

IEITI 4th Annual Report 2012- Pros and Cons
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For the fourth year in a row Iraq Extractive Industry Transparency Initiative-IEITI has been successful by releasing, in December 2014, its annual report entitled this year: **Iraqi Oil Revenues 2012, Local Consumption and Field Development**, hereinafter referred to as the Report.

A thorough review and analysis indicate that this year Report is qualitatively much better, more comprehensive and well written compared with the previous three annual reports. IEITI National Secretariat-NS and the Multi-Stakeholder Counsel/Group (MSG) were positively responsive to external remarks and assessments, including those of this author. This openness and responsiveness, which is highly praised and appreciated, had contributed to reach this apparent improvement in the Report.

Ernst & Young-EY, which prepared the previous report for 2011, was commissioned as the “Reconciler” for this report, though many of the chapters were prepared by Iraqi official entities.

The 365 pages Report is composed of executive summary, terms and abbreviations, 9 chapters and 8 annexes. Chapter 1 introduces the EITI and its objectives, Iraq’s implementation of the initiative and the reconciliation logic and process presented in this report. Chapter 2 (based on State Oil Marketing Organisation -SOMO information) presents international oil export and marketing process adopted by SOMO. Chapter 3 (prepared by Petroleum Contracts and Licensing Directorate-PCLD of the Ministry of Oil-MoO) highlights upstream petroleum development activities, including the four bidding rounds. Chapters 4 and 5 (prepared by EY) present the reconciliation processes and its results. Chapter 6 (prepared by Ministry of Industry and Minerals-MIM) deals with Iraq’s Mining Industry. Chapter 7 (prepared by SOMO) presents SOMOs marketing research. Chapter 8 (presumably prepared by EY) presents an insight on the extractive industries of the Kurdish Region-KR of Iraq. Finally, chapter 9 summarizes the lessons learned from the reconciliation process.

The recognized good improvement in preparing and finalizing the Report surely indicates to an enhancement in the learning curve of the involved entities, mainly IEITI-NS, the MSG, EY and other Iraqi reporting entities referred to throughout the Report.

That said, there remains many serious flaws, shortcoming, inaccuracies and inconsistencies, which I will attempt to address briefly in the remaining space of this paper. The purpose is to help IEITI-NS, the MSG, EY and other Iraqi reporting entities in their future efforts so that they could contribute to produce good and more improved Reports.

OIL EXPORT REVENUES

The Report reconciliation indicates that total export reported by SOMO is \$94,032,633,453, while those reported by the 43 International Oil Buyers-IOBs is \$93,136,980,753. The

difference of \$895.6 million, which is under the Materiality threshold of 1%, was explained in details on pages 65-69.

Statement by Development Fund for Iraq -DFI indicates that total proceeds deposited in Oil Proceeds Receipts Account-OPRA \$93,778,486,000; Amounts transferred to the United Nation Compensation Fund (5%) \$4,688,924,000 and the net proceeds deposited in DFI (95%) \$89,089,562,000.

I have noticed that the amount deposited in OPRA is lower than what was reported by SOMO (\$2.541billion) and higher than what was reported by IOBs (\$6.415 billion). The differences between OPRA on one side and both SOMO and IOBs on the other could be explained, mostly but not fully, by the payment in-kind to IOCs for cost recovery and remuneration fees only when IOB is also IOC, which is not necessarily the in case (as the list of 43 IOBs clearly implies). Moreover, there is some confusion in reporting these payments in-kind to IOCs, as discussed in the next item.

These differences reflect the complexity of the accounting procedures though DFI 2012 Statement of Proceeds of Oil Export Sales (p.162) and the Report (in item 4.5.2, p.54) provide some explanation.

Considering the above the Report has to be clearer and elaborate more when addressing these differences and should not assume that all readers and general public can resolve the puzzles of accounting.

My calculations based on the data and information supplied by SOMO to the Report indicates that during 2012 year 49.7% of oil exports went to East Asian, 22.6% to Europe, 27.4% to the US and 0.003% to Jordan.

Actual realized oil prices vary according to the above mentioned market destinations reflecting SOMOs pricing mechanism. Prices per barrel are as follows: East Asia (\$108.42), Europe (\$106.4), USA (\$103.57) and Jordan (\$93.41); the national oil export price was (\$102.95).

PAYMENTS “IN-KIND” TO IOCs

Iraq began in 2012 to pay IOCs who managed to achieve the 90 day sustainable threshold as per the related service contracts. Payments were made in-kind for cost recovery and remuneration fees to the consortia working on the oilfields of Rumaila, WQ1, Zubair, Alahdab, Halfaya and Missan (3 oilfields).

