CHAPTER

8 Transparency Requirements

Background Discussion

Transparency and accountability in oil sector operations are necessary to improve governance in oil-producing countries. The same transparency and accountability guidelines that apply to non-oil revenue should apply to oil revenue. Oil revenue is part of government budgetary operations, and it is of overwhelming importance in the countries we are dealing with in this paper. The IMF's *Manual on Fiscal Transparency* (IMF, 2001) states that comprehensive coverage of all fiscal activity undertaken by the central government is essential from a transparency standpoint. In some cases, the coverage should extend beyond the government itself: the public sector balance should be reported when nongovernmental public sector agencies undertake significant quasi-fiscal activities. The public should accordingly be provided with full information on the past, current, and projected fiscal activity of the government.

Three concepts of government revenue flows need to be distinguished: (1) payments due, (2) payments made, and (3) payments received. Regarding the first, contractual arrangements between governments and oil companies are usually complex, and payments due to the government are calculated using a multitude of concepts. The most important sources of government revenue in developing countries are royalties (percentages of gross production), production shares (percentages of production net of cost), profit shares (percentages of net project returns), bonuses (fixed, one-off payments due at certain stages of the lifetime of a petroleum reservoir, starting with the signature of the license agreement), and corporate income tax on companies incorporated locally.

Royalties and signature bonuses are easily determined. However, while royalty rates are often publicly available and in some cases contained in basic petroleum legislation, bonuses are agreed upon with individual companies and are usually confidential. Not even royalties are transparent when precise information on production volume is lacking. Similar to bonuses, production shares or profit shares are usually negotiated on a project-by-project basis. The shares due to the government then depend on cost accounting by the project operators and on contractual rules regarding the extent to which costs are tax deductible. Corporate income taxes are paid on net operating profits of companies incorporated locally; these depend on transfer pricing with the company headquarters and are probably the least straightforward of the revenue sources described here.

Regarding the second concept of government revenue flows, revenue payments made to the government, these often differ from payments due. The reasons can be as simple as the accrual of arrears or more complex when offsetting arrangements have been made—for example, when loans have been taken against future oil revenue or oil companies provide goods and services to the government in lieu of cash payments. It is essential that government departments and agencies charged with monitoring the oil sector and managing oil fiscal revenues put in place adequate control mechanisms that allow them to reconcile payments due and payments received on a continuous basis. Equally important is the need to phase out those practices that hinder effective budget control and central cash management by the treasury, such as earmarking specific oil revenues for financing expenditures in a way that bypasses established budget control procedures.

Finally, with respect to the third concept of government revenue flows, payments in most countries are made to more than one administrative unit. They can go to an international bank, a national bank, the NOC, and different ministries. Payments are also frequently made to foreign bank accounts in foreign currency (usually the U.S. dollar); repatriation of the payments then depends on the central bank. In particular, when an NOC participates in oil sector operations, this filters at least some of the revenue payments made, and the pass-through to the treasury is not always straightforward. Payments made and payments received by the treasury need to be reconciled regularly.

Transparency in oil sector operations is needed to allow democratic debate on fiscal policy and spending priorities. Verification mechanisms and enhanced accountability are instrumental for avoiding corruption and the waste of public resources. Transparency is also needed to allow forward planning. An argument often used against transparency in oil sector operations is that spending pressure will build up from disclosures about resource availability (for example, it is forbidden by law to disclose the value of foreign assets accumulated in Kuwait, because such a disclosure is feared to generate spending pressure). However, it would seem better to inform the public and foster constructive debate. The existence of oil resources cannot be kept secret, and spending pressure will mount when citizens have little confidence in public institutions.

