POLICIES AND LEGAL FRAMEWORK IN EXTRACTIVE INDUSTRIES TO ENSURE SUSTAINABLE GROWTH: UGANDA’S EXPERIENCE IN OIL AND GAS

Presented by

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3RD ANNUAL MEETING OF INTOSAI WORKING GROUP ON EXTRACTIVE INDUSTRIES

Mombasa, KENYA
24th – 26th August 2016
PRESENTATION OUTLINE

1. Overview of Extractive Industry
   - Extractive Industry Value Chain
   - Characteristics of Extractive Industry

2. Extractive Industry in Uganda
   - Petroleum Resources and Reserves
   - Mineral resources

3. Legal Framework and Sustainable Development of the Petroleum Industry in Uganda

4. Auditing of Extractive Industry
   - Mandate for cost recovery audits
   - Processes and Experiences
   - Benefits of the processes adopted

5. Summary and Conclusions
COUNTRY OVERVIEW - UGANDA

- **Location:** On the Equator, Bordering Kenya, South Sudan, DRC, Rwanda & Tanzania
- **Area:** 242,000 km²
- **GDP (2014):** US$27.0 Billion
- **Population (2015):** 39.00 million
- **GDP Per Capita (2014):** US$750.00
- **GDP Growth Rate (2014):** 4.8%
- **Distance from Coast:** 1,250km from Mombasa
- **Government:** Republic and Constitutional Democracy with regular elections
- The land linked position, gives the country a strategic advantage to be a regional hub for trade and investment

*Data source: The World Bank*
• The **extractive industry** consists of any operations that remove metals, mineral, petroleum and aggregate from the earth
  
  o *Petroleum includes oil and natural gas*

• **Extractive processes** include oil and gas extraction, mining, dredging and quarrying

• Extractives can be both on land, under water and under the ground
OVERVIEW OF EXTRACTIVE INDUSTRY

The Extractive Industry Value Chain – Oil and Gas
OVERVIEW OF EXTRACTIVE INDUSTRY

The Extractive Industry Value Chain – Minerals

EXPLORATION
Geological mapping and prospecting
Drilling, grading and mine planning

MINING
Extraction of ores and transportation for processing
Environmental impact management

SMELTING & REFINING
Mineral ore processing to produce metals

MARKETING
Sales of the metal and revenue management
OVERVIEW OF EXTRACTIVE INDUSTRY

Characteristics of the Extractive Industry

• Resources (oil, gas, and solid mineral) get depleted with time and are non-renewable
  
  o *Extraction therefore does not create new wealth but transforms wealth from one form to another*
  
  o *Importance of not losing or wasting value or revenue from extractives but invest it to create other forms of durable wealth*

• Generate significant windfall revenues which are volatile and exhaustible
  
  o *Global market keeps fluctuating*
  
  o *Need for careful planning*
OVERVIEW OF EXTRACTIVE INDUSTRY

Characteristics of the Extractive Industry

• Create direct, indirect and induced jobs

• Often create significant opportunities for transfer of technology and knowledge

• Extractive industries are often capital and technology intensive, and characterized by long term and risky investments
  o High sunk costs
  o Takes time to realize revenue. Its common for revenue to start flowing after ten years from onset of investment

• Extractive Industries can be a cause for conflict and are prone to corruption

• Demand high attention to environmental conservation
Characteristics of the Extractive Industry

- Attraction of large Foreign Direct Investment (FDI)
- Provision of raw materials to spur industrial development including manufacturing and petrochemicals
Acreage/Licences

- Four (4) Active Production Sharing Agreements (PSAs)
- 3 License Operators (Tullow, TOTAL and CNOOC)
- Transition from small oil companies to super independent and major oil companies
Exploratory and Appraisal Drilling

- 121 exploration and appraisal wells drilled in the Albertine Graben to date
- 106 wells encountered hydrocarbons
- 39 exploration wells and 82 appraisal wells
- 21 oil and gas discoveries made and drilling success rate of over 88%
- 36 wells have been flow tested
- Crude blend between 17° – 33° API with very low sulphur of 0.16wt%.
- Paraffinic and waxy
Reserves and Resources

CRUDE OIL
- 6.5 Billion Barrels of Stock Tank Oil Initially In Place (STOIIP)
- 1.4 Billion barrels of recoverable reserves

