

# Precept 2. Accountability

## *Technical Guide*

### **1. Introduction: Objectives, Trade-offs and Guiding Principles**

Successful governance of natural resources requires governments to be held to account for their actions. Accountability forces governments to face difficult decisions and implement them effectively, but requires that the public is well informed. This means that making information on the natural resource sector, and the actions of government, widely available is key.

Transparency is of special relevance to the extractive industries – oil, gas and mining – where country dependence on revenue flows from those sectors is often high and their economic and social impact is correspondingly great.

The benefits expected of transparency are considerable, comprising:

- ***Enhanced government effectiveness.*** Transparency can be a key contributor to public policy effectiveness and efficiency. Motivated decision-makers need feedback on how their policies are working out in practice and feedback is only possible when information flows freely in both directions – from government to the public and vice-versa. Information flows within government are equally important, and essential to the operation of intra-government checks and balances.
- ***Reduced corruption and waste.*** The amounts of money involved and the ease with which transactions in the extractive industry sectors can be obscured have made rent-seeking, corruption and waste endemic around resource revenues and expenditures. The prospect of public scrutiny based on transparency can be expected to reduce the risk of corruption and deter wasteful expenditure
- ***Fostering democratic debate.*** Access to information is generally seen as fundamental to the functioning of a democratic society. The essence of representative democracy is informed consent which requires that information about government policies and practices be disclosed. Informed democratic debate can, among other things, help determine priorities in the allocation and expenditure of resource revenues.
- ***Safeguarding human rights.*** It is often argued that access to information is not only a human right in itself, but also necessary to the realization of all other rights – freedom to speak on public issues, social and economic justice,

security, clean environment, etc. – many of which relate closely to resource sector operations.

- ***Enhanced access to finance.*** Development agencies, commercial lenders and credit rating agencies all have a strong interest in transparency and serious government commitments to transparency can improve access to both concessional and commercial finance. Research by the IMF and others has found a significant positive correlation between measures of transparency and country credit ratings.

If the benefits of transparency are considerable, the challenges to its implementation are correspondingly great, and include:

- ***Entrenched interests.*** Opposition to improved transparency from those whose political and personal agendas have depended on its absence will be strong. Overcoming this very serious obstacle requires political will at the highest level in-country. International support to transparency reform may also prove critical.
- ***Ambiguity.*** Persistent ambiguity in the roles and responsibilities of government agencies and in the policy, legal, contractual and fiscal frameworks against which their performance might be measured too often undermines efforts to introduce meaningful transparency.
- ***Weak institutional capacity.*** Translating the availability of information into accountability depends on the beneficiaries of the information flows having the capacity to understand and act on those flows. Developing that capacity in both government and the public is essential if the potential gains from transparency are to be realized.

Against this background, the rest of this Precept reviews the objectives, trade-offs and guiding principles of transparency reform, and the instruments and actors involved in its pursuit.

## **Objectives**

The overriding need to bring transparency to the governance of natural resources requires government and other stakeholders achieving two objectives:

***Apply transparency across the whole process chain.*** Effectively leveraging transparency and an informed public to hold government and other stakeholders accountable for good governance in the resource sectors requires a systematic approach across the entire sector decision chain: from the decision to extract; fiscal regimes and administration; institutional, legal and contractual frameworks; social

and environmental requirements; the use of national resource companies; and finally to revenue and expenditure management. The benefits of transparency stated above will be achieved only if transparency is applied across the whole decision chain; otherwise poor performance, misallocation and corruption can be expected to migrate from transparent domains to weaker links in the chain.

***Clearly define the responsibilities of government and other stakeholders.*** The International Monetary Fund’s *Guide on Resource Revenue Transparency*<sup>1</sup> sets out a comprehensive series of guiding principles for the achievement of transparency and accountability in the resource sectors, calling for: clarity of roles and responsibilities; open budget processes; public availability of information, and assurances of integrity. In particular, the responsibilities and obligations of the state and the rules for exploitation of the petroleum and mining sectors should be clear, transparent and codified so that roles are clear, inefficiencies and duplication are minimized, and those responsible for poor performance or corruption are held accountable.

Table 1 below summarizes the transparency and accountability implications of the IMF framework for each of the links in the resource sector decision chain. Transparency and other dimensions of good governance are discussed in greater detail under each of the precept headings indicated in the table.