The question is how to make oil revenue information available to the public. A credible aggregation of the payments due to the government needs to be made, for the following reasons: (1) the multitude of concepts means that the fiscal authorities often do not have the capacity to follow up on oil revenue due, in particular in countries with a large number of oil-producing companies; (2) transparency is difficult to achieve when the public cannot easily understand the nature and origin of government revenue, even if it were to be made public; and (3) insofar as contractual details are negotiated on an individual basis, they are usually protected by confidentiality clauses. These considerations argue in favor of simplifying or standardizing fiscal arrangements and presenting information in a way that can be understood.

Fiscal operations in the oil sector should be subjected to independent scrutiny. Foreign oil companies are usually required to make regular declarations to the government of their contractual payments and submit audited account statements at the end of each year. Independent auditing of their adherence to contracts and payments of oil revenue, performed by the government, should verify the companies' declarations and compare them with assessments and payments received. The government auditor should also check the activities of the revenue-assessing and -collecting agencies and prepare timely and trustworthy reports on the financial integrity of government accounts—including oil revenue. The multitude of concepts involved means that the fiscal authorities often do not have the capacity to follow up on oil revenue due, in particular in countries with a large number of oil-producing companies. In order to help governments become more transparent, administrative capacity in oil sector operations needs to be strengthened in most African countries.

To establish transparency in fiscal operations related to the oil sector, an administrative unit is needed that is trustworthy in the public's eye and technically capable of handling the complex tasks involved in the follow-up of oil revenue. Depending on country circumstances, this can take very different forms. In most of the SSA oil-exporting countries, the public has less than full confidence in government agencies, and administrative capacity is generally low. The creation of a new unit may therefore be necessary.

In countries where fiscal accounts are generally trustworthy and well presented, the unit could be created within the treasury or ministry of finance and could consist of a number of tax and customs officials under the overview of the minister of finance. In many countries, more officials would be needed. Where governance concerns are strong and the public has come to mistrust officials and institutions, we could envisage an independent authority, with a board of governors that includes finance and oil ministers, the central bank governor, and representatives of civil society and oil companies.

In addition, the international oil companies operating in the countries could take steps to improve transparency. As argued recently by a broad coalition of civil society groups, international oil companies should open their books and publish what they pay to governments, with the hope that this would immediately increase the pressure upon these governments to account for the uses made of the oil revenue payments.[31] In September 2002, U.K. Prime Minister Tony Blair launched the Extractive Industries Transparency Initiative (EITI), which encouraged governments, public and private companies, international organizations, and others with an interest in these industries to work together and voluntarily develop a framework to promote the transparency of payments and revenues arising from extractive natural resources.[32] Adopting the initiative's approach to promoting transparency and the prudent use of extractive revenues would help in achieving sustainable economic growth and development in countries dependent on these resources.

At Evian, in June 2003, the Group of Eight (G-8) industrialized nations expressed support for the EITI, reaffirming their commitment "to fight corruption more effectively, including a specific initiative on extractive industries." The G-8 also suggested a role for the IMF and other multilaterals. It encouraged governments and companies to disclose information on revenue flows and payments from the extractive industries to an agreed third party, such as the IMF or the World Bank. The G-8 also encouraged the IMF and the World Bank to give technical support to the governments participating in the EITI. Since its launch, the initiative has developed into a multi-stakeholder group. At the first EITI conference in London, Nigeria and São Tomé and Príncipe pledged to participate in the EITI and to publish the financial results of their next licensing rounds.

B. Current Practice

In all the countries in the group, oil sector operations lack transparency and suffer from institutional capacity constraints (Table 8). Although there are variations, in general arrangements among the treasuries, the ministries in charge of the oil sector and the NOCs, where they exist, are not clearly defined; the government institutions in charge of the oil sector lack human resources; and data provision is not adequate to allow for a comprehensive monitoring of oil revenue. Oil companies usually provide information on export liftings to ministries, and NOCs are informed automatically if they hold a working interest in a field. However, ministries in charge of the oil sector are frequently not in charge of government revenue collection and therefore do not pass on information to the finance ministries or the treasuries.

