318/50b167ce2bb58f256cf8c2225aa4da82/OSS_2003-01-09.pdf)

[5] Ibid

[6] Ibid

[7] Ring fencing here refers to the segregation of different income streams for taxation purposes. A government may decide that companies must “ring fence” a given project or license, preventing companies from offsetting profits or losses against other projects and licenses and thereby reducing overall tax payments.

### SAIs and the audit of Extractive Industries

Read the Chair's article on the role of SAIs in the Extractive Industries in the [International Journal of Government auditing](http://www.intosaijournal.org/coverstory/coverstory_04-2015.html) ([http://www.intosaijournal.org/coverstory/coverstory\\_04-2015.html](http://www.intosaijournal.org/coverstory/coverstory_04-2015.html))

### Trainings and events

The 2<sup>nd</sup> WGEI meeting to be held in Oslo 21-23 September

The Chair has the pleasure to invite all WGEI members and observers for the 2nd annual meeting of the WGEI. The meeting will be hosted by SAI Norway in Oslo, Norway from 21st – 23rd September 2015. To sign up or read more, visit the meeting webpage on the WGEI website: <http://www.wgei.org/wgei-activities/2nd-wgei-meeting/>

## Seven African SAIs gather for regional EI training *(By Sandy Richter, GIZ)*

With the assistance of the GIZ Academy for International Co-operation, SAI representatives from Ghana, Kenya, Malawi, Mozambique, Tanzania, Uganda and Zambia gathered in Germany 1 June to exchange experience and build competence in audit of the extractive industries. Colleagues from SAI Brazil, SAI Estonia and the EITI secretariat in Oslo also contributed to the event, which will see a follow-up training in Uganda in September. The results of the workshops will be shared with the WGEI in a discussion paper.

SAIs, in ensuring effective external oversight and scrutiny of public sector activities in extractive industries, face considerable challenges in establishing whether they are in line with the principles of legality, regularity, economy and efficiency. Limited knowledge and understanding of extractive industries are major challenges for SAIs, particularly when seeking to develop the audit scope and criteria for the sector. In addressing this issue, the SAIs from seven African countries came together with the German technical co-operation support (GIZ), to develop approaches and strengthen capacity in their important work in this challenging sector. Their collective aim was to contribute to improved accountability and transparency through more effective and efficient scrutiny of public sector activities in the extractive industries. The training approach was intended to underpin and complement regional and global initiatives in the audit of extractive industries, such as the work of AFROSAI-E and the INTOSAI Working Group on Extractive Industries. Additional collaborative efforts include the bilateral partnership programmes involving the SAIs of Uganda, Tanzania, Ghana, Zambia and Norway.

### **Training in Germany 14-27 June**

The GIZ Academy for International Co-operation supported a training workshop from 14 to 24 June in Germany. 27 participants from the SAIs of Ghana, Kenya, Malawi, Mozambique, Tanzania, Uganda and Zambia shared their experiences in the audit of extractive industries. These shared experiences enabled the development of more informed and integrated approaches to the audit of public sector activities in extractive industries.



*Participants at GIZ training*

Oil and gas sector experts from Brazil, as well as representatives from the EITI secretariat in Oslo and the Estonian SAI, jointly carried out the training workshop. The experts' presentations provided essential knowledge and understanding related to the EI value chain, including fundamental regulatory aspects, licensing and contracting issues, monitoring and oversight in production, as well as fiscal regimes and taxation. The participants took advantage of opportunities to apply the knowledge gained through group activities that resulted in, for example, the development of an audit matrix with specific audit titles, objectives and questions. A highlight of the training, which completed the training experience, was a visit to the Federal Court of Auditors and a guided tour of the lignite mines in Hambach.

A key result and benefit of the training is a series of options, which participants prepared through SWOT analysis that the SAIs can use to strategically conduct audit activities in the extractive industries sector.



*Participants at GIZ training visiting lignite mine in Hambach in Germany*

## Follow-up training to be held in September

The experiences and knowledge that the participants gained in the training, as well as the results of the various group activities, will now be taken to the next level in a regional workshop this September, in Uganda. The objective will be twofold:

- Firstly, to develop strategies for the improvement in the oversight of public sector activities in the national extractive industry sector; and
- Secondly, to design a capacity development strategy for SAIs, which is based on their needs regarding the fulfilment of their role in the sector. The results of the workshop will form a platform for SAIs in enhancing oversight in the sector and making a valuable contribution to the Good Governance Agenda. These results will be shared with the INTOSAI Working Group on Extractive Industries in the form of a discussion paper.