The Report identifies a discrepancy of US\$160.8 million between what was reported by the related IOCs (\$6,923,435,851) and that given by PCLD (\$7,084,270,641). The difference was explained on pages 79-81.

But the Report does not provide clear details of what was paid, for what item (cost recovery and/or remuneration fees) and to which IOCs. However, a total of \$5,249,233 was mentioned in the Executive Summary (p.5), but this amount is too little compared with what was reported by both IOCs and PCLD, as mentioned above. Also it is much less than the 2012 taxes (discussed in the next item). Most likely there is a typing error in the Executive Summary and the above amount should be \$5.249 billion, as mentioned in item (4.5.2), p.54.

As I mentioned in my contributions and assessment of previous IEITI annual reports the payment in-kind for cost recovery and remuneration fees will be increasing in magnitude, profile and implications. Therefore special templates and procedure need to be prepared so that future Reports provide clear and detailed clarification and explanation on these payments to IOCs.

TAXES PAID BY IOCs

Corporate income tax for 2012 on IOCs working in oilfields Rumaila, WQ1, Zubair and Halfaya totaled \$84 million. But according to the existing tax law, tax payments would be made in the following year, while deductions were recorded (but not paid) by most providers (IOCs) during the year 2012.

But, the Report was silent whether there was any taxes paid in 2012 covering 2011 or not. I would also suggest that Public Tax Authority amends IOCs tax collection procedure to the extent that it permits monthly tax deductions during the year while the final settlement of all tax dues be made in the following year.

The Ministry of Oil, the Ministry of Finance and Public Tax Authority could prepare the needed tax collection amendment and related directives. This amendment is urgently needed considering the fiscal crisis facing 2015 state budget.

STATE PARTNERS SHARE IN THE REMUNERATION FEES

The Report does not mention any information about the magnitude of the State Partners Share in the Remuneration Fees, which stand at maximum 25% of the Remuneration Fees, entitled to IOCs as per the service contracts of the related fields.

Moreover, the Report does not provide disaggregated (cost recovery, remuneration fee) data of the in-kind (oil) payment made in 2012 by MoO to IOCs, and why it is not possible to do so (as referred to on page 5).

It is vital to highlight that this disaggregation is a prerequisite legally and contractually because remuneration fee is the base for calculating the State Partners share it on one hand and to calculate the corporate income tax on IOCs (after deducting the State Partners share) on the other.

And because of the increasing magnitude of these amounts as the development of the related oilfields progresses it becomes necessary to properly disaggregate cost recovery from remuneration fee. Surely the accounting and auditing capacities at Regional Oil Companies - ROCs and MoO levels have to be enhanced to perform this mission for the protection of the national interests and the proper relation with working IOCs.

EMPLOYMENT

Service contracts for upstream petroleum development require IOCs to employ at least 85% of its workforce by Iraqis in the related petroleum project.

The Report asserts that “According to the information received from the Ministry of Oil (PCLD), the actual percentage of Iraqi labor force exceeds 85%.” (p.48). However, data

provided by the “*respective entities*”-the IOCs themselves, as provide on the table (3.8.1.5; page 49) contravenes what PCLD claims. The Report was silent about this contradiction. Moreover, table (3.8.1.5) is incomplete since 5 out of 11 IOCs did not provide employment data. In addition what was reported was not project/field-based for the IOCs with multi-project engagement such as CNPC, Petronas, Kogaz, Lukoil, TPAO and Shell. The EITI new Standard y requires project based reporting and declaration.

TRAINING- HUMAN SKILLS CAPACITY DEVELOPMENT AND CORPORATE SOCIAL RESPONSIBILITY-CSR

In each service contracts for upstream petroleum development there is *Training, Technology and Scholarship Fund* with specific provisions governing it.

The Report (3.8.2.1; p.50) provides information supplied by 5 IOCs only, and again not project/field-based. The reported spent amounts by IOCs in 2012 range between \$482,269 and \$30 million.

It is worth mentioning that no verification from the Ministry of Oil or the related ROCs on these amounts was mentioned in the Report, especially when some of the reported amounts are much more than contractually required, or whether the cost of the training programs are reasonable, etc.

The Report should have reconciled the reported information by asking MoO and related Regional Oil Companies.

The same table indicates that only 4 IOCs reported “Social expenditures” in 2012 ranging from only \$2000 to \$11.7 million, and again not project/field-based.

INTERNAL SERVICE PAYMENTS

These are payments received by the four Regional/National Oil Companies-R/NOCs (SOC, NOC, MOC and MdOC) to cover the production cost of crude oil. They are made by the Ministry of Finance to SOMO which in turn makes the required transfers to the R/NOCs on a monthly basis.

