

Subject: on the Draft IPSASB Work Plan 2019-2023

We support the work priorities of the IPSASB for the coming 2019-23 period. In particular, we believe that the Natural Resources project is of critical importance to correct public accounting.

Maximising knowledge of Valuation

It is important to note that many governments have little understanding of the monetary value of extractive resource assets at the point at which they sign agreements, licenses or contracts to allow extraction of those resources. Indeed, it is not uncommon for companies bidding for exploitation rights to know more about the potential value of the assets than government.

As a result, fiscal regimes – royalties, special tax rates, bonuses and other revenue streams to government – are often set “blind”, effectively, before the market value is assessed, and the profitability of the project can be evaluated.

This is problematic since there is broad agreement that, where the state owns or manages sub-soil assets, which is in most of the world, the purpose of taxation of natural resources should be the capture of all economic rent – defined as profit above and beyond costs and a reasonable return on capital to the investor. The lack of ability to assess the value of the assets therefore makes it impossible to implement such a policy.

The ability to obtain reliable estimates of quantities and degrees of extractive resources varies case by case, and project by project, and depends a lot on government access to geological data and interpretations. As such, it might be considered to lie directly outside the scope of public accounting standards. However, IPSASB-supported standards could, for example, define the norm of having a formal and published policy by each government on statement of such reserves, to create greater emphasis on maximum utility of currently available information.

Such a reserves policy would normatively also use well known and used international standards for the statement of reserves, such as the SPE (the US-based Society of Petroleum Engineers) classification system of petroleum resources, and the JORC standard (the Australasian Code for Reporting of Exploration Results, Mineral Resources and Reserves), which is widely used internationally in mining. Such a policy could also include a formal and periodic review by accounting authorities of current licenses and contracts already signed by government to determine all geological information currently available under the terms of the contract. This could help reduce what we have often observed in government practise, which is that rights of access to information which are included in contracts are not exercised.

It should be noted that as in recent years government policy in several countries (Ghana, Kenya, Indonesia et al) has been to encourage national private sector investment alongside international investors, often through stock markets, encouraging the adoption of a more rigorous policy towards statement of reserves would also strengthen the security of such investments.

This is an area where IPSASB's ongoing efforts at convergence with private sector practise could also come into play.

Determining economic rent within revenue streams to government

Determining measures to maximise government knowledge of the value of extractive assets is one part of the picture. Another is to review accounting standards as they relate to determining the economic rent of each producing asset.

For example, if a return on capital to the investor is defined in public budgeting, then it should be possible to quantify the rent attaching to each asset, as distinct from turnover, or cash flows. All project analysis by government should seek to determine as accurately as possible what investor return is, so that revenue flows to government can then be analysed in a way which aligns with policy, which is to determine what proportion of rent is captured by the fiscal regime.

Another practical step the IPSASB project could take would be to review the revenue codes in the IFS system to determine if there is any further differentiation which can be made between income streams which derive from rent, and other kinds of income from extractive industries. We note here that the current IFS standards contain some classifications of revenue streams that can be clearly identified as "rent", such as royalties and bonuses. The reality is, however, that many other revenue streams have an element of economic rent within them, such as special rates of corporate income tax which apply to extractives companies. It is thus not currently possible to determine capture of rent within public accounting of extractive assets, even though that remains a key goal of most governments' fiscal regimes.

Extractive resources as capital assets, not revenue streams

One other related aspect of extractive assets is that as they are depletable, they should be accounted for as a capital asset instead of a potential revenue flow. The classification as revenue creates a skewed analysis under which all revenues accruing to the government are seen as a positive, instead of being analysed as the transformation of one form of capital, physical, into another, financial capital. True cost-benefit analysis becomes difficult under this approach.

Institutional Capacity: promotion of explicit standards for financial modelling

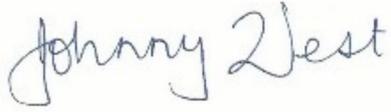
Given that a key constraint in the public policy space continues to be the growth of institutional capacity, another area IPSASB could look at is whether formal standards for financial modelling and analysis can and should be encouraged for adoption by governments. Use of a common standard, especially one which was in wide use in the private sector and is open sourced so as to be freely available, could significantly strengthen capacity building efforts, and improve both management and cost effectiveness of financial analysis programs in the public sector.

About Open Oil

OpenOil is a consultancy based in Berlin specialised in analysing natural resources for public policy. Since 2013 we have provided financial and commercial analysis to over a dozen governments on oil, gas and mining projects around the world, including advice on setting fiscal regimes, negotiations and renegotiations, revenue forecasting, the impact of tax incentives,

and tax gap analysis. OpenOil is a signatory to the FAST modelling standard, and has published the largest collection of full financial models of natural resource assets on the Internet.

Yours Sincerely,

A handwritten signature in blue ink that reads "Johnny West". The signature is written in a cursive style with a large, stylized 'J' and 'W'.

Johnny West, Director OpenOil