**Table 1      *Transparency and Accountability across the Decision Chain***

<b>Precept</b>	<b>Transparency Requirements</b>	<b>Examples of Responsibility, Inputs, Oversight</b>
<b>Sector strategy (P1, P2)</b>	Public disclosure, Freedom of Information laws and constitutional requirements Inclusive public discussion	Government, legislature, civil society and media, industry and the private sector

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<sup>1</sup> The International Monetary Fund’s (IMF) Revised Code of Good Practices on Fiscal Transparency has been accepted by the organization’s Executive Board and is applicable to all its members. Many of its general prescriptions for good fiscal practices are highly relevant to resource management, and the updated Code includes a number of specific principles for the extractive sectors. The Code has been supplemented by the Fund’s Guide on Resource Revenue Transparency offering more detailed guidance for petroleum and minerals rich countries. This precept of the Charter reflects the IMF’s advice in both the Code and the Guide.

	and debate Benchmarking against performance	
<b>Fiscal regime (P3)</b>	Public disclosure of intentions Inclusive public discussion and debate of fiscal intentions Clear, publicly accessible fiscal legislation and contractual fiscal provisions Clear definition of national and sub-national rights and responsibilities	Finance ministry, sector ministry, legislature, industry, civil society
<b>Fiscal administration (P3)</b>	Clear public administrative procedures Rigorous third party audits Regular, timely industry submission of all necessary information Regular timely reporting of all payments made and revenues received Clear, credible appeal procedures	Finance ministry, revenue authority, sector ministry, Accountant/Auditor General, legislative committees, independent auditors, industry, civil society, tax courts
<b>Sector structure and institutions (P4)</b>	Clear definition in legislation and practice of agency roles and responsibilities Separation of powers to promote checks and balances and avoid conflicts of interest	Government, legislature, key ministries (sector, finance, environment, economy...), Civil society and industry
<b>Legal, contractual and regulatory frameworks (P4)</b>	Comprehensive coverage Public disclosure and debate at design stage Public, easily accessed laws, model contracts and regulations Public disclosure of regulatory	Government, legislature, key ministries and regulatory agencies, civil society, industry

	procedures and proceedings	
<b>Licensing (P4)</b>	<p>Clear public requirements, criteria and procedures for license award</p> <p>Unambiguous assignment of licensing authority</p> <p>Public disclosure of signed contracts</p> <p>Public record of held and open license areas</p> <p>Public disclosure of true beneficial ownership in all licenses</p>	Government, sector ministry, licensing authority, civil society, industry
<b>Social and environmental requirements (P5)</b>	<p>Clear, public legal and regulatory framework identifying rights and responsibilities of all parties at national, subnational and local/project levels</p> <p>Regular reporting to and from government on social and environmental impacts</p> <p>Clear provisions for fiscal treatment of social and environmental expenditures</p>	Social and environmental ministries, sector ministries, national and sub-national agencies, impacted communities, civil society, finance ministry, international and regional agencies , e.g., the United Nations
<b>National resource companies (P6)</b>	<p>Clear controlling legislation</p> <p>Clarity in legislation and practice on governance (board composition, reporting and approvals, etc.)</p> <p>Clarity on flow of funds to and from the company.</p> <p>Clarity on fiscal and financial treatment of the company (taxes, dividends etc.)</p> <p>Clarity on contractual arrangements with private sector investors.</p>	Legislature, government, sector and finance ministries, regulatory and revenue authorities, national resource company, civil society, Accountant/Auditor General, independent auditors

	Regular public audits	
<b>Revenue management (P7, P8)</b>	<p>Clear, public declaration and discussion of the management strategies to be followed</p> <p>Transparent legislation on the governance and operation of any resource funds, including provisions for public reporting and third party audit.</p> <p>Public reporting of any/all resource based borrowing</p>	Government, legislature, central bank, resource fund authorities, auditors, civil society, international lenders
<b>Public expenditure and investment (P9, P10)</b>	<p>Full budgetary reporting of all resource revenues and expenditures</p> <p>Budgetary identification of any quasi-fiscal expenditures by the national resource company and of any resource related fiscal risks</p> <p>Public reporting of any resource revenue transfers to subnational levels of government</p> <p>Public access to budgetary documents</p> <p>Public audits of spending</p>	Legislature, government, civil society, finance and sector ministries, national resource companies

## Trade-offs

There are three problems with accountability that must be considered.

Greater accountability will inevitably be costly for those sections of government that are not operating properly. The resulting disruption as these sections of government respond to incentives can deliver long-term benefits, but may still involve short-term costs.

