

# Making it add up



A constructive critique of the EITI  
Reporting Guidelines and Source Book



## Is the EITI Adding Up?

Since its inception in 2003, the Extractive Industries Transparency Initiative (EITI) has recorded some important achievements. There is now extensive international awareness that transparency of oil, gas and mining revenues is vital to prevent corruption in countries that depend on resource revenues, and to ensure that these revenues are used to promote growth and development.

There is also broad acceptance of the EITI's central concept that extractive companies should publish what they pay to the government of each country where they operate, and governments should publish their receipts of these revenues. The EITI has brought together companies, investors, governments, civil society groups and international institutions to promote this shared aim, which is in the enlightened self-interest of all. Several countries have already begun implementing the EITI principles in a way which brings credit to their governments and citizens.

However, the success of the EITI as a concept is increasingly threatened by the lack of clarity about what it means in practice. The criteria for EITI reporting are "understandability, relevance, reliability, comparability and consistency." If EITI is to be a credible international benchmark for measuring the governance of oil, gas and mining revenues in different countries, then the guidance in the EITI Reporting Guidelines and the draft EITI Source Book must meet these criteria. Unfortunately, it does not.

At present there is no way for EITI stakeholders to tell who is truly implementing the EITI in letter and spirit, and who is merely going through the motions. As a result, countries and companies which are genuinely implementing EITI may not get the credit they deserve for improved governance, while free-riders will be able to claim participation in EITI as a way of evading international pressure to curb corruption. This problem has already emerged in several countries.

Nearly two years after the inception of EITI, there is still no clear benchmark for what it

means to implement the EITI Principles, a benchmark which countries can refer to when designing their own initiatives, and which can be used by citizens, investors and others to compare one country or company with another. The benchmark needs to include the following seven elements:

1. companies in each country publish all their payments to government, in a full and timely manner which allows for meaningful comparison;
2. governments publish their receipts of these payments, in the same manner;
3. the data from both parties is independently verified and the results published;
4. there is a transparent mechanism for resolving any discrepancies in the data and, if necessary, taking action against those responsible;
5. that data published be readily and freely accessible to citizens;
6. state fiscal agents which handle resource revenues (like national oil companies) are independently audited and the results published;
7. citizens and civil society groups play an active part in and help to oversee all stages of EITI implementation.

Save the Children and Global Witness asked Richard Murphy, an independent chartered accountant, to analyse the Reporting Guidelines and the EITI Source Book and assess whether or not they provide a clear model for implementation. His conclusion is that they do not. His report reveals major flaws, inconsistencies and opt-outs which, we fear, could allow a country or company to claim to be implementing EITI without providing anything like a clear picture of revenue flows.

The report makes recommendations which, if adopted, would greatly strengthen the EITI. If these recommendations are not adopted, EITI's credibility will be put at risk, and the original aims endorsed by its stakeholders from government, industry and civil society will not be achieved.

### Recommendations

The recommendations in this section concern the issues that we perceive to be of greatest concern either in the EITI Source Book (SB) or in the Draft Reporting Guidelines (RG).

Each recommendation is offered in the following format:

The issue	A brief summary of what the issue is.
Our concern	Why we think the issue is important.
Who it affects, and why	A summary of the parties about whom we're concerned.
Recommendation	What we think should be done about it.
Cost impact	A rough and ready assessment of the cost implication of the recommendation.

### Recommendation 1

### Clarity in focus

The issue	<p>The EITI has a national focus. It is about transparency within individual countries. But it:</p> <ul style="list-style-type: none"><li>• is also about an issue that faces many nations;</li><li>• is an international initiative;</li><li>• is about an international industry;</li><li>• requires international comparisons.</li></ul> <p>There is an inherent conflict within the EITI. Is it to have a national or an international focus?</p>
Our concern	<p>We do not think this issue has been resolved by the new EITI source book. This allows national choice on:</p> <ul style="list-style-type: none"><li>• reporting templates (SB10);</li><li>• benefit streams to be reported (SB10);</li><li>• whether to audit, or not (SB10);</li><li>• whether reporting is mandatory (SB10);</li><li>• accounting policies (SB10);</li><li>• materiality levels (SB11);</li><li>• what to publish, and how (SB11).</li></ul> <p>We believe that:</p> <ul style="list-style-type: none"><li>• the EITI is an international initiative;</li><li>• that if it is to be effective the EITI requires consistent accounting;</li><li>• consistent accounting requires consistent standards to apply in all nation states that adopt the EITI;</li><li>• consistent standards with sufficient room for adaptation to local circumstance are now normal e.g. International Financial Reporting Standards for the private sector and the IMF's ROSC project<sup>1</sup> for the fiscal sector;</li><li>• a consistent standard does not allow local negotiation on key issues of what is, in effect, an accounting standard.</li></ul>
Who it affects, and why	<p>This issue affects all users of EITI reports and those who produce them since a consistent basis of preparation would:</p>

- make the EITI Source Book clearer;
- make assessment of compliance more straightforward;
- prevent abuse of the EITI “brand”;
- assist production of standard materials;
- encourage the creation of transferable expertise;
- set a single standard for transparency;
- reduce implementation cost;
- speed the process of implementation;
- greatly assist private sector reporting entities by having to generate just one type of report for all countries in which they operate, so encouraging participation;
- ease comparability of data produced;
- enhance the quality of reporting;
- promote understanding.