[31]See www.publishwhatyoupay.org

[32]See www.dfid.gov.uk

Box 5. Does Governance Matter?

There is now a general consensus that poor governance, corruption, and lack of transparency are major obstacles to effective policymaking, economic growth, poverty alleviation, and good economic performance generally. Promoting good governance and strengthening institutions are recognized to be urgent responsibilities of governments, aided by international, regional, and nongovernmental organizations. In view of the importance of the role of good governance and as mandated by the Interim Committee in September 1996, the IMF addresses governance issues with all member countries, including African countries, where such issues are relevant.

There are many acceptable definitions of governance. A common meaning of the term would be the act or the process of being governed. In the case of countries, governance would be the role of the government, its policies, and the diverse range of its activities and practices. If we consider only economic governance, it would involve transparency, good economic and financial management, and accountability by the state (Wolf and Gürgen, 2000).

While it is easy to agree on the desirability of good governance, we are here interested in empirical evidence linking governance to development indicators. In a recent study, Kaufmann, Kraay, and Zoido-Lobatón (1999) group governance indicators into six clusters: Voice and Accountability, Political Instability and Violence, Government Effectiveness, Regulatory Burden, Rule of Law, and Graft. Using these six clusters over a cross section of more than 150 countries, the authors produce new empirical evidence of a strong causal relationship between improved governance and three better development outcomes: per capita income, infant mortality, and increase in literacy. From these results, the authors conclude: "governance matters."

One important manifestation of poor governance is corruption. Much empirical evidence shows that corruption adversely affects growth (Wolf and Gürgen, 2000). It is a significant force inhibiting investment and discouraging foreign donors. Corruption also has costs "in terms of the deterioration in the quality of the existing infrastructure. These costs can be very high in terms of their impact on growth" (Tanzi and Davoodi, 1997). Another empirical study by Mauro (1997) presents "regression analysis to show that the amount of corruption is negatively linked to the level of investment and economic growth, that is to say, the more corruption, the less investment and the less economic growth." Corruption imposes a heavy burden on the most innovative and most productive segments of the economy—the small and medium-sized enterprises. And corruption hits the poor particularly hard since they cannot afford to pay bribes.

In sum, given the accumulating evidence of a strong correlation among good governance, economic growth, and economic welfare, good governance can be considered to be an essential building block of a country's economic success.

In some countries, different branches of the government are in charge of different types of oil revenue. In Nigeria, receipts from direct sales of crude oil are channeled through the NOC, royalties are collected by the Department of Petroleum Resources, and petroleum profit taxes are collected by the Federal Inland Revenue Service. Where there is an NOC, government oil revenue flows pass through the company accounts, and deposits in treasury accounts depend on the dividend policy of the NOC, at least for those oil fields in which the NOC has an active working interest. In fields without NOC participation, the NOC may nevertheless market the government's share of production, while the proceeds from the marketing are transferred to the treasury (e.g., in the Republic of Congo). This practice can introduce a time lag between accrual and payment of government oil revenue, which further reduces transparency in oil sector operations. Carried interest (the financing of the NOC's share in the investment costs of an oil field by other investors in the field) is another obstacle to transparency, insofar as it implies contingent liabilities that may be difficult to quantify. This situation is further complicated by financial agreements subsequently made with private oil companies. In the Republic of Congo, for instance, the liabilities of the national oil company, the SNPC, from carried interest have been subject to swapping arrangements between private oil companies and the government, through which the government has agreed to reduce its future claims on these companies in exchange for a reduction in their claims on the SNPC. The role delineation between the NOC and the treasury can easily become blurred if the NOC's dividend and investment policy is not clearly defined (as in the Republic of Congo), or if the NOC is directly involved in financing public expenditure without the funds used passing through the treasury.