The actual production information may involve some costs, although these are likely to be less than the overall benefits of transparency, and can actually spur better management practices where it results in efficient information management systems. These costs also include building the capacity to use information to hold government agents to account. This is a vital part of the process chain that must be in place to ensure that efforts at other stages of the process are not wasted. However, improving such capacity also has the positive side effect of creating better management information systems in government.

Finally, a significant worry is that while accountability is likely to lead to some positive change, it is not certain what the magnitude of these benefits might be in comparison to the costs. Costly transparency initiatives may be hard to support in the face of such uncertainty. However, here again, the positive spill-over effects of producing and using government data to improve internal management processes can be included when making this judgment.

## Guiding Principles

To help achieve these objectives, a number of principles can be distilled from Table 1 and merit underscoring:

- **Clarity of rules.** Natural resource management is best conducted under a clear set of public laws and regulations. Clear, binding public rules reduce the opportunities for manipulation, favoritism, or corrupt transactions by companies and officials.
- **Clarity of roles and responsibilities.** Divisions of responsibility need to be formalized and made public to improve transparency and minimize overlap.
- **Certainty.** Uncertainty deters commitment. Securing necessary investment can be aided by setting out, in published laws and regulations the basis for

- any decision to permit the exploration for or exploitation of a petroleum or mineral deposit. Governments are encouraged to set out the basis upon which extractive concessions or licenses are granted in published law and regulations which are easily accessible to citizens.
- **Reporting.** All revenue flows should be disaggregated and made publicly accessible through a centralized data system. Disclosure to the public of revenue streams and their disposition through the budget, through a state company, or through savings and investment funds should be made in a timely fashion. In order to fulfill the accountability goals of such disclosure, the data produced should be clear and easy to use. Reporting on technical and operational matters should be similarly timely and accessible.
  - **Independent audit and inspection.** Timely, clear and accessible disclosures are insufficient if the validity of the data is in question, or the independent capacity to analyze and synthesize it is lacking. An independent inspector general can be empowered to monitor transactions, for instance, with regular reports to the legislature so that it becomes difficult to bury important disclosures with parliamentary indifference.
  - **Minimization of discretion.** Any discretion should be maximally transparent and subject to justification by previously agreed criteria.
  - **True beneficial ownership.** Opaque corporate structures may be used by officials or families to subvert otherwise strong transparency and accountability requirements.

Additional topics deserving of special attention include:

**Contract confidentiality.** Contract terms, including fiscal terms, should be promptly disclosed and easily accessible. When extraction deals are individually negotiated rather than operating under a standard license this is all the more important. The IMF *Guide* notes that ‘good practice for transparency ...would require publication of all signed contracts’. Although a number of countries, among them Liberia, Mongolia, Kazakhstan, Ghana and Timor-Leste, already follow the practice, there is still some distance to go towards achieving this goal. Positive indicators include the International Council on Mining and Metals’ (ICMM) requirement that its members to ‘engage constructively in appropriate forums to improve the transparency of.....contractual provisions on a level-playing-field basis’<sup>2</sup>, and the contract disclosure requirements under the IFC’s Sustainability Framework.

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<sup>2</sup> ICMM Position Statement on the Transparency of Mineral Revenues, January 13, 2009



Governments do not enhance their bargaining power with new investors by refusing to reveal the terms of previous contracts. Investors can have access to most resource contracts from commercial data bases – albeit for a sizeable fee which may restrict country access. Information asymmetry is much more likely to favor the companies over the resource states particularly those with new discoveries or within the developing world. Transparency of contracts pushes against this, since dubious controversial or excessively one-sided arrangements are likely to damage the reputation of extractive companies in future negotiations with other countries.

***Savings, stabilization and investment funds.*** The IMF Guide offers pointers for the stringent rules and regulation needed to ensure the transparency of these funds. The International Working Group of Sovereign Wealth Funds has adopted a set of Generally Accepted Accounting Principles (GAAP), the Santiago Principles, while the Peterson Institute for International Economics has created an influential ‘scorecard’ for judging fund performance, with the objective of providing a blueprint for best practices.