Recommendation

We believe this issue is central to the future of the EITI. We are committed to the EITI principles. We believe they can be best effected by setting clear standards on:

- who should report;
- what should be reported;
- how it should be reported;
- where it should be reported;
- what accounting procedures should be adopted;
- what verification procedures should be applied.

All our other recommendations in this report build on this foundation.

Cost impact

We are convinced that adoption of this recommendation would result in substantial cost savings for:

1. the EITI Secretariat by setting one standard, and only having that one standard to monitor;
2. adopting countries, who can adopt most of a system for immediate use with only minor modification required;
3. private and public sector reporting entities, especially those of an international nature who would only have to use one system, and not many as the current proposals would require;
4. aggregators, who could adopt standard systems;
5. auditors, who value consistency and comparability as part of their work.

## Recommendation 2

### Who should report

The issue

The EITI allows local decisions to be made on who should report benefit streams (SB10 D1a1).

Our concern

To be effective the EITI needs all benefit streams flowing to a host government to be reported. As soon as opt outs are allowed the value of any reporting is substantially reduced and may be completely undermined.

Who it affects, and why

Users of the EITI reports who want to know that the information they receive is to be understandable, relevant, reliable, comparable and consistent.

Recommendation	<p>We believe that:</p> <ul style="list-style-type: none"><li>• all participants in the EI in the host country should be required to report the benefit streams they remit to the host government and its agents;</li><li>• all government entities involved in the EI should be required to report their benefit streams (SB 22);</li><li>• an entity should be exempted from reporting only if it can show with a high degree of certainty that the amounts that it would report would in any event be immaterial as defined by a standard set internationally to prevent local abuse;</li><li>• exemption from publication of data submitted by a Reporting Entity should only be allowed below a similarly internationally agreed sum and exemption from publication should never be allowed if discrepancies have arisen on payments made by the Reporting Entity.</li></ul>
Cost impact	<p>Mandatory reporting will increase cost by including all participants, including small ones, but the benefit of completeness will be greater than the cost.</p>

### Recommendation 3 Benefit streams

The issue	<p>The Draft EITI Source Book allows local decisions to be made on which benefit streams should be reported (SB10 D1i).</p>
Our concern	<p>To ensure international comparability it is essential that agreement be reached on an international basis as to which benefit streams should be reported, and how. Any national opt out will effectively destroy any chance of comparability. The option to change the benefit streams reported might eliminate the possibility of comparability being possible over time within any one host country.</p>
Who it affects, and why	<p>Users of the EITI reports who want to know that the information they receive is to be understandable, relevant, reliable, comparable and consistent.</p>
Recommendation	<p>All reporting entities affected by the EITI should be required to report on all benefit streams which they transact with a host government.</p> <p>Technical guidance on preferred approaches to issues such as those raised in the Draft Source Book (SB 20) to ensure consistency.</p> <p>Materiality limits should be set internationally rather than nationally. (SB 20).</p>
Cost impact	<p>This recommendation has an initial cost impact in terms of data collection for the reporting entity. However, since most reporting entities will be international companies the saving resulting from consistency may well offset any initial additional costs.</p>

### Recommendation 4 Disaggregation

The issue	<p>The EITI Draft Source Book makes clear that a decision can be</p>
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made nationally on whether disclosure of government and company data should be on an aggregated or disaggregated basis (SB 11 D3i).

Aggregated data means that the information from all sources of a similar type, e.g. companies submitting information, are added together before publication. Disaggregated data means that when the information is published the information provided by each Reporting Entity is shown separately.

Our concern

We note that the same Source Book says “Benefits to companies and investors centre on mitigating political and reputational risks. Transparency of payments made to a government can also help to demonstrate the contribution that their investment makes to a country”. (SB 3)

In addition the same Source Book requires under its disclosure heading that discrepancies and inconsistencies be dealt with (SB 11 D2). This can only happen at a disaggregated level. The publication of meaningful information on irreconcilable differences (which are a foreseeable outcome of the work) must, therefore, require the use of disaggregated data.

Who it affects, and why

Users of the published information need to have access to disaggregated data to determine:

- what problems are arising;
- which parties are involved;
- whether those same parties are involved in similar problems elsewhere;
- whether progress in eliminating problems between parties is occurring over time.