Operations of foreign oil companies are audited by independent external auditors in most countries, although the auditing may not always be in line with international auditing standards. Operations of NOCs are audited only in some cases. Audits of foreign oil companies were conducted in Equatorial Guinea for the first time at end-2000, and the authorities contracted with the auditors to perform annual audits henceforth. In Gabon, audits were called for under the now-lapsed Stand-By Arrangement but were not initiated until March 2002. In addition to the independent external financial audits, a detailed operational and managerial audit was recently carried out in Cameroon. The conducting of a financial audit of the SNPC in the Republic of Congo by an independent, internationally recognized auditing firm in conformity with international auditing standards is one of the structural benchmarks under the staff-monitored program.[33] Government accounts are generally not audited, although some of the countries conduct public expenditure reviews, usually with support from the World Bank.

[33]Financial audits can play a useful role only if NOCs prepare regular financial statements, with proper coverage and based on proper accounting.

Table 8. Current Practice in Governance and Transparency

Country	National Oil Companies	Production Sharing	Bidding Rounds	Contract Transparency	Audits	Data Availability
Angola	Yes, Sonangol.	The latest generation of Angolan production-sharing agreements (PSAs) is regarded as "international best practices."	Award of new blocks, in principle, through a competitive bidding process but recent licensing rounds have not been transparent.	No.	No independent audit of Sonangol available. Tax payments by foreign oil companies are audited regularly. But audits are not made public.	Insufficient. Data on contracts, audits, net tax liability of Sonangol etc. not available.
Cameroon	Yes, Société Nationale des Hydrocarbures (SNH).	Yes.	No.	Yes.	Independent audits of SNH being conducted annually.	Under the PRGF-supported program the authorities are committed to report monthly data related to oil sector operations.
Chad	No, but the government is a partner in a joint venture with foreign oil companies that manages the export pipeline.	Yes.	No.	Yes.	Audits are to be conducted annually of oil revenue payments, of offshore accounts that receive oil payments, and of spending financed by oil revenue.	Under the PRGF-supported program the authorities are committed to report monthly data related to oil sector operations.
Republic of Congo	Yes, SNPC.	Yes.	No.	Yes.	The World Bank has offered financial and technical support for the operational audit of the petroleum sector and the SNPC. Audits have not yet been conducted.	Insufficient.

Table 8 *(concluded)*

Country	National Oil Companies	Production Sharing	Bidding Rounds	Contract Transparency	Audits	Data Availability
Equatorial Guinea	Yes, Gepetrol. Established in 2001 and expected to take working interest in any new oil projects.	A model PSA is posted on the website of the Ministry of Mining. The details of taxation are negotiated. The percentage of government oil revenue is low by international comparison.	No.	Bilateral negotiations between companies and government not transparent. PSAs remain confidential and not discussed outside small circle in Ministry of Mining and the Presidency.	Audits of oil company operations and government oil revenue payments undertaken for the first time in 2001 and reports made available to IMF staff.	Insufficient. Data on government bank deposits abroad and on oil exports and government oil revenue are not available. Also, information on borrowing against future oil revenues not transparent.
Gabon	None.	Most fields are operated under PSAs, but some older license regimes persist.	No.	No.	Audits of three smaller oil companies were completed in end-2001 while those for the two largest companies and two smaller ones were initiated and completed in September 2002.	Insufficient. There is no systematic comparison by the authorities of data available on (1) tax payments; (2) tax declaration by companies; and (3) tax obligations assessed and controlled by the Tax Department.
Nigeria	Yes, NNPC.	Used since 1991 to encourage deepwater and inland basin exploration, although production is still marginal. A standard model contract was published in 1993.	In principle, but with a lack of transparency. Some ad hoc allocation of blocks persists.	Yes.	Tax audits of oil companies seem to be ineffective. Frequency of audits of the oil sector is inadequate.	Insufficient.

Sources: Country authorities; and IMF staff analyses.