NATURAL GAS
- 500 BCF of non-associated Gas Initially In Place (GIIP)
- 172 BCF of associated gas

Statistical increase in Uganda’s resources (Source: PEDPD)
Commercialization Plans

The petroleum resources discovered in the country to date will be developed in line with the Commercialization MoU entered into between the Government of Uganda and the Upstream Partners (Tullow, CNOOC and Total) in 2014

- Refinery development to be led by the Government of Uganda and a crude to power project
- Upstream development and Crude oil export pipeline being led by the Upstream companies

**CRUDE TO POWER**
Use of crude oil and gas for power generation
Provide long-term dynamic reservoir data for optimizing the full field development

**CRUDE OIL REFINERY**
Phased development of a 60,000 barrels of oil per day refinery
Natural gas processing and commercialization
Development of petrochemical and energy-based industry

**CRUDE EXPORT PIPELINE**
Export of crude oil by pipeline
STATUS OF UGANDA’S MINING SECTOR
Mineral Resources of Uganda

**Metallic Mineral Resources**

Are minerals which contain one or more metallic elements and can be melted to obtain new products.

Metallic minerals occur in rare, naturally formed concentrations known as mineral deposits.

**Industrial Mineral**

Are geological materials which are mined for their commercial value, which are not metallic ores, mineral fuels, and gem stones.

They mainly provide resources for the construction, chemical and manufacturing industries.

**Gemstones**

A gemstone or gem is a piece of mineral crystal, which, in cut and polished form, is used to make jewelry or other adornments.
Mineral Resources of Uganda

**Metallic mineral resources**
Beryllium, Bismuth, Copper (4.6m tonnes), Cobalt, Columbite-Tantalite (Coltan), Gold, Iron Ore (300m tonnes), Lead, Lithium, Manganese, Platinum Group of Metals (PGMs), Rare Earth Elements (REEs) (3bn tonnes at Makuutu in Mayuge), Tin, Uranium, Wolfram and Zinc

**Industrial minerals**
Bentonite, Clay, Diatomite, Dimension Stones (Granite), Feldspar, Glass sands (3m tonnes), Graphite, Gypsum (2m tonnes in Kibuku, Bundibugyo), Kaolin, Kyanite, Marble /limestone (300m tonnes in Hima and Langa), Mica, Phosphate (Apatite) (230m tonnes in Sukulu, Tororo), Pozzolana, Salt (rock salt, halite), Talc and Vermiculite (55m tonnes in Manafwa district)

**Gemstones**
Apatite, Corundum (ruby, blue sapphire), Fluorite, Garnet, Opal, Quartz (amethyst, rose), Topaz, Tourmaline and Zircon
Countries where petroleum industries have contributed to sustainable development usually have comprehensive and effective regulatory framework, with laws that are tailored to address the challenges of the extractive industries in the respective jurisdiction.

The laws in these countries clearly specify among others:

- The ownership of the natural resource
- How Foreign Direct Investment (FDI) can be invited to contribute to the development of the resources
- The roles of the state institutions that will regulate industry operations
- Comprehensive Health, Safety and Environment protection requirements
- A clear framework for fiscal terms
- Institutions with the requisite knowledge, organization and strength

The law, regulations and contractual framework that reflect the government’s key policy decisions.

Provisions that may need periodic adjustments such as technical requirements, administrative procedures, and administrative fees are set in regulations.

Equally important is the need for effective enforcement of these laws through effective institutions.
The National Oil and Gas Policy (2008)

**POLICY**

**LAWS**
- The Petroleum (Exploration, Development and Production) Act, 2013
- Petroleum (Refining, Conversion, Storage and Transportation) Act, 2013
- Public Finance Management (Amendment) Act 2015 that handles petroleum revenue management

**REGULATIONS**
- The Petroleum (Exploration, Development and Production) Regulations 2015
- The Petroleum (Exploration, Development and Production) (Health, Safety and Environment) Regulations 2015
- The Petroleum (Exploration, Development and Production) (National Content) Regulations 2015
- The Petroleum (Exploration, Development and Production) (Metering) Regulations 2015
- The Petroleum (Refining, Conversion, Transmission and Midstream Storage) Regulations 2015
Institutional Framework for Uganda’s Petroleum Sector