The Santiago Principles include a variety of transparency and accountability provisions including the requirement that the key features of a Sovereign Wealth Fund’s (SWF) legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed. Such principles can also be applied to so-called *sovereign stabilization funds* (see Precept 8). In addition to the legal basis, structure and relationships, legislation should also specify the policy purpose of the SWF clearly and define accountability for success and failure to fulfill these purposes. In addition to the key constitutive documents the governance framework and objectives and—crucially—the manner of a fund’s managerial independence from other public and private entities should be disclosed. The detailed policies, rules and procedures governing funding and withdrawals should be rule-based, clear and publicly disclosed well in advance of the commencement of operations.

The Peterson Institute goes beyond the Santiago Principles in calling for the clear statement of post-withdrawal uses of the principal and earnings of any fund. The IMF Guide sets a higher bar; the best practice for resource-rich countries requires that ‘all resource-revenue related transactions, including through resource funds, should be clearly identified, described and reported in the budget process and final accounts documents’.

The benefits of maximum feasible disclosure and operational independence in pursuit of clearly and legally defined goals accrue not only to resource-rich countries. By demonstrating their reliably economic and financial orientation funds

can contribute to the stability of international financial markets and enhance trust in countries where they operate (Santiago Principle 17).

***Anti-bribery provisions.*** Resource-rich countries cannot depend on the home regulators of investors to prevent or prosecute illicit transactions. Improper payments should be grounds for termination of a contract or concession and should also incur criminal liabilities.

***Regional-Central government arrangements.*** The sharing of extractive revenues with other levels of government, as is prevalent in many countries including Canada, Indonesia, Nigeria and Peru should be transparent. The formulas for revenues sharing, whether by divided taxation authority or transfer from the central should be authorized by the legislatures concerned and made fully available to the public. Such arrangements should also provide for the publication of the amounts and dates of transfers on a regular schedule of at least annual frequency; quarterly disclosure is preferable. Nigeria pioneered quarterly disclosure in regional newspapers resulting in soaring sales for the special petroleum revenue transfer issues. Central authorities can make use of fiscal transfer arrangements to impose uniform standards of transparency to permit greater comparability and accountability in the sub-national distribution of resource revenues. The aim is not to achieve uniformity on how sub-national entities dispose of resource revenues, but uniformity in how that disposal is communicated to the public so that lines of accountability are clear.

## **2. Implementation: Instruments and Actors**

### **Instruments**

A variety of instruments or approaches are available and have been applied to implement transparency, ranging from mandatory to voluntary and from single actors to multiple stakeholder groups:

***Host country policies.*** In order to hold relevant actors to account, stakeholders must have some idea of what natural resource exploitation is intended to achieve in a given context – accountability requires assessment criteria. The role of extractives can be specified in a strategic vision, policy statement or national development plan.

***Host country legislation.*** Transparency may be required by host country legislation of a general, non-sector-specific nature, such as Freedom of Information Acts or anti-money laundering legislation. Or it may be required or enabled by sector legislation or regulations and cover a wide range of topics as suggested by Table 1

above. Transparency rules are best set in law to increase the likelihood that they will be sustained from one government to the next.

***Host country contractual requirements.*** Petroleum and mining contracts should and typically do contain a number of reporting requirements on the behalf of both government and the investor. Many of these require public reporting. At the same time, most agreements contain confidentiality clauses which have, to date, prevented release to the public of important technical, fiscal and financial information. As noted above, international best practice would argue in favor of disclosure of such information and a growing number of countries are moving in that direction.

***Home country legislation.*** Legislation on the home countries of international investors and lenders can helpfully complement host country legislation in the transparency area. Recent legislation in the United States requires all resource companies as a condition for New York Stock Exchange registration to publish all resource-related payments they make to host countries. Similar reporting requirements have been drafted by the European Commission. Home country anti-money laundering and anti-bribery and anti-corruption legislation can also promote host country transparency.

***International codes of conduct.*** International and regional charters or codes of conduct, including United Nations resolutions, may be wholly directed at transparency or contain important transparency provisions. Examples include the UN resolution in support of the Extractive Industries Transparency Initiative, and OECD Guidelines on State-owned Enterprises, which contain recommended best practice on state-owned enterprise transparency, governance and accountability. Compliance is voluntary but such codes do act as influential points of reference.