Recommendation

Disaggregated data must be used as part of EITI reporting and the aggregated option should not be used.

We note the IMF appears to share this view.<sup>2</sup> There is also strong evidence from some of those countries implementing the EITI such as Azerbaijan, Nigeria and Sao Tome & Principe share this view.

Cost impact

Limited. Disaggregated data has to be used to produce EITI reports in any event and reconciliation has to take place on a disaggregated basis.

## Recommendation 5

### Accounting Policies

The issue

The EITI recommends the use of a cash basis of accounting. We accept the practicality of this recommendation but note that:

- the Draft Reporting Guidelines suggest different transaction recognition dates for payments and receipts since their entry on bank statements is unlikely to be simultaneous (RG 14 7.1);
- the Draft Reporting Guidelines suggest reporting on the basis of bank statement cleared dates, which is a basis neither governments or commercial entities use for accounting purposes (RG 14 7.1);
- the use of a cash basis means that the information supplied by international companies will not be reconcilable with the

information included in companies' own financial statements, even if produced under International Financial Reporting Standards as recommended by the IMF<sup>3</sup>.

### Our concern

The first of these issues is a fundamental accounting problem. Reconciliation between receipts and payments can only occur if consistent dates are used.

The second issue will impose considerable additional costs on both governments and other reporting entities who would have to fundamentally change their methods of accounting for these transactions and collect significant additional information to meet this requirement for little apparent benefit.

The third issue is of substantial significance. The verification of data is vital to the credibility of reporting within the EITI. If payments reported by international companies and national state owned companies cannot be reconciled with their published financial statements the credibility of that data will be open to question.

### Who it affects, and why

The first two concerns materially affect producers of reporting templates and will substantially increase their costs of doing so unless modified. Unless transaction recognition dates are changed the cost of the aggregation and reconciliation process is likely to be inflated.

The third issue is of concern to all users of EITI data. Host governments, administrators and aggregators will wish to ensure they have been supplied with reliable data. Auditors will have a similar concern. International companies will wish to demonstrate their commitment to the process by reconciling their declared payments with their accounts to make clear sound governance is in place. Users will want an assurance that publicly available data can be reconciled as evidence of the credibility of the EITI process.

### Recommendation

The first two issues are addressed by the following recommendation:

1. that transaction flows be recognised on:
  - a. the date of physical supply in the case of production entitlements;
  - b. the date on which the reporting entity initiating the benefit stream records the cash payment.
2. International and national state owned companies should be required to provide a reconciliation statement as part of their reporting template which reconciles the cash payments made with reporting in their published or unpublished financial statements of:
  - a. opening and closing taxation and related liabilities;
  - b. taxation charges recorded in the profit and loss account or other reserves statement;
  - c. cash flow

and these reconciliations should be published as part of EITI reporting.

### Cost impact

The first recommendation should result in substantial cost

savings for all parties.

The second recommendation will have limited cost for the reporting entities involved as they will have all such information available within their accounting systems and should be verifying the accuracy of the reporting they make by undertaking such reconciliation in any event.

## Recommendation 6

### Currency

The issue

The Draft Source Book suggests that for mineral reporting national currencies be used and that for oil and gas reporting US Dollars should be used.

Our concern

There are several reasons why information in the currency of the Host Country might be always be useful:

1. the transactions which require reconciliation may actually be settled in the currency of the Host Country. If that is the case it makes sense to report in that currency as the reconciliation process will be substantially eased in that case;
2. a major stakeholder group for the data to be published are the resident population of the Host Country. US Dollar information may be alien to them; national currency information may be comprehensible;
3. the US Dollar is now a volatile currency. At a time when oil prices are also volatile it makes little sense to report Host Country government revenues in a currency which may not be used for their settlement and therefore add an unnecessary extra variable into the process, so obscuring national level comparison and consistency over time.

For these reasons there must be serious doubts about whether the dollar is the only appropriate currency for reporting.

Who it affects, and why

The Aggregator who has the responsibility for matching transactions, in countries where an aggregator is used, and all users of the published EITI data who want both national and international comparability of data.

Recommendation

That EITI information be published for both the mineral and oil and gas sectors simultaneously in both the national currency of the Host Country and US Dollars.

Cost impact

Marginal. Translation costs when data has been produced will be small.

## Recommendation 7

### Verification is essential

The issue

The Draft Source Book adds additional uncertainty with regard to the processes to be used to produce EITI data. This is because the term “administrator” appears to have replaced the word “aggregator” but the term “aggregating body” has been retained. It is not clear what is now expected of this body, or where its limits of responsibility might be, especially as audit appears to be optional (SB 10 C a 2).