Tables 5.8 to 5.11 (p. 71 to p.74) provide monthly details for such transactions between the Ministry of Oil on one hand and the four R/NOCs on the other. But the reconciliation from SOMO and Ministry of Finance were not reported though the transfer of such payments involves these two entities. Though this does not undermine the reconciliation process since it is “based on matching relevant and credible data from two or more sources accompanied by appropriate explanation of differences” (p. 52), nevertheless having the corresponding data from the Ministry of Finance consolidates the reconciliation process.

INTRA AND INTER-MINISTERIAL RECONCILIATION

Tables 5.12.4 (p. 76) to 5.4 (p. 78) provide detailed data on the supplied crude oil to the refineries (MoO), and gas quantities to the Ministry of Industry and Minerals-MIM. Table 5.22 (p. 91/2) provides detailed data on the supplied crude oil and gas to the Ministry of Electricity-MoE.

The following remarks are made on this reconciliation:

- 1- It covers the quantities only without providing (or estimating) the values of these supplies;
- 2- The reconciliation is only *intra* within the MoO and within MIM (three state companies only), but not *inter* between MoO, MIM and MoE;
- 3- Oil and gas supplied for power generation was reconciled between Oil Pipeline Company-OPC (of MoO) and six Electricity Generation Directorates of the MoE;
- 4- As the Report asserts, “*Although receiving this data was an achievement, not receiving it directly and separately from the concerned entities jeopardies the credibility of data reported by these entities and ultimately its reconciliation.*”

These are serious flaws in the Report since EY had more than 16 months to prepare the reconciliation fully and properly.

THE MINING INDUSTRY IN IRAQ

This chapter, as mentioned earlier, was prepared by the Iraqi Ministry of Industry and Minerals-MIM.

The information and data are focusing on future visions, strategies and aspirations, thus they are useful and much better than the “promotional” material used to be published in the previous two IEITI reports. But the fact remains that the chapter represents the “official view” without any view by the Report editor, EY, on the submitted material.

Even the only table (6.6, p.107), which give data on the quantities of the produced and locally consumed 17 extracted commodities in 2012, it does not provide the values (or collected revenues) of these commodities. Moreover, no reconciliation was done regarding these quantities even within the MIM structure itself. This is another serious shortcoming of the Report.

Ironically, the Templates-Research on Mining Extractive Industry in Iraq by Ministry of Industry and Minerals, (p. 159) makes absolutely no reference to the needed subject matter of the reconciliation: revenues.

The Report should redraft its templates to specifically request MIM to provide information and data on production, export, local consumption and related revenues of these commodities. Also the template should highlight the multi-entity reporting nature of the reconciliation process.

KRG EXTRACTIVE INDUSTRY

As the Report asserts since no data was provided by KRG, IEITI Stakeholder Council (MSG) has requested the inclusion of information about the extractive industry in KRG based on publicly available information. MSG assumes no responsibility for the information contained in this chapter, and EY confirms that information in this chapter was not subject to the data collection and reconciliation processes adopted for purposes of this Report.

It is regrettable that KRG, for the fourth year in a row, refuses to provide the needed information though it has and could supply such information and data.

IEITI National Secretariat and IEITI Stakeholder Council have been responsive by accepting my suggestion (when evaluated IEITI Report 2011) to prepare the chapter on KRG extractive industry based on publically available information in case KRG declines to submit formally the needed data.

However, most of this chapter is provided in item 8.6 (p.114 to p.123) and it is “copy and paste” from the formal website of KRG Ministry of Natural Resources “mnr.krg.org”. This is a major flaw in the Reconciler -EY ability and its methodologically to conduct independent and professional research.

Moreover, the reconciliation “Templets” should have been sent directly to the IOCs working in the KR.

REPORT TIMELINESS AND REPORTING ENTITIES

Time used for preparing the Report have been unusually long and more than enough, and most likely a result of the contracting procedure with the Reconciler.

Preparing the report requires communicating with, collecting information of data and information and reconciling of such material from 43 International Oil Buyers-IOBs; 13 operators of the International Oil Companies-IOCs; 4 third party verification companies; 18 Iraqi Ministries and other governmental entities.

The reporting “templates”, which are used to facilitate the reporting process by different reporting entities, were reviewed and approved by the IEITI MSG on 28 August 2013 (the same meeting held for the same purpose but for the previous annual Report 2011!!!!).

Surprisingly, these 27 page detailed “templates” were reviewed and approved in one meeting, though most of these templates have been used for the reconciliation of the previous three annual reports!!

