

TOR FOR A TARGETED EFFORT ON TRANSPARENCY IN COMMODITY TRADING

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Scope of the pilot

It is proposed that a pilot project on transparency in commodity trading is established to support a group of countries, where this issue is relevant, in a targeted effort to improve transparency commodity trading. All countries, where “in-kind” revenues are materials are invited to participate. This would include countries piloting innovative approaches on transparency in commodity trading that go beyond the minimum requirements.

The pilot will assist EITI implementing countries with significant commodity trading activities by the state or state-owned enterprises (SOEs) in addressing EITI requirements related to disclosure of sales of “in-kind” revenues by SOEs.

Key output of the pilot will include:

- Commodity trading reports by the pilot countries, bringing further transparency to commodity trading by SOEs;
- Model reporting templates;
- A guidance note to implementing countries on transparency in commodity trading; and
- An evaluation report on the main findings of the pilot, including lessons learnt and recommendations.

The pilot countries are expected to address reporting on the sales of in-kind revenues, including piloting reporting by the type of product, price, market and sales volume. To maximize time and cost efficiency, pilot countries are encouraged to include these disclosures as a chapter in their forthcoming EITI reports. Where the timetables for the pilot and the forthcoming EITI Report are not aligned, pilot countries may decide to produce a dedicated commodity trading report.

Activities within the scope of the pilot will include:

- (i) gaining a good understanding of the mandate of the government agency or SOE in selling commodities on behalf of the state;
- (ii) identifying the key actors and transactions involved in commodity trading;
- (iii) developing a framework for disclosure of timely and reliable information on the sales of “in-kind” revenues by SOEs;
- (iv) ensuring adequate reporting in accordance with the relevant EITI requirements (Requirement 4.2¹);

¹ Other EITI Requirements applicable to SOEs include EITI Requirement 2.6 State participation, 4.5 transaction related to SOEs and 6.2 quasi fiscal expenditure.

- (v) facilitating peer learning and promoting disclosure of EITI in user friendly formats;
- (vi) promoting innovative approaches beyond the EITI's minimum disclosure requirements on revenues from the sale of the state's share of production, to include reporting by product, price, market and sales volumes, as well as potentially reconciling such data with data reported by buying companies.

Deliverables from pilot countries

Pilot countries are expected to:

1. Produce an inception report, determining the scope and methodology of reporting on commodity trading, documented in an inception report.

The inception report should include:

- a. A definition of SOEs consistent with Requirement² 2.6 a;
- b. A definition of what constitute "in-kind" revenues³;
- c. A brief overview of the SOE's and/or other government agencies' mandate in collecting "in-kind" revenues on behalf of the government;
- d. A statement of materiality confirming the MSG decision with regards to the sale of the state's share of production or other revenues collected "in-kind";
- e. A statement of the scope of the report and level of disaggregation which should include reporting by type of product, price, market and sales volumes by cargo or shipment. The MSG should also decide whether the report should include monthly, quarterly or annual figures.
- f. A description of the agreed quality assurance procedures for the information to be disclosed. Where practically feasible, the multi-stakeholder group is encouraged to task the Independent Administrator with reconciling the volumes sold and revenues received by including the buying companies in the reporting process; and
- g. Reporting templates reflecting the scope agreed by the MSG.

² For the purpose of EITI reporting, a state-owned enterprise (SOE) is a wholly or majority government-owned company that is engaged in extractive activities on behalf of the government. Based on this, the multi-stakeholder group is encouraged to discuss and document its definition of SOEs taking into account national laws and government structures. (Requirement 2.6.b)

³ In some cases, majority state-owned companies undertake their own commercial activities, within or outside their country of origin. The MSG may decide to treat this production separately from "in-kind" revenues.