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<th><strong>DIRECTORATE OF PETROLEUM</strong></th>
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<td><strong>PETROLEUM AUTHORITY OF UGANDA</strong></td>
<td>• To regulate and monitor compliance of petroleum operations</td>
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| **UGANDA NATIONAL OIL COMPANY LTD** | • To move forward the country’s commercial interest in PSAs  
  • Create Joint Ventures with IOCs |
The World Bank Model

• The World Bank recognizes that proper stewardship of revenue from extractive industries has potential to lift people out of poverty and contribute to sustainable development

• Provides an integrated and comprehensive approach to managing the full Extractive Industry value chain, including EI development and impact

• The approach aims to support countries in their efforts to translate mineral and hydrocarbon wealth into sustainable development
The Petroleum Act 2013 and related Regulations:

- Clearly define the role of the state institutions. The Minister is mandated with strategic issues of policy, legislation and licensing.

- Provide for Contract awards through transparent and competitive licensing rounds to attract investors.

- The fiscal terms in the MPSA for sharing benefits between Government and investor is based on progressive R-Factor to cope with changes in prices and different conditions throughout the project life.

- Define local content obligations, including the use of local labor, goods and services. Can improve project economics, social benefits and minimize long-term risks.
The Petroleum Act 2013 and related Regulations:

- Clearly define the role of the state institutions. The Petroleum Authority is mandated to regulate operations and monitor compliance of the investors.

- Comprehensively address technical, costs, auditing and health, safety and environment requirements of operations. Incorporates internationally recognized standards.

- Provide for regulation of production, export volumes and regular audits of these including cost of operations.

- Provide for establishment of National Oil and Gas Resource Databank to facilitate better knowledge of the resource base and hence, reliability of government revenue estimates.

- Environmental Impact Assessments and Management Plans governed by the NEA (1995) and related regulations is enforced by National Environment Management Authority.
LEGAL FRAMEWORK AND SUSTAINABLE DEVELOPMENT OF PETROLEUM INDUSTRY

The Income Tax Act regularly updated

The Public Finance Management (Amendment) Act 2015 and related Regulations
Mandate for Cost Recovery Audits

• The Constitutional mandate of providing an independent assurance on the use of public resources is vested in the Office of the Auditor General and also created by the National Audit Act 2008

• Audits and Inspection Rights of Government in the contractual framework and in accordance with the Accounting Procedures described in the agreements

Overall purpose of Cost Recovery Audits

The Statutory Audits are undertaken to ensure that the costs of investments incurred by licensees are realistic so that the State and Investor get fair shares from petroleum resources
Some Industry Audit Issues

• According to the IMF, Extractive Industry revenues are vulnerable to failure to audit during exploration and development phases [...]. Neglect in auditing exploration and development expenses cost the tax base dearly when a project starts to generate income.

• Multinational oil and gas companies behave differently in different parts of the world.

• The petroleum industry is typically characterized by excessive project costs in the forms of “Gold-plating” and “Cheating on Actual Cost”.

• Audits therefore also need to assess the reasonableness of capital and operating expenditures of the companies.
AUDITING OF THE PSAs

Some Industry Audit Issues...

GOLD-PLATING

• Typically refers to costs inflation through overspending on projects

• Companies gold-plate when the fiscal regime gives an incentive to spend more on capital investment to claim a greater share of project revenue

• Characterized by among others;
  o Limited transparency and competitiveness in tendering
  o Procuring goods/services from affiliates, subsidiaries and foreign suppliers even when locally available
  o High rates of services often due to low volume of activity and work
  o Costs arising out of delays to operations (poor planning)
  o Excessive stockpiling of services and materials as operational risk mitigation measure
  o Excessive Head office cost allocation to operating countries

CHEATING ON ACTUAL COSTS

• Refers to over-invoicing, transfer pricing and other forms of cheating on actual costs

• Companies cheat to claim larger deduction for avoiding tax

• These are often confronted by tax officials when assessing corporate income tax
AUDITING OF THE PSAs

Processes and Experience - Uganda’s Cost monitoring Framework

The PSA provides for minimum work programme and Budget commitment;
A minimum level of exploration work guaranteed by the PSAs.

Licensees required to develop Procurement Procedures in consultation with GoU;
The Procurement Procedures need to be approved.