The reporting templates and the related instructions for their completion were posted electronically via email to all entities on 29 August 2013 (the same posting date for the previous annual Report 2011!!!!). The Report does not mention whether the reporting entities were requested to confirm recipient of such emails.

The entities were required to report directly to the reconciler (EY) to whom they were also requested to direct any related inquiries. EY instruction to the reporting entities say, “Reporting Templates (submission) must be completed and submitted with the IEITI Reconcilers by no later than 15 September 2013.” (p.131). As already mentioned EY had requested the same deadline in preparing the previous annual Report for 2011!!

Is it realistic to expect the reporting entities to complete and return these templets within two weeks when EY has more than 16 months to finalize the Report?. Something seriously wrong here!!! Then how is this reconcile with what the Report mention that as of 20 February 2014, 75 out of 78 entities (excluding KRG) responses were received by EY?.

On 25 December 2014, the MSG held a meeting during which the draft Report was presented, discussed and approved.

Again only one meeting to present, discuss and approve 365 page report written in English!) If what was mentioned in the Report is correct then MSG involvement was confined to two days only: 28 August 2013 (but for 2011 annual report) and 25 December 2014! That's all, since the Report does not mention the dates of any other meeting(s)!

Surprisingly enough the Report recommends,"9.3.2 It is recommended that the IEITI Stakeholder Council engage the reconciler at an earlier time of the year in order to have more time to perform the reconciliation tasks." (p.125). The same recommendation was made in the previous two reports 2010 and 2011!!

From the contents of the report, EY has only prepared three chapters while the remaining chapters and all the annexes were already prepared by the Iraqi entities. Yet EY used more than 16 months preparing these three chapters!! How much more time EY needs and how earlier the contract has to be conclude.

Moreover, EY seems to adopt a passive approach by relying on email facility. The Report does not mention any meeting that took place with any of the reporting entities during the 16 months preparation period.

The above tarnishes the credibility of the contracting process with the Reconciler and related referred timeline. Probably there is only one contract with the Reconciler to do the two annual reports 2011 and 2012; and this has caused this overlapping of meetings and "copy & paste" of the templates, instructions, and other written materials, excluding the export revenues of 2012 for reconciliation purpose. Surely, convincing clarification is needed.

INACCURACIES AND INCONSISTENCIES

The following inaccuracies and inconsistencies have been identified

- 1- The Report mentions that, total value of oil exports by IOCs amounted to US\$5,249,233 during the year ended 31 December 2012 (p. 5).
This is not correct since IOCs do not have the right to export oil; they can only use their dues (cost recovery and remuneration fees) to buy oil FOB at the export terminal.
- 2- The Report covers,..., signature bonuses received from the IOCs (p.13).
This is inaccurate since no signature bonuses were due or paid in 2012 (p.44)
- 3- The Report gives three different figures for Iraq's proven oil reserves: 140.3 billion barrels (p. 12 & 15); 115 billion barrels (p.115) and 145.295 billion barrels (p.112);
- 4- Alahdab oilfield was not offered under first bid round (as mentioned in table 3.3 p. 38), rather, it contract was concluded in November 2008 while first bid round was held in June 2009.
- 5- The "R-Factor" table (p. 45) is not used for all contracted fields. In fact there are many different "R-Factor" tables. This inaccuracy applies to all information that are covered in section (3.6; P 45-47) of the Report;

- 6- Numbers and percentages in items (3.8.1.1; 3.8.1.2; 3.8.1.3 and 3.8.1.4 (p. 48/9) do not match and thus need clarification or correction.
- 7- The definition of signature bonus as related to “a concession license agreement (or technical service contract)” is incorrect since other contracts such as production sharing could involve also signature bonus.

TABLES AND CHARTS

Few remarks are made on some of the tables and charts presented in the Report.

Charts 5.17 (p.83); 5.18 (p. 85); 5.19 (p.87) and 5.20 (p.89) are these charts represent “reconciliation”(though the related tables exhibit no discrepancies in the reported data by the concerned ROC and by MoO) or “total production” of the related ROC?

In my view it is not necessary to presents the same data in tabular and graph formats- the tables should be enough. But if the two formats are used then the title of the charts has to be written properly, and should be “production” not “reconciliation”, unless there are actual discrepancies, and in this case the chart is different from what have been presented in the Report.

The same also applies to charts 5.1 (p.58); 5.2 (p.60); 5.3 (p.62); 5.4 (p.64);

Chart 5.26 (p. 100) does not correspond to the aggregate data of tables 5.24 (p. 94) and 5.25 (p. 97). Thus the chart needs correction.

