Extractive Industries Transparency Initiative
State-owned enterprises and the EITI: tackling risks through transparency

EITI Asia SOE workshop
23 November 2021

The global standard for the good governance of oil, gas and mineral resources.
The IMF on SOEs: “Bang for the taxpayer’s buck”

When governments are facing increasing demands and struggle with high debt, a core principle for state-owned enterprises is not to waste public resources. Four key IMF recommendations:

- Governments should regularly review if an enterprise is still necessary and whether it delivers value for taxpayers’ money.
- Countries need to create the right incentives for managers to perform and government agencies to properly oversee each enterprise.
- Governments also need to ensure state-owned enterprises are properly funded to achieve their economic and social mandates.
- Ensuring a fair playing field for both state-owned enterprises and private firms would have positive effects by fostering greater productivity and avoiding protectionism.
Tackling risks through transparency

Risks, disclosures and the EITI’s value add
What disclosures does the EITI require of SOEs?

SOE financial relations

Government
- Equity
- Budget transfers
- Dividends/other payments
- Transfers

Banks
- Loans
- Loan repayments

Institutional & Retail Investors
- Equity
- Dividends

State-Owned Enterprise (SOE)
- Balance sheet, income statement, cash flow statement
- Retained earnings

Extractives Projects

SOE Subsidiaries, Joint Ventures & Affiliates
- Payment for commodity purchases (to state or SOE)
- Commodity sales (including state's in-kind revenues)

Commodity Buyers
- Participating interest
- Revenues
- Equity
- Reinvestment
- Dividends
## Performance on SOE Requirements at Validation

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Diagnostic of SOEs’ financial relations

EITI Requirements 2.6 and 4.5 requires that both the rules and practice are clear:

- How SOEs manage their profits and financing.
- The flow of profits within the SOE group, between subsidiaries, JVs and affiliates.
- In which companies the state owns interests, and what terms are attached to the interests.
- What support the state and SOEs provide to extractive companies and projects.
- Procurement, sub-contracting and corporate governance.

The objective of this requirement is to ensure an effective mechanism for transparency and accountability for well-governed SOEs and state participation more broadly through a public understanding of whether SOEs’ management is undertaken in accordance with the relevant regulatory framework. This information provides the basis for continuous improvements in the SOE’s contribution to the national economy, whether financially, economically or socially.
# Common risks in SOEs’ financial relations

## Dual commercial and socio-economic mandates:
- SOEs manage sometimes competing priorities in line with their commercial imperatives and their socio-economic priorities as state-owned entities.
- Lack of clarity on the regulatory framework for SOEs’ financial relations can lead to public misunderstanding of these dual mandates and competing claims on the SOE’s resources.
- Competing mandates can create challenges in access to finance, given uncertainty on use of funds.

## High profit retention by subsidiaries, JVs, affiliates:
- Lack of clarity on the statutory financial relations within a SOE group can lead to excessive profit retention by subsidiaries, JVs and affiliates.
- Lack of clarity on the flow of profits within the SOE group can create public mistrust over the SOE’s contribution to government revenues (dividends).
- Clear rules on financial relations support better financial management.

## Challenges in benchmarking performance:
- Gaps in SOEs’ financial disclosures create challenges for benchmarking the company’s performance against peers.
- Lack of disclosures by SOE subsidiaries, JVs and affiliates can complicate the SOE leadership’s oversight of the companies’ financial management.
- Weak SOE public disclosures can reflect gaps in internal record-keeping, a common challenge for management oversight.

## Lack of clarity on return on public investment and social license to operate:
- Weak public reporting by SOEs can exacerbate the lack of clarity on SOEs’ profitability and the return on public investment.
- Lack of clarity on SOEs’ financial management can elicit questions about their commercial orientation and subsidies they provide or benefit from.
- Weak SOE disclosures can lead to greater public scepticism about their social license to operate.
In the Philippines, state-owned mining company PMDC publishes full corporate information on its website, including any subsidiaries, financial statements, and corporate governance.

In Afghanistan, the Ministry of Mines and Petroleum has established a webpage for SOEs, publishing information on both rules and practices of financial relations. This included the first ever audit of SOEs’ financial statements.
Locating EITI data in SOEs’ financial statements

- This guidance maps Requirements of the EITI Standard against conventional financial statements prepared in accordance with International Financial Reporting Standards (IFRS).
- A type of expanded glossary of financial terms and their equivalents in the EITI Standard.
- Guidance for practitioners that is complimentary to Guidance Notes on Requirements 2.6, 4.2, 4.5 & 6.2.
Diagnostic of SOEs’ commodity sales

EITI Requirement 4.2 requires that both the rules and practice are clear:

- The volumes of physical commodities collected and sold by SOEs for government.
- The value of sales and transfer of proceeds to the Treasury.
- Details of products and prices per cargo.
- Buyer selection and sales contracts.
- Coverage of swaps and resource-backed loans.