2. Produce a commodity trading report, or commodity trading chapter as part of the EITI Report

In producing the report, the MSG should follow the steps outlined in phase 2-5 of the standard Terms of Reference for Independent Administrators for the production of EITI Reports⁴, i.e.:

- a) Data collection (phase 2). The purpose of the second phase of work is to distribute reporting templates and collect the data on commodity trading in accordance with the scope confirmed in the Inception Report.
- b) Initial reconciliation and data compilation (phase 3). The purpose of this phase is to complete an initial compilation, analysis and reconciliation of the commodity trading information with a view to identify any gaps or discrepancies to be further investigated.
- c) Investigation of discrepancies and draft report (phase 4). The purpose of this phase is to investigate any discrepancies identified in the initial reconciliation, and to produce a draft EITI Report that compiles the commodity trading information, reconciles financial data, explains any discrepancies and presents recommendations related to commodity trading.
- d) Preparation of a final report and dissemination of main findings (phase 5). The purpose of this phase is to ensure that any comments by the MSG on the draft report have been considered and incorporated in the final report.

3. Evaluate the findings of the commodity trading report

The MSG is expected to produce a brief evaluation note, documenting the key findings and recommendations of the commodity trading report and next steps in terms of addressing the recommendations.

Time schedule

Pilot countries are expected to include a timetable for the pilot in the inception report, reflecting the agreed methodology for data collection and the schedule for the forthcoming EITI reporting cycle.

Invitation to participate in the pilot	No later than 30 June 2016
Submission of inception reports by pilot countries	No later than 31 July 2016.
Analysis, review and publication of a final report	No later than 31 December 2016
Publication of evaluation note	31 January 2017
Review and publication of the outcome of the Pilots by the EITI international Secretariat	No later than 28 February 2017

⁴ <https://eiti.org/guidance-notes-and-standard-terms-reference#ToRIA>

Production of a guidance note	No later than 31 March 2017
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Technical and financial assistance

The International Secretariat will support pilot countries to gain a good understanding of the reporting requirements, provide comments on inception reports, including definition of materiality and reporting templates, and draft reports. In collaboration with DFID and SECO, the International Secretariat will provide the following support to countries participating in the pilot:

1. Training for MSG members and staff at National Secretariats on commodity trading.
2. Technical assistance to EITI National Coordinator as needed.
3. Review and comments on draft reporting templates, scoping notes and draft reports.
4. Guidance on addressing barriers to disclosures.

Pilot countries that require technical and/or financial assistance to carry out the pilot are requested to contact the International Secretariat.

Background

Estimates of oil reserves controlled by State Owned Enterprises (SOEs)⁵ vary from 80 to 90 percent of the world's oil reserves. SOEs also control three quarters of the world total output of crude oil. Of the top 25 oil and gas reserves holders and producers, 18 are state owned. In addition, an estimated 60 percent of the world's undiscovered reserves lie in countries where SOEs have privileged or exclusive access. Production of natural gas is equally controlled by SOEs. Similar to the oil and gas sector, governments often use state owned mining companies to develop its mining sectors including managing exploration activities, issuing licenses, holding equity stakes and undertake commercial activities. Some SOEs in the mining sector also act simultaneously as commercial operators, holders of government equity stakes, regulators and providers of social goods and services like subsidised oil products.

EITI Reports have shown that these SOEs play an important role in producing, transporting, refining and selling oil, gas and minerals on behalf of their governments. Many governments of resource rich countries not only derive the largest share of their revenues from their extractive sector, but also much of these revenues are often received "in-kind" rather than as cash payments. These physical revenues can occur because the state or state owned entity operates or owns shares in a producing license, through the production-sharing agreements, or when companies make payments such as royalties with physical commodities rather than money. The state or the SOE then sells these physical resources and transfer the proceeds to the governments. Crude oil is the most common form of "in-

⁵ National oil companies and value creation/Silvana Tordo with Brandon S. Tracy and Noora Arfaa, World Bank working paper; no. 218, 2011, <http://siteresources.worldbank.org/INTOGMC/Resources/9780821388310.pdf>

kind” revenues, followed by natural gas and precious metals such as gold. Although less common in the mining sector, some SOEs also sell minerals and metals on behalf of their governments.