Table 7.5.1 (p. 111) needs updating since the Report is issued in Dec 2014.

THE LENGTH OF THE REPORT AND OTHER MATTERS

The report is rather long 365 pages! The basic reason for that it includes four new appendixes, 4 to 8, adding 203 pages, and they are copies of model contracts, in addition to another one containing scanned templates that are difficult to read.

The positive side is that adding the text of a model contracts is good, but the negatives are many:

- 1- A long Report could deter the reader from it;
- 2- The Report has to be translated into Arabic and Kurdish. That could be very difficult and costly mission especially for the two model contracts;
- 3- There is too much repetition in the main body of the Report (in chapters 2 and 3) due to reproduction (copy & paste) from appendixes 6, 7 and 8;.
- 4- The two model contracts are rather different from the actually signed five versions of upstream development contracts.

In my view this length is both unnecessary and impractical. Instead I suggest uploading appendixes 3, 5, 6, 7 and 8 on IEITI website and write on the Report the web-link to access them.

The Report should make proper referencing when using data and information (Ministry of Planning, p. 4; p. 48).

It should also use proper and known industry petroleum terminologies: Drilling engineering not Excavation engineering (p. 37); International oil companies not International extractive companies (p. 53);

Finally, it will be very useful if the Report make comparison with previous year(s) and identify progress made during the year.

CONCLUDING REMARKS

Despite the recognized improvement in the Report, it remains far from the requirements of the EITI new Standard. This could be attributed to the Terms of Reference-ToR upon which the contract with EY was premised. Unfortunately the ToR text was not included in the 365 pages of the Report. Moreover, it is apparently clear that EY still think of its role as “Reconciler” focusing primarily on oil export revenues, while EITI new Standard calls for “Administrator” of the entire report that should be prepared in compliance with the said EITI Standard.

The Report gives the impression that the Multi-Stakeholder Counsel/Group-MSG was inactive (only one report-related meeting in 2014 2) and symbolic (approving a 365 page report in one meeting only). That, regrettably, could be true since no more meetings were reported on IEITI website.

MSG, according to EITI norms and practices, is the most important organ for the good implementation of and compliance to EITI Standard. Thus MSG needs to be more proactive, especially members representing civil society organization-CSO. I sincerely have high hope and good faith in the newly elected representatives to play active and effective role in preparing the forthcoming IEITI Report(s).

National capacity development in research and analysis within IEITI National Secretariat is vital, needed and opportune. It is about time to have a well-structured IEITI National Secretariat that could play essential role and make qualitative specialized contributions to the annual reports aiming for enhancing transparency in country’s extractive industry. I have repeatedly called for this and hope that IEITI and its cooperating parties come with viable options for this purpose.

For my assessments of previous IEITI Reports please see:

Transparency Governance in Iraq’s Extractive Industry at a Crossroads. Posted on IBN through the following link: <http://www.iraq-businessnews.com/2014/10/07/transparency-in-iraqs-extractive-industry-at-a-crossroads/>

IEITI Response to [Ahmed Mousa Jiyad]Recent Article
<http://www.iraq-businessnews.com/2014/02/20/ieiti-response-to-recent-article/>

Iraqi EITI Report 2011- Initial Assessment. Posted on IBN
<http://www.iraq-businessnews.com/2014/01/06/iraq-eiti-report-initial-assessment/>

Iraqi EITI Report 2011: The Need to Act Promptly, Effectively and Properly. Paper based on PowerPoint presentations I delivered before “EITI Beyond Compliance Report Analysis Workshop” organised by Revenue Watch Institute-RWI (USA), Erbil, Iraq, 6-8 June 2013. Also posted on IBN on 18 June 2013: <http://www.iraq-businessnews.com/2013/06/18/iraqi-eiti-report-the-need-to-act/>

IEITI Future Reports: Expectations and Challenges.

Presentation delivered at the Oil Cultural Centre, Baghdad, Iraq, on the 4 April 2013 as part of the “EITI Compliance & Second IEITI Report Conference” held at Al-Rasheed Hotel on 3 April. Abstract and the PowerPoint slides were posted on IBN website: <http://www.iraq-businessnews.com/2013/04/08/ieiti-future-reports-expectations-and-challenges/>

Review and Assessment of the Second Report from Iraq Revenue Transparency. Posted on IBN <http://www.iraq-businessnews.com/2013/01/02/review-of-2nd-report-from-iraq-revenue-transparency/> 1 January 2013.

Also my views in “Addicted to Oil Cash, and Seeking Help (Part 1)”, posted on 21 January 2013 on <http://theriskyshift.com/2013/01/addicted-to-oil-cash-and-seeking-help-part-1/>

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