The Advisory Committee composed of industry and Government reviews and approves work programmes & budgets;
To ensure that the proposed activity and budget is acceptable;

Activities of licensees monitored throughout the entire duration of operations;
To ensure that work programmes are implemented as agreed and in accordance with approved budgets.

The Auditor General (AG) has overall mandate of scrutinizing the costs through a cost recovery audit;
The AG finally approves the expenditure that should be recovered by the licensees;

Cost recovery audit by OAG undertaken in Coordination with the Regulator (MEMD)
AUDITING OF THE PSAs

Benefits of the Coordinated Audited Approach

• Cost Recovery Audits by third party independent auditors have had limited success and may therefore not be the future of EI audit for the country to realize its fair share of benefits

• Audits now carried out by the OAG personnel have achieved higher success in identifying non-recoverable costs

• Audits increasingly benefiting from;
  
  o The 3E (Efficiency, Effective and Economy) Objective – “Was the expenditure to be incurred in the first place rather than authenticity of expenditure”
  
  o Multidisciplinary participation through increased engagement with the regulator
  
  o Trained and experienced personnel in various industry fields including petroleum accounting, finance, cost engineering and geosciences
AUDITING OF THE PSAs

Future Focus Areas - Cost Auditing

The following areas will require urgent focus in order to contribute to the achievement of realistic cost of investments in the petroleum industry in the country;

1) Undertaking of regular PSA audits to timely address emerging cost issues
2) Increase collaboration between OAG, the Petroleum Authority and the National Oil Company to support establishment of costs
3) Establishment of national supplier database as a platform for pre-qualification and selection of suppliers for contracts
4) Affiliate services have to be matched with third party services cost and quality
5) Explore better ways of regulating and auditing Head office and other operating centres cost allocation to the country
6) Enhancing technical capacity of the personnel entrusted with sector regulation and monitoring including PSA auditing
7) Harmonization of upstream petroleum accounting practices and standards
8) Benchmarking with other jurisdictions to share experiences
AUDITING OF THE PSAs

Future Focus Areas – Production and Revenue Audits

- Government revenue consist of several revenue streams, which may be collected in cash or in kind
  - Non-tax revenue - Royalties, fees, bonuses, production sharing
  - Tax revenue – Income tax, capital gains tax
  - Shareholder payments – Dividends and other forms of payments to shareholders of the Uganda National Oil Company Ltd (UNOC)

- Therefore, revenue collection and management is subject to multiple fiscal and legal instruments including the PSAs, the Petroleum Act, the Income Tax Act and the Public Finance Management Act.

- The same procedures are applicable to the UNOC who is responsible for selling crude oil received in kind on behalf of the Government
AUDITING OF THE PSAs

Future Focus Areas – Production and Revenue Audits

- Therefore, the Office of the Auditor General will realize new audit scope for the oil and gas industry covering among others, verification of:
  
  1) Data on the hydrocarbon volumes produced, consumed (Refinery) and exported
  
  2) The prices for petroleum actually realized by the sellers in the market conditions at time of the traction
  
  3) Whether the sale of crude oil and gas and other inter-affiliate transactions followed transparent and arms-length procedures
  
  4) Reconciliation of Government’s revenue collection accounts and the accounts of the companies involved

- Building capacity in specialized oil and gas accounting/finance disciplines and coordination between the Petroleum Authority, OAG, Ministry of Finance and Uganda Revenue Authority will be key in collecting the right petroleum revenue
SUMMARY AND CONCLUSIONS

- Successful and efficient exploration for oil and gas in Uganda resulting in 21 discoveries, 6.5 Billion barrels of Oil In Place and 1.4 to 1.7 Billion barrels of recoverable reserves at an investment of less than US$ 4 Billion

- The petroleum resources discovered in the country to date are planned to be developed in line with the Commercialization MoU agreed between the Government of Uganda and the Upstream Partners (Tullow, CNOOC and Total) in 2014

- The technical capacity of the government institutions entrusted with the regulations and monitoring of compliance (Petroleum Authority of Uganda, PEDPD, Office of the Auditor General, NEMA, MoFPED) is critical for effective, efficient and sustainable development of the petroleum industry

- Coordinated procedures and collaboration between the regulator and Office of the Auditor General is key to achieving realistic cost of investment and fair share of petroleum revenue to Government
THANK YOU

For Further Information, Contact
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