Transparency in

EITI transactions and reporting

The Extractive Industries Transparency Initiative (EITI) seeks to introduce transparency and accountability into dealings between companies and governments. The initiative has limited objectives: that companies should disclose their payments and benefit streams to governments, and governments should disclose their receipts from companies; the two sets of figures are independently compared and reported on. Extractive industries are characterised by a high degree of complexity in financial relationships and transactions. Mining operations, for example, may be making payments to a variety of levels of 'government', comprising perhaps royalties to local village chiefs, local taxes, regional taxes and central government taxes, concession rents, production shares, bonuses as well as contributions in cash or in kind to local community development such as road building, school running cost and healthcare. EITI guidelines provide a benchmark for disclosure, but it is up to country working groups to define what is included and excluded from the scope of their reports.

Most 'benefit flows' to the government should be included in the aggregation. A benefit is typically an in-kind transaction such as a transfer of a quantity of oil under a production sharing contract (PSC). Data collection for this kind of transaction requires specialist engineering and sector-specific production accounting skills. Physical resource flows, under the terms of PSCs can comprise equity sharing, taxation and sometimes also royalty.

Confidentiality provisions in existing legal agreements are respected by EITI, but governments and companies can agree to waive their rights.

Reporting of transactions may be aggregated or disaggregated. Disaggregated reporting puts into the public domain the transactions of each company, suitably summarised, whereas aggregated reporting provides only the total of transactions of all companies.

Chris Nurse looks at a new initiative to help countries avoid corruption by reporting their transactions with extractive companies

It seems a paradox that countries with generous natural resource endowments tend also to be those high on the list of the poorest nations. Why are countries such as Equatorial Guinea, Nigeria and Angola clumped toward the bottom of the GDP per capita statistics while they have been exploiting scarce mineral and hydrocarbon resources that command high prices on international markets?

Various explanations have been offered, including the diversion of revenues into private pockets. Poor transparency means weak accountability, which opens the door to corruption. In an attempt to improve the matter, the UK government's Department for International Development launched the Extractive Industries Transparency Initiative (EITI), which offers a framework for reporting transactions between host governments and companies developing their resources.

How does EITI work?

EITI is a voluntary initiative that has nevertheless attracted support from the World Bank, the International Monetary Fund and the United Nations and some companies; it is welcomed by the international non-governmental community and is gathering support also from governments. Institutional investors have publicly supported the initiative.

A country wishing to implement EITI establishes a working group of stakeholders, embracing companies (private and state), regulators, the media and NGOs. The group decides how the initiative will work in their country, consistent with the minimum EITI principles and criteria.

Companies and governments supporting the initiative publish on their websites statements of support for the EITI principles and criteria. A government should spell out measures it is taking to meet the criteria.

An independent organisation, which may be known as an auditor / administrator / reconciler, depending on local circumstances (referred to in this article as an administrator) is appointed to gather data and prepare a report.

resource extraction

The role of the independent professional

The administrator confirms that data provided by a paying party is in agreement with data provided by a receiving party and reports on agreement or otherwise. The role is defined by contract with the client.

Working with a multi-stakeholder group is challenging. Stakeholders have varying understandings of how extractive industries operate, and may be short on experience of financial and non-financial reporting. Strong communication skills are required.

The administrator will also formalise a professional relationship with companies that will provide transaction information, and with the government as recipient of moneys.

The aggregated approach to reporting puts the administrator in possession of confidential data from each company and from the government and requires that it be (a) cross-checked and reconciled and (b) aggregated for publication. Confidentiality agreements with each of the providing parties will be required.

The criteria require that International Standards on Auditing be applied, although at present there are no relevant auditing standards as such. Ethical standards apply. The International Framework for Assurance Engagements and ISAE 3000, *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*, published by the International Auditing and Assurance Standards Board provide some guidance and high-level principles. The ISAE 3000 guidance however is limited to an assurance engagement involving three separate parties, and ISRS 4400 applies only where the report has restricted circulation, whereas an EITI report will generally be widely circulated.

The administrator must be independent – a possible source of difficulty. Concentration within the sector and the geographical spread of multinational companies may mean that those firms with audit clients in the oil and gas sector find they have a conflict of interest. Other firms will also be constrained to decline assignments for which they lack the technical and sector expertise. This problem is particularly acute in the oil and gas sector.

The workscope may be considerably expanded beyond the minimum, as in the case of Nigeria (see box), where the multi-stakeholder group required a wide review of sector processes and management of physical production.

Information empowers

Democratic accountability depends on information. Political debate on how resource revenues are spent can only take place once trusted information on those revenues is published. EITI is about empowering civil society with information to enable them to start asking the right questions.

Some civil society organisations complain that companies do not report what they pay to governments: companies respond that they comply with financial reporting standards; governments say they cannot disclose individual payments because of confidentiality clauses. Publish What You Pay, a coalition of more than 300 NGOs worldwide, has been lobbying the International Accounting Standards Board (IASB) for mandatory disclosure of payments to governments, as part of the proposed IFRS on the extractive industries which would supersede IFRS 6; an IASB discussion paper is expected sometime in 2008. Meanwhile, financial statement disclosure is voluntary.

> Poor transparency means **weak accountability,** which opens the door to corruption

Some companies have published details of their payments to governments, either in annual reports or as part of a local social reporting document. Such disclosures do not usually carry an audit report. A company cannot easily act alone in reporting transactions without compromising its short-term commercial interests. Where, however, a country government implements EITI and all companies operating there are subject to the same rules, companies can generally participate without incurring a competitive disadvantage.

Transparency and accountability

This is a new area of work in which traditional accounting skills and experience need to be combined with a range of soft skills, for communicating and capacity building in multi-stakeholder environments and also technical skills in oil, gas and minerals extraction.

Accountants have long held that disclosure goes a long way towards satisfying accountability and demonstrating appropriate stewardship of resources, whether they be natural or financial. Financial reporting standards have largely codified how those disclosures are made, but the principle of publication remains. The transparency that EITI can engender is a powerful tool for those seeking to hold their government to account for stewardship of their resource endowment.

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Nigeria – leading the field

Nigeria determined that all reporting would be disaggregated. Its report contained detailed information on financial transactions and physical production data for the past six years.

The audit asked about amounts paid and also that were due to be paid. This radical widening of scope was seen as necessary to the credibility of the figures.

Nigeria also audited key processes of management of the oil and gas sector, revealing weaknesses in institutional capacities and sector management. An inter-ministerial team is now addressing these.

Strong political support from president Olesugun Obasanjo, a founder member of Transparency International, was essential to the success of the process, as was the drive of minister Obiageli Ezekwesili, a current TI board member. Absolute determination and professionalism has been a key success factor in the Nigerian EITI.

The audit took some 18 months to complete and required around 5,000 audit person days.