Our concern	<p>Serious governance concerns are not being addressed. It is not clear:</p> <ul style="list-style-type: none"><li>• who is responsible for the work of the administrator;</li><li>• to whom they report;</li><li>• how their independence is guaranteed;</li><li>• what responsibility they have for the final reports produced, especially if these are unaudited.</li></ul> <p>It is also noted that the administrator may be an audit firm (SB 17). This is confusing when there is now international acceptance that it is inappropriate for an auditor to both prepare accounting data and audit it. The language of the Source Book appears in this respect to run counter to current levels of expectation of corporate governance.</p>
Who it affects, and why	<p>Without clarity in procedure transparency of outcome cannot be guaranteed for the EITI process. The absence of clearly delineated responsibilities for the administrator and aggregating bodies will lead to widespread confusion and variance in practice. This will have consequences for:</p> <ul style="list-style-type: none"><li>• those seeking to negotiate adoption of the EITI;</li><li>• the EITI secretariat in seeking to monitor its use;</li><li>• those who wish the EITI process to be as independent of government interference as possible;</li><li>• those who wish to know that the highest levels of corporate governance procedure are in use.</li></ul>
Recommendation	<p>We remain concerned about the principle of aggregation. We therefore welcome the use of the term Administrator which removes the implication that aggregation is necessary. We therefore suggest that the term Aggregating Body be removed from the SB and RG. We suggest the term Administrative Body be used in its place.</p> <p>We believe that clear guidelines on acceptable terms and conditions under which an Administrative Body may operate under the supervision of an Administrator should be published.</p> <p>In our opinion anyone responsible for auditing EITI data should not be able to act as Administrator or as the Administrative Body.</p>
Cost impact	<p>Savings should arise from the elimination of possible confusion.</p>

## Recommendation 8

### Audit is a necessity

The issue	<p>The Draft Source Book appears to suggest audit of EITI data is optional (SB 10 C a 2).</p>
Our concern	<p>Verification of the published data by audit scrutiny and reporting is vital to its credibility.</p> <p>We note that the IMF and OECD appear to share this opinion with regard to financial data<sup>4</sup>.</p>
Who it affects, and why	<p>All stakeholders to the EITI process will benefit by having the published data accepted as creditable.</p>

Recommendation	<p>That all EITI reports be audited by a party or firm approved as suitable for that purpose by the EITI Secretariat and who can demonstrate themselves to be sufficiently independent of the Reporting Entities within the Host Country. That auditor shall:</p> <ul style="list-style-type: none"> <li>• report to the EITI Secretariat;</li> <li>• be remunerated by the Host Government;</li> <li>• draw attention to all material discrepancies arising in the course of their work and shall :             <ul style="list-style-type: none"> <li>○ quantify those discrepancies;</li> <li>○ name the parties involved;</li> <li>○ ensure any reasonable representations the parties to the discrepancy wish to make are published;</li> <li>○ otherwise confirm that the data they have examined supports the information published;</li> <li>○ that the information published gives a true and fair view of the benefit streams arising, and their source.</li> </ul> </li> </ul>
Cost impact	<p>Audit has a cost. Savings made elsewhere as a result of the recommendations made should more than cover the cost of auditing.</p>

## Recommendation 9      Clarity on Publication

The issue	<p>No guidance has been provided on the form of the reports to be published as a result of the EITI process. Nor is guidance given on the acceptable levels of publicity to be given to EITI reports.</p>
Our concern	<p>Without guidance being provided a significant amount of time and effort will be expended by many people in many countries to generate reports, all of which will be incompatible one with another, therefore ensuring that the sought for understandability, relevance, reliability, comparability and consistency will be lost.</p> <p>Unless guidance is given on the degree of publicity required to be given to EITI reports that information will not be freely and widely available to all EITI stakeholders, and especially the citizens of the country about which the report is made.</p>
Who it affects, and why	<p>All parties to the EITI process are affected by this failure. Much time, effort and expenditure will be wasted in creating national arrangements which could be saved if guidance was given. All users will benefit from a consistency of approach. Without such consistency much of the benefit of the EITI will be lost. Without widespread publicity transparency will not be achieved.</p>
Recommendation	<p>Clear guidance should be published on the required style and content of EITI reports. Similarly, guidance on the degree of publicity required should be given. Limited national variation should be allowed where this is necessary to suit national circumstance or to ensure a true and fair view is provided, but any such variation in practice should always be explained.</p>
Cost impact	<p>Substantial cost and time savings should result from use of consistent formats.</p>

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<sup>1</sup> The IMF has promoted fiscal transparency in member countries through fiscal Reports on the Observance of Standards and Codes

<sup>2</sup> IMF Draft Guide on Resource Revenue Transparency, p22

<sup>3</sup> *ibid*, p61

<sup>4</sup> *ibid*, p61