***Internal oversight.*** Independent watchdog or regulatory agencies and parliamentary committees can be very effective in policing compliance with transparency requirements

***Third party oversight.*** Third party initiatives have been successful in recent years in advancing the resource transparency agenda with both government and investors. Publish What You Pay (PWYP) is a coalition of over 60 international and local non-governmental organizations (NGOs) focused on resource transparency issues, among them home country legislation requiring resource companies to publish payments made to host countries, and contract transparency. Individual members of PWYP, e.g., Oxfam America, have had an impact independently pursuing the same agenda. The Extractive Industries Transparency Initiative (EITI) is a multi-stakeholder initiative whose participants include host and home country

representatives, and representatives from civil society, industry, the financial sector and the donor community. Some 35 petroleum and minerals-rich countries have signed on to the initiative, and once it has been adopted its criteria become binding on government and industry alike. EITI has confined its mandate to the publication of audited data on payments made by industry and received by government. Once the data are in the public domain, however, they can be used to hold government accountable for the management and expenditure of revenues received. The ICMM, which represents the major international mining companies, has been very active in establishing good governance benchmarks for its membership which, among other things, endorse transparency and, with government's no objection, publication of contracts.

***IFI conditionality.*** International financial institutions (IFIs) like the World Bank and the International Monetary Fund have “mainstreamed” transparency in their dialogues with resource-rich countries, making it a consideration, or even a condition, for sector or country lending. The International Finance Corporation, the private investment arm of the World Bank Group, has now made its funding conditional on public disclosure of the main fiscal and financial terms of any resource project investment it supports.

***Investor/lender due diligence.*** Investors, lenders and rating agencies in doing their due diligence investigations generally favor environments where transparency is encouraged or enforced. This is not uniformly the case, but it does seem to hold true for most of the internationally recognized and preferred investors and lenders, and countries seeking to attract them must take their concerns into account.

***Capacity-building Technical Assistance.*** As noted earlier, the lack of capacity in the institutions expected to benefit from transparency, or ensure adherence to transparency requirements, is one of the most important challenges to its implementation. Technical assistance support from governments, donor agencies, civil society or industry with a view to putting that essential capacity in place can prove critical in this regard.

## **Actors**

Table 2 below indicates the principal actors involved in implementing resource sector transparency, and their roles relative to elements of the sector decision or value chain. These are brought together and summarized briefly below:

**All governments.** At the most senior levels promote transparency and act to remove, to the maximum extent possible, any legal or political impediments to public disclosure of resource sector information. Support international transparency initiatives, including the possibility of international or regional codes or treaties.

**Host country governments.** Through executive branch ministries, their agencies and the legislature provide for transparency and clarity across the entire resource sector decision chain, where possible anchoring transparency requirements in law. Promote capacity building in those agencies responsible for overseeing compliance with transparency requirements. Table 2 below summarizes the transparency responsibilities of several key host country government actors.

**Table 2 Responsibilities of Host Country Actors**

<b>Actor</b>	<b>Responsibility, Inputs and Oversight</b>
<b>National legislature</b>	Informing the public, performing oversight, serving as channel of government accountability through the electoral process. Requires a minimum amount of technical capacity and clear rules for the frequency and content of submissions from government agencies and the methods of validating this material
<b>Executive</b>	Delineation and assignment of potentially overlapping and conflicting responsibilities. Balance the independent accountability of regulators, national resource companies, finance ministries, revenue authorities and central banks with the need for a comprehensive approach to resource sector governance. Accountable for development and implementation of a national strategic vision for the resource sectors.
<b>Revenue authority</b>	Transparent administration of revenue collection, payments and procedures.
<b>Regulator</b>	Development and implementation of transparent rule-making procedures, comprehensible to the public and requiring timely disclosures

Transparency responsibilities of the Revenue Authority are further discussed under Precept 3. Responsibilities of government actors beyond transparency are considered under Precept 4.

***Home country governments.*** Promote good transparency practice on the part of the resource companies domiciled in their countries, particularly with respect to payments made to the countries in which they operate.

***Companies/investors.*** Public disclosure in a regular and timely manner of resource-related payments to host country governments. Strict adherence to all other operating and financial reporting requirements, and voluntary public reporting on company activities, with special attention to locally affected communities.

***Civil society.*** Both nationally and internationally strengthen capacity to collect, analyze, explain and disseminate information on sector activity, develop independent monitoring capability, lobby governments, companies and IFIs. Form umbrella coalitions uniting the various constituencies affected by resource sector operations. Civil society also plays a strong role in initiatives such as the International Association of Oil and Gas Producers and EITI, often having a formal position in the process.

***International Financial Institutions.*** Continue to mainstream transparency objectives in policy and lending dialogues with all resource-rich client countries and in international fora. Where appropriate, include transparency conditions in lending operations.

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