



RESOURCE REVENUE TRANSPARENCY

**A Project Brief for the
International Public Sector Accounting Standards Board**

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RESOURCE REVENUE TRANSPARENCY

Scope of the Issue

Changes to international accounting standards for governments so that natural resource revenues received by them are more easily verifiable by parliaments and other users of public accounts.

Definition of the Problem

"Corruption hurts the poor disproportionately by diverting funds intended for development, undermining a government's ability to provide basic services, feeding inequality and injustice, and discouraging foreign investment and aid".

Kofi Annan, then United Nations Secretary-General
in his statement on the adoption by the General Assembly of the
United Nations Convention against Corruption, 2003

Corruption is the abuse of power for private gain. It has become a leading concern for parliamentarians around the globe. The diversion of public funds robs public policies of resources to do the good they were intended to finance. It undermines parliamentary control of the public purse. It thrives when accountability and transparency are weak or absent.

And it can have substantial economic costs. According to the World Bank, "while the economic costs of corruption are difficult to measure, some studies suggest that its costs would include:

- An additional 3-10 percent increase for the price of a given transaction to speed up the delivery of a government service.
- Inflated prices for goods by as much as 15-20 percent.
- Diverted tax revenues that can cost the government as much as 50 percent of its tax revenues."

Curbing Corruption: Toward a Model for Building National Integrity
Edited by Rick Staphenurst, Sahr Kpundeh
World Bank, 1999

Countries dependent upon natural resource revenues can be particularly vulnerable to corruption. For example, "the [Nigerian] anti-corruption commission estimates that some \$380 billion of oil money was stolen or squandered between 1960 and [...] 1999. That is equivalent to about five years of national output. It is as if America's leaders had walked off with, say, \$50 trillion."

Oil and Democracy Don't Mix Well
Robert Guest

The Wall Street Journal, May 1, 2007

As a result, in recent years many international organizations have been working towards increasing transparency in regards to extractive industries payments to national governments. In countries where public transparency and parliamentary oversight are weak, such large flow of funds are an attractive potential source of funds to corrupt senior officials. Knowing both what companies pay and what governments receive is a critical first step to holding governments to account for these revenues.

For example,

- We emphasise our determination to fight corruption and mismanagement of public resources in both revenue raising and expenditures. Transparency inhibits corruption and promotes good governance. Increased transparency of government revenue and expenditure flows, as well as strengthened enforcement efforts against bribery and corruption, will contribute to achieving these goals and to increasing integrity in government decision-making - thereby ensuring that resources, including development assistance, achieve their intended purposes.

Fighting Corruption and Improving Transparency: A G8 Declaration, 2003

- In many countries, money from oil, gas and mining is associated with poverty, conflict and corruption. Commonly referred to as the “resource curse”, this is often driven by a lack of transparency and accountability around the payments that companies are making to governments, and the revenues that governments are receiving from those companies.

Extractive Industries Transparency Initiative, 2005

- Given the[se] potentially substantial costs of non-transparent practices, institutional strengthening to improve transparency in vulnerable resource-rich countries should provide an ample pay-off for a relatively modest investment. Many analysts have emphasized the essential role played by fiscal transparency in improving resource revenue management.

International Monetary Fund, Guide to Resource Revenue Transparency,
2005

- As institutional investors representing US\$12.3 trillion we actively support the development of international mechanisms to address payments transparency, and encourage other investors to join us in this statement.

Investors' Statement on Transparency in the Extractives Sector
October 2006

Analysis of Existing Practices that Illustrate the Issues

Abuse of power for personal gain can occur in both the public and private domains and often in collusion with individuals from both sectors. Resource extraction and the revenues they provide present a particular challenge.

- Many countries are rich in oil, gas, and minerals and studies have shown that when governance is good, these can generate large revenues to foster economic growth and reduce poverty. However when governance is weak, they may instead cause poverty, corruption, and conflict – the so called “resource curse”. Ensuring that revenues from natural resources make it into government coffers for needed public sector expenditure is key to reducing poverty, promoting democracy and reducing the risk of conflict.
- The high-risk, high cost and uncertain nature of exploration, coupled with a long gestation before profits are realised and the finite nature of resources, makes financial management of the sector difficult. Companies investing large amounts in natural resource extraction need to be assured of a stable, reliable environment for their investments. At the same time, the fiscal regime covering these projects is generally complex, and often leaves significant scope for discretionary arrangements in individual agreements. Payments can easily be hidden.

