Reporting on In-Kind Revenues through the EITI

Background paper for the EITI Strategy Working Group

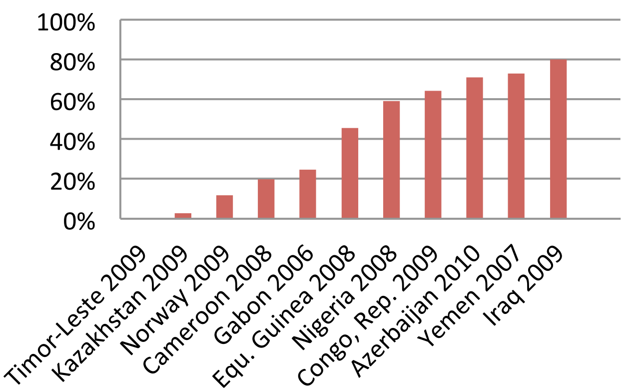
April 2012

This note discusses in-kind oil revenues, though would apply to the receipt of gas and minerals by state-owned enterprises as well.

1. The importance of in-kind revenues

The sale of crude oil by national oil companies (NOCs) generates a large share of government revenues for oil producing countries. These sales bring in over two-thirds of *total* government revenue in countries including Angola, Azerbaijan, Congo-Brazzaville, Iraq, Saudi Arabia and Yemen. Even in Norway and Mexico, with their more diversified economies, export sales equal 14 and 17 percent of the national budget. At this scale, suboptimal processes, small leakages or the unauthorized retention of funds by the NOC can impact the resources available for public goods and services.

Fig. 1. In-kind revenues as a share of total government revenues. Source: EITI reports, and IMF World Economic Outlook



The public has a direct interest in the sale of what is essentially their oil. NOCs sell oil that they own and oil that is owned by the state. This crude belongs to the nation entirely or in large part (depending on the ownership structure of the NOC), with government acting as their steward in its management.

NOCs sell oil on behalf of their nations. First, they sell oil that belongs to the government, acting as an agent of the state. The proceeds from these sales usually enter the treasury directly, though the NOC often retains a fee for its services. This oil includes the government's share of profit oil that it receives through production sharing agreements, the oil that is extracted by companies working under service contracts, or royalties that are paid by companies "in-kind" rather than with currency. Second, NOCs sell the oil that they themselves produce, or their production entitlement through their equity holding in various concessions.

Transparency would improve the governance of oil sales, netting higher returns for the nation. The strong oil-sale systems consistently maximized the selling price, and limited the use of middlemen such as commodity traders. Their NOCs were accountable and largely free from political interference. Finally they avoided production losses such as oil theft. Transparency is a practical tool for helping to realize these good practices. The disclosure of crude sale data will encourage NOCs to seek out the best price and identify optimal buyers. It will help protect their ability to make commercially (not politically) driven decision-making, and to maintain full control over production volumes.

Transparency could also improve public returns on oil sales by reducing informational asymmetries, especially between NOCs and other arms of government. Entities such as Finance Ministries often lack detailed information about oil revenues, and oil sales in particular. In a startling example, the IMF reported in late 2011 a $32 billion discrepancy in the Angolan government's accounts which stemmed from the retention and expenditure of funds by the NOC Sonangol, the majority of which are crude sales revenues.[1] Nigeria's budgeted oil revenues fell short by 39% in the first half of 2011, despite higher than anticipated prices.[2] The unilateral withholding of oil sale proceeds by the NOC, unanticipated by financial authorities, was a leading cause.

In addition to serving accountability functions, transparency could help buyers and sellers as well. Companies have identified transparency as central to their "license to operate", or the legitimacy and utility of their engagement in the countries where they work. Moreover, in an industry replete with uncertainty, transparency could offer reassurances to potential buyers, especially in unstable environments. For example, regular export sale data would inform potential buyers how regularly governments deliver on their contractual allocation commitments- a leading factor in the market's attractiveness.

2. Existing approaches to reporting on in-kind revenues

Some NOCs provide aggregate data on crude sales, usually in their annual reports. The annual reports of NOCs in Norway, Mexico and Azerbaijan provide annual sale volumes and average prices, and those in Brazil and Nigeria provides annual sale volumes. Going a step further, Iraq's oil marketing company publishes monthly volumes and sale revenues (and therefore monthly average prices) for its two main grades of crude.[3] However, even these disclosures are not thorough enough to effectively open up crude sale transactions. Significantly more information, such as loading schedules, is readily available through limited-access industry sources.