Given the importance of the resources involved, the high risks associated with management of state assets and complexity of the transactions, this pilot project will support implementing countries, where commodity trading is relevant, to address the pertinent requirements. It seeks to shed light on the sales of “in-kind” revenues, by encouraging consistent and extensive reporting on commodity trading and sharing of best practices. Transparency in commodity trading including information on the parties in the transaction and the factors influencing the sales is important in providing a full picture of the government’s revenues and management of natural resources. This document sets out what is expected of countries participating in the pilot project, provides guidance and examples of reporting templates for disclosure of sales of “in-kind” revenues, and outlines the technical assistance offered by the International Secretariat to pilot countries.

With 51 implementing countries, the EITI has emerged as a practical, flexible and cost-effective tool to bring about transparency and accountability in the management of natural resources. While recognising that the management of natural resource wealth for the benefit of a country’s citizens is in the domain of sovereign governments, EITI principles and requirements seek to bring high standards of transparency and accountability in public life, government operations and in business⁶ along the entire value chain of extractive industries.

The EITI Standard includes provisions requiring disclosure of the sales of the state’s share of production and other ‘in-kind’ revenues (EITI Requirement 4.2):

“Where the sale of the state’s share of production or other revenues collected in-kind is material, the government, including state owned enterprises, are required to disclose the volumes sold and revenues received.”

According to this requirement, all material commodity sales by SOEs or other government agencies related to the government’s share of production or other revenues collected in kind must be disclosed in the EITI Report, including exports sales as well as sales to domestic buyers and refineries. This typically means that state-owned enterprises (SOEs) will disclose the volumes of commodities sold and the revenues received, broken down by buying company. In some countries, like Iraq, the buyers of the oil from the government also disclose how much they pay to the government, allowing an Independent Administrator⁷ to reconcile these figures in EITI reports⁷.

Implementation of this requirement has been particularly challenging for many multi-stakeholder groups tasked with the mandate to implement the EITI in their respective countries. A review by the International Secretariat showed that commodity trading is relevant in at least 17 EITI implementing countries. A review of EITI reports published by 31 December 2015 also found that many EITI implementing countries where “in-kind” revenues were material did not adequately address this

⁶ EITI Principles 2 and 9; EITI requirements 2, 3, 4, 5, and 6, in the EITI Standard, https://eiti.org/files/english_eiti_standard_0.pdf

⁷ See Iraq’s 2013 EITI Report, in which USD 80 billion of government revenues were reconciled on the EITI website <https://eiti.org/report/iraq/2013>

requirement. Some MSGs struggled to establish whether “in-kind” revenues were material. Others grappled with complex transactions between SOEs and commodity buyers, including crude swaps between SOEs, commodity traders and oil refineries. Implementation of the relevant requirements to commodity trading was uneven across countries, with varied levels of disclosure and disaggregation of data that was often not commensurate with other form of payments. In the revised Standard published in February 2016, the Board clarified the language on the level of disaggregation and required that information about the sales of “in-kind” revenues be broken down by buyer.

Box 1: EITI Requirement 4.2

4.2 Sale of the state’s share of production or other revenues collected in-kind.

Where the sale of the state’s share of production or other revenues collected in-kind is material, the government, including state-owned enterprises, are required to disclose the volumes sold and revenues received. The published data must be disaggregated by individual buying company and to levels commensurate with the reporting of other payments and revenue streams (4.7). Reporting could also break down disclosures by the type of product, price, market and sale volume. Where practically feasible, the multi-stakeholder group is encouraged to task the Independent Administrator with reconciling the volumes sold and revenues received by including the buying companies in the reporting process.

In collaboration with the Swiss government, the EITI International Secretariat convened a meeting with commodity trading companies in Berne in October 2015. Participants at this meeting agreed to establish a working group that will assist the EITI with the implementation of the requirements related to commodity trading. The working group on transparency in commodity trading met in London in January 2016 and agreed to support pilot projects in a select group of countries for the implementation of EITI requirements applicable to commodity trading. This would include countries piloting more extensive reporting on commodity trading, such as providing details on price, markets, sales volumes etc.