Box 6. Oil Sector Operations in Cameroon—Improvements in Transparency Under the PRGF

The national oil company (SNH) was created in 1980, under the aegis of the Secretary General at the Presidency, to receive payments from, and make payments to, oil companies for operations related to oil exploration and exploitation. The SNH is also responsible for negotiating and supervising the partnership agreements concluded with private oil companies, as well as marketing and selling the government's share of oil output and transferring oil revenue to the treasury.

Before the implementation of the Poverty Reduction and Growth Facility (PRGF)-supported program, a lack of transparency was manifested, notably by extrabudgetary government operations financed directly by the SNH, as well as tax evasion by private oil companies through tax loopholes. In recent years, the government has made noticeable progress in consolidating transparency and accountability in the sector:

- The SNH, which previously reported directly to the president of Cameroon, now transfers oil revenue to the national budget on a timely basis. An automatic transfer mechanism was worked out in December 1999 between the Ministry of Finance and the SNH, with the assistance of the World Bank and IMF staff. Under this mechanism, regular meetings are held between the technical monitoring committee for the government's program (CTS) and SNH officials to review the company's cash-flow position on the basis of actual data on production, exports, international oil prices, and exchange rates, and to agree on the timing of the transfers to the budget.

- Independent audits of the SNH have been conducted as part of the IMF-supported program since 1998 by international auditing firms. The harmonization of the accounting system of the SNH with international norms was implemented with the assistance of Ernst and Young in mid-2000. The SNH was able to produce for the first time financial statements for end-June 2001 in accordance with international accounting standards. This new accounting system will allow the company to provide accounts on a real-time basis and financial statements every six months. The government is determined to ensure that the SNH completes the installation of its upgraded financial management and accounting system in order to avoid a return to old accounting practices.

- An operational and organizational audit of the SNH has been completed, its recommendations adopted, and a reform strategy formulated in early 2001. Among the recommendations of the action plan, the government intends, by end 2002, to (1) redefine the respective roles and responsibilities of the private and public sector in the oil industry and provide a timetable for the implementation of the reform program; and (2) provide a strategy and an action plan for promoting private sector investment in the hydrocarbon sector.

Regular data on general government revenue and expenditure—including oil revenue—are available in only about half of the oil-producing countries. Most countries suffer from an insufficient follow-up of oil revenues by treasury officials, while in some countries accounts between finance ministries and NOCs are not reconciled.

C. Discussion and Recommendations

Poor governance and lack of transparency have been a major concern in oil-producing countries in sub-Saharan Africa. They are a major factor contributing to these countries' apparent inability to benefit from the ample availability of extractive resources. Indeed, such resource endowment is now often seen as a "resource curse."

Some participants in the Douala workshop felt that calls for greater transparency often did not properly acknowledge the improvements already made. Also, they cautioned against publication of information with regard to oil receipts as this could lead to spending pressures and even pose dangers to political stability. They felt that they needed to be cautious in disseminating information, so as to avoid unreasonable expectations and confusion, especially when oil revenues fall short of budgetary projections due to unforeseen events. Participants stressed the weak administrative capacity of their governments and, in particular, the lack of skills and resources in statistical agencies to provide adequate data on the oil sector. They also felt restricted by the confidentiality clauses in the existing contracts.

It will therefore be necessary to strengthen skills and resources in statistical agencies and to strengthen administrative capacity in general. In these areas, international institutions like the IMF and the World Bank can provide technical assistance. However, it is important that the governments of oil-producing countries create a more transparent environment. It is equally important that oil companies promote transparency in their transactions with the oil-exporting countries by, among other things, agreeing to reduce the requirements for confidentiality in their contracts. Governments and oil companies could therefore agree on greater transparency, as proposed under the EITI. Good governance and transparency have the potential of helping African oil-exporting countries increase revenues, which could then be used for much-needed development and poverty reduction. Ultimately, success in these countries also serves the interests of international oil companies, because it will show that they can avert the reputational and operational risks they face in these circumstances.