Existing EITI reports illustrate several methods for reporting on production share earnings that fall short of a useful standard:

- Azerbaijan, Cameroon and Congo-Brazzaville provide only the number of barrels that constitute their production share and in-kind revenues. Citizens do not know what the NOC did with that oil or the monetary value it generated.

[1] IMF (2011). "Angola—Fifth Review Under the Stand-By Arrangement."
[2] Nigerian Federal Ministry of Finance(2011), Budget Implementation Report, Q2.
[3] http://somooil.gov.iq/en/index.php?option=com_content&view=article&id=126:-2011&catid=44:2010-04-13-14-35-16&Itemid=18

- Yemen reports the volume of government exports and transfers to domestic refineries. The report also assigned a monetary value of the exported oil, but provides no information about what price was used. The actual sale revenues remain unknown.
- Norway reports how much the Central Bank receives from the NOC Statoil after Statoil sold the state's share of production. The sale transaction itself is not covered, nor do we know if Statoil retains a fee or other portion of the sale proceeds.
- Nigeria provides the amount of total NOC oil sale revenues, but this aggregate figure hides important information. For instance, the government sells 445,000 b/d of its crude to the NOC NNPC. The EITI report finds that through its pricing practices, "NNPC is taking advantage of its position as both buyer and agent for the seller to make a profit at the expense of the Federation [the government]."[4]The size of this advantage remains invisible because sale transactions are opaque.

Iraq is the first EITI implementing country to reconcile export sales data through the EITI. The report,[5] published in December 2011, provides the following data for 2009:

- Description of the sale process and the list of 34 buyers.
- A monthly reconciliation of volumes extracted for export that compares data from the two national oil companies, SOMO (the state oil marketing agency) and the Ministry of Oil.
- An annual reconciliation of volumes sold that compares data payment data from the buying companies with receipt data from SOMO.
- Explanation of variances in the data when possible.
- Average monthly prices and export quantities for the four main buying markets: North America, Europe, Asia and the special bilateral deal with Jordan.

This information reveals the revenue implications of policy decisions (such as decision to sell 3.6 million barrels to Jordan at a heavy discount of $18 below the Brent benchmark price), identifies the revenues that SOMO receives which can be cross-checked with oil revenues that enter the national budget, and deters manipulation of the exact same transactions that were abused during the Oil-for-Food scandal.

Best practice reporting would go several steps further. The templates used to gather data for the Iraq EITI report illustrate how this would look. They ask each buying company to report information by shipment, including: the shipment number, contract number, invoice number and data, quantity, price, loading port and data, quality of crude (API), destination, due date, settlement and vessel name. This information was not contained in the EITI report. The regular publication of this data by SOMO would represent thorough oil sale transparency.

3. The implementation of in-kind revenue reconciliations through the EITI

[4]NEITI (2012). Nigerian Extractive Industries Transparency Initiative 2006-2008 Financial Report, p. 18.
[5]http://ieiti.org.iq/uploads/English%20IEITI%20Report%2020%20Dec.%202011.pdf

Disclosures should contain enough detail to generate accountability gains. To help secure a good deal and inform citizens about the resources that government has at its disposal, disclosures of export sales would need to basic information about each cargo sold: the price, the volume, the crude's grade, and the identity of the buyer. This would permit the comparison of the actual prices paid by NOCs with the market value of the particular grade of crude at the time in question. Domestic sales would require similar treatment.[6] **Disclosures that aggregate this information would limit accountability gains as NOCs could still manipulate prices and hide how much they receive.**

Disclosure requirements should be tailored to specific environments. For example, buyers sometimes provide loans to the NOCs or government in exchange for preferential access to oil. In Angola and Congo-Brazzaville, for instance, some NOC oil is used to repay loans.[7] Only alongside the basic terms of the loan agreement would the sale data make sense.

The EITI should require a reconciliation of the sale of state oil, as the proceeds from these sales constitute revenue inflows—the core target of EITI transparency. The EITI rules should be revised to require the following reconciliation:

- Government agencies including state-owned companies report the revenues received from the sale of their production share and in-kind revenues. For each cargo sold, they will provide the price, grade, volume, date of export and identify of the buyer.
- Companies that buy crude from national oil companies should, for each cargo bought, the price, grade, volume, and date of export.

Improved reporting on financial transactions between the NOC and the treasury are an essential complement (see separate note on State Owned Enterprises).

[6] Additional information would also be needed given the complex involvement of NOCs in the administration of petroleum product subsidies or in the processing of crude oil. This brief focuses on export sales but recognizes that domestic utilization and sales requires transparency and accountable management as well.
[7] Sonangol 2010 Annual Report; https://www.cia.gov/library/publications/the-world-factbook/geos/cf.html
.