The objective of this requirement is to ensure transparency in the sale of in-kind revenues of minerals, oil and gas to allow the public to assess whether the sales values correspond to market values and ensure the traceability of the proceeds from the sale of those commodities to the national Treasury.
## Common risks in SOEs’ commodity sales

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<th>Low valuations of commodity prices:</th>
<th>Foregone revenues linked to buyer selection:</th>
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<td>- Sales of commodities that are not traded on commodity exchanges run the risk of low valuations of the commodity price.</td>
<td>- Excessive discretion in buyer selection can lead to the sale of commodities to others than highest bid.</td>
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<td>- In sales transactions that are not based on the spot market in particular, the process for assessing whether commodities were sold at fair market value can be challenging.</td>
<td>- Opacity in the beneficial ownership of buyers can create challenges in selecting qualified buyers.</td>
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<td>- Inadequate buyer selection processes can lead to the selection of buyers without sufficient technical or financial capacities to lift and market products.</td>
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<th>Weak oversight of sales terms and conditions:</th>
<th>Public mistrust over SOE’s commodity sales:</th>
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<td>- Less robust commodity sales processes can lead to the terms and condition of sales to be on unfavourable terms for the SOE.</td>
<td>- Opacity in commodity sales can lead to public mistrust of the management of sales proceeds and allegations of diversion of funds.</td>
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<td>- Weak oversight of commodity sales can lead to contravention/circumvention of sales terms and conditions by buyers.</td>
<td>- There is often a lack of public understanding of special commodity sales agreements (e.g. resource-backed loans).</td>
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<td>- Public mistrust can lead to calls for greater regulation of SOEs and, in extreme cases, the removal of commodity sales from SOEs’ mandates.</td>
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SOEs’ disclosures of commodity sales

In Iraq, the oil marketing SOE, SOMO, publishes crude oil sales volumes and values in aggregate on a monthly basis on its website, with a list of buyers.

In Nigeria, NNPC publishes cargo-level data on crude oil sales on its website, which includes volumes & values of oil sales, product type, vessel and buyer name, B/L date, invoice number, unit price, producer name and fiscal regime.
Diagnostic of SOEs’ quasi-fiscal expenditures

EITI Requirement 6.2 requires that there are reliable public disclosures of quasi-fiscal expenditures, including:

- Subsidies related to extractives (coal, gas, oil).
- Public infrastructure (roads, railways, airports).
- Social infrastructure (hospitals, schools).
- Repayment/servicing of national debt.
- Operating costs of government Ministries, Departments and Agencies.
### Common risks in SOEs’ quasi-fiscal expenditures

#### Lower profitability than private-sector peers:
- Non-commercial activities such as QFEs can lower SOEs’ profitability compared to their private-sector peers. QFEs are often undertaken at a loss for SOE.
- Quasi-fiscal expenditures tend to displace SOEs’ expenditures from other commercial activities.
- Non-commercial activities can impact the level of SOEs’ capital expenditures and lead to a reduction of growth prospects and profitability over the medium/long term.

#### Government interference in SOE management spending decisions:
- Quasi-fiscal expenditures are often made at the direction of government, reflecting political interference in the SOEs’ management.
- Government-directed expenditures can be at odds with a SOE’s business strategy.
- Government influence on SOEs can complicate access to finance, given non-commercial activities.

#### Impact on the balance in SOEs’ dual mandates:
- Excessive QFEs can tilt the delicate balance between SOEs’ commercial and socio-economic mandates.
- Lack of clarity on SOEs’ QFEs can complicate efforts to corporatize the companies and ensure they operate with a focus on profitability.
- Non-commercial activities can create confusion over the SOEs’ core mandates.

#### Public mistrust over SOEs’ non-commercial spending:
- Quasi-fiscal expenditures can lead to allegations of circumvention of Parliamentary oversight.
- Non-commercial activities can lead to unrealistic public expectations of the SOEs’ roles and mandates.
- Public mistrust of SOEs’ QFEs can lead to calls for additional regulations of SOEs compared to private-sector peers.
SOEs’ disclosures of quasi-fiscal expenditures

In Nigeria, the national oil company NNPC publishes monthly data on the value of NNPC’s ‘under-recovery’ on domestic crude oil allocations, through which NNPC is compensated for fuel subsidies not reimbursed by the Federal Budget.

In Mauritania, the state-owned mining company SNIM’s audited financial statements describe the company’s payment to the contractor for the capital’s new airport, which are reimbursed through off-sets to the SOE’s tax liabilities.

In Afghanistan, the Supreme Audit Office’s audit report on North Coal Enterprise’s 2017 financial statements raised concerns over the freeze in coal sales prices since 2008. This represents an implicit subsidy in NCE’s coal sales since 2008.

In Madagascar, the state-owned oil and gas company OMNIS covers certain international travel costs for government officials. The audit report on the financial statements raised concern over these expenditures.
SOE transparency through EITI: a tool to support national objectives

- **Domestic resource mobilisation**: Clarifying SOEs’ financial relations with the state opens up financial management of public organisations in the extractives and supports improved government revenue collection.

- **Corporate governance**: Annual diagnostic of the rules and practices related to SOEs’ financial relations provides a basis for assessing SOEs’ corporate governance. Transparency breeds accountability.

- **Anti-corruption**: Tracing the flow of extractive funds through SOEs improves accountability of revenues not transferred to the Treasury. Opening up SOEs’ commodity sales allows for public oversight of the efficiency of SOEs’ marketing, sales and financial management.

- **Investment promotion**: Clarifying SOEs’ financial management helps reduce information asymmetry and improves the credit-worthiness of SOEs and the confidence of private investors.