At its Second Global Conference, GOPAC members acknowledged that in many jurisdictions the large amount of money received by governments from natural resources royalties does not find its way into the public finances. GOPAC undertook as a first step to seek to ensure that government financial accounting standards require that all such revenues be documented and reported as part of annual financial reports of government (see Annex 1).

This was seen as a useful complement to the voluntary business-oriented *Publish What You Pay*, *Extractive Industries Transparency Initiative* and other efforts which focus on transparency at the level of individual companies and individual projects. But the latter initiatives deal with only one side of the balance sheet.

Publish What You Pay is right when they say that “revenue transparency means that:

- Companies extracting resources publish what they pay to the government (taxes, fees, royalties, signature bonuses etc.)
- The government publishes what it receives from the companies, and
- Information is audited and discrepancies investigated and reconciled

so that ordinary citizens can track the money from their natural resources into the national budget and government reserves. If citizens do not know how much money their government is receiving and how it is being spent in the budget, there is no way of knowing whether the money is being properly used or not. In this circumstance, trust in the government is weakened and corruption by officials is made much easier.”

Standards, by enhancing the quality and transparency of public sector financial reporting, strengthen public confidence in public sector financial management. Many countries are in the process of adopting International Public Sector Accounting Standards or are applying standards consistent with them. They look to the Board for guidance on significant issues.

Why Should the Board Approve this Project?

The Board is the international body that focuses on the accounting and financial reporting needs of national, regional and local governments, related governmental agencies, and the constituencies they serve. It has a broad tool kit that it can bring to bear on this critical public sector issue, including

- issuing and promoting benchmark guidance,
- conducting educational and research programs, and
- facilitating the exchange of information among accountants and those who work in the public sector or rely on its work.

The Board has issued similar types specific disclosure requirements for governments and other public sector entities in order to strengthen accountability. IPSAS 24, for example, on the *Presentation of Budget Information in Financial Statements*, identifies disclosures to help readers to compare budget amounts with actual amounts arising from carrying out the budget.

Increasing transparency and knowledge of revenues will empower citizens and institutions to hold governments to account for the use of resource revenues, which are the major revenue source for many developing countries. Mismanagement or diversion of funds away from sustainable development purposes will become more difficult.

Demonstrating transparency and accountability should also benefit developing and transition economies by improving the business environment, helping them to attract foreign direct investment. Transparency and good governance are often pre-conditions for access to international financial institution lending or donor programmes.

Suggested revisions to International Public Sector Accounting Standards

The revisions needed to demonstrate leadership and support for this important initiative is straightforward. Minor revisions to IPSAS 1, Presentation of Financial Statements and the Cash Basis IPSAS, Financial Reporting under the Cash Basis of Accounting would be needed as set out below:

Revise paragraph 149 of IPSAS 1 by adding a new clause (c) as follows:

“ (c) An analysis of royalty or other revenue, obtained from the exploration and extraction of natural resources. “

Revise paragraph 1.3.17 of the Cash Basis IPSAS by adding in the fourth sentence the phrase “royalties or other cash inflow, obtained from the exploration and extraction of natural resources” so that the sentence reads as follows:

“Total cash receipts may be classified to, for example, separately identified cash receipts from: taxation or appropriation; grants and donations; royalties or other cash inflow, obtained from the exploration and extraction of natural resources; borrowings; proceeds from the disposal of property, plant and equipment; and other ongoing service delivery and trading activities.”

In addition, it is suggested that the explanatory specimen financial statements, particularly Appendix 1a which illustrates the financial statements of a government, be revised to include appropriate line items showing cash receipts obtained from the extraction of natural resources. For example, by adding the following after **Grants and Aid**:

Natural Resources

Royalties from Oil and Gas extraction	X	-	X	-
Revenues from Mineral Exploration and Mining Operations	X	-	X	-
Royalties and Revenues from Renewable Resources (eg. Timber)	X	-	X	-

Annex 1

2nd Global Conference, Arusha Tanzania

RESOLUTION ON RESOURCE REVENUE TRANSPARENCY

Recognizing

- There are large flows of money receivable by governments in many jurisdictions from natural resources extraction companies by way of royalties.
- A significant portion of the funds receivable are not paid in full to the states by the resources extraction companies as persons in authority collect part of the money secretly.
- The accounts of private companies in many jurisdictions are not audited by the Auditor General.

GOPAC resolves

To establish a parliamentary Task Force to seek changes to the international accounting and auditing systems and standards for sovereign nations so that revenues receivable by the states are easily verifiable by parliaments.

Adopted by delegates at the 2nd Global Conference, September 23rd, 2006, Arusha Tanzania.