## Members in action – featured audits and colleagues

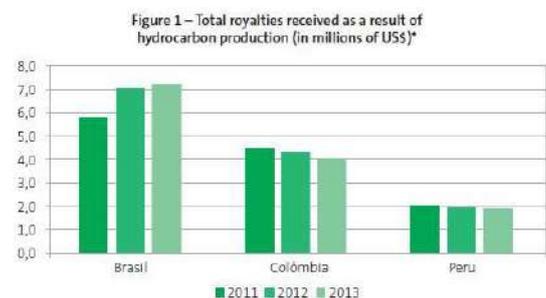
### Netherlands Court of Audit Reviews Spending of Gas Field Revenues

The Netherlands Court of Audit has investigated how much money has been earned from the Groningen natural gas field since 1960 and what it has been spent on. The report concluded that the precise use of natural gas revenues cannot be identified. NCA has also drawn up three scenarios of how the Netherlands could use natural gas revenues in the future. [Read more here:](http://www.courtofaudit.nl/english/Publications/)

[Coordinated EI Audit in OLACEFS \(By the Federal Court of Accounts \(Tribunal de Contas da União\) Brazil, Chair OLACEFS\)](http://www.courtofaudit.nl/english/Publications/)

Cooperative audits have been carried out in INTOSAI with different objectives and methodologies. In most cases, they are tools to study and analyze policies of regional and international interest. More recently, the cooperative audits have also been used as part of a strategy for capacity development. Under the Organisation of Latin America and Caribbean Supreme Audit Institutions (OLACEFs), the SAIs of Brazil, Colombia and Peru jointly investigated oversight of public revenues from the oil and natural gas exploration and production.

This coordinated audit is part of a cooperation project between OLACEFs and GIZ, and was carried out mainly in 2013, with a final report published in 2014. The topic of the oversight of public revenues from the oil and natural gas exploration and production was defined as a priority by the OLACEFs Regional Training Committee (CCC). The hydrocarbon production is a relevant economic activity for many Latin American countries because, besides its strategic energy importance, it generates significant impacts on public revenues, mainly by collecting government takes. As a result, the appropriate oversight of these resources, by the State, is a sensible issue, mainly considering the involved amounts – only in Brazil almost US\$ 13 billion were collected in 2013.



Sources: Own creation, based on data of EnerRio, ANP, Perupetro S.A. and Comptroller General of Colombia. \*In Brazil, there is also the special take, another materially relevant remunerative type. In 2011, 2012 and 2013 US\$ 3.0, US\$ 7.0 and US\$ 6.9 were collected, respectively.

## Methodology

The institutional model set for the hydrocarbon exploration and production, as well as how the oversight of these activities is performed, differs a lot among countries. The Federal Court of Accounts (TCU), with the consulting assistance provided by EnerRio, carried out a study on the institutional conditions related to the control of public revenues from oil and natural gas exploration and production activities in some of Olacefs countries. The study was funded by GIZ and included the following countries: Argentina, Bolivia, Brazil, Colombia, Ecuador, Mexico, Peru, and Venezuela.

Based on this institutional analysis, it was possible, therefore, to identify common challenges and potential topics of interest for the conduction of coordinated audits among these SAIs.

Thus, the topic selected for this audit was related to the integrity, reliability and transparency of the processes in oil and natural gas production measurement and in the calculation and payment of government takes as a result of this Production.

The selection was done considering that this topic is a starting and comprehensive point, capable of providing a wide analysis based on which new questions, sometimes specific for each country, become visible.

Each participating SAI carried out an audit in its own country, based on common guidelines. The TCU was responsible for the general planning, coordination of tasks and consolidation of the final obtained results.



Source: TCU.

### Purpose and scope

The purpose of this coordinated audit is to evaluate the regulatory, institutional and operational conditions of the governmental agencies and entities in charge of the control of the oil and natural gas production measurement and of the calculation and payment of the government takes, identifying eventual bottlenecks and opportunities for improvement, as well as good practices for management optimization.

Based on this general purpose, three analysis focus were defined: (1) to what extent the control of oil and natural gas production measurement performed by the regulatory entity has the required principles to reasonably ensure reliability and integrity of the produced volumes; (2) to what extent the control of the calculation and payment of the government takes from oil and natural gas exploration and production performed by the regulatory entity has the required principles to reasonably ensure reliability, integrity and timing of the values; and (3) to what extent the data and the information related to the oil and natural gas production measurement and the calculation and payment of the due government takes are officially made available, in a transparent, accessible and friendly manner, in order to allow for its replicability by a third party, outside the process.

Findings and conclusions of the audit itself vary between the countries, and will be presented at the 2nd WGEI meeting in Oslo in September 2015. In general, however, participating SAIs concluded that the process of collaborative audit was highly successful.

First of all, its conduction enabled the approach of relevant topics in the national environments and with similarities and common interest topics with other countries, which allowed for the creation of a wider and more complete vision regarding the faced problems and the different solutions applied in each situation.

In addition, although the audits individually developed by each SAI have been carried out in accordance with each country characteristics, the success of this coordinated audit showed that it is possible to analyze the issue based on common interest points and under perspectives not restricted to the SAIs themselves, which, subsequently, enables external control entities to extrapolate their traditional line of thought and try new points of view. In this sense, it is highlighted the knowledge acquired by the teams involved in the work regarding oil and natural gas production measurement and government takes processes, including technical visits made, whether individually or in Group.



Figure 3 – technical visit to a offshore platform in Brazil

To learn more about the use of collaborative audits in the OLACEFS, check out this latest INTOSAI IDI newsletter

article: <http://intosaidevelopmentinitiative.cmail2.com/t/ViewEmail/t/3CAEC77D3F5F97B1/850AC1FC67AF6D9F6A1C87C670A6B9F>

**WGEI SECRETARIAT**

**WORKING GROUP ON AUDIT OF EXTRACTIVE INDUSTRIES**

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