



**Ministry of Finance**

Assessment of Angolan  
Petroleum Sector - Final  
Report  
VOLUME 1b - Executive  
Summary

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*This report contains 30 pages*

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# **1 Introduction**

KPMG has been engaged by the National Bank of Angola (BNA), acting as agent for the Ministry of Finance of the Government of Angola (“the Government”), to conduct a diagnostic study of State petroleum revenues (“the Study”) and to provide an Inception Report and Final Report on the Petroleum Sector.

This Executive Summary represents a summary of the Final report, Volume 2. It crystallizes the issues leading up to as well as the recommendations emerging from our findings.

As such, this Executive Summary is presented as a stand-alone report which is available to the Government for publication.

## **1.1 Objectives of the study**

The aim of the ‘Financial Diagnosis and Monitoring of State Petroleum Revenues’ project was to conduct a diagnostic study of the upstream petroleum sector as it affected the public finances of the country, and the objectives of the diagnosis were to assist the Government of Angola to increase transparency in the flows of revenues from petroleum production, and to build managerial capacity for monitoring and forecasting the amounts and flows of those revenues.

As stipulated by the Government and the World Bank, our work does not amount to an audit conducted in accordance with international auditing standards and does not give the same level of assurance as an audit would. In performing our work we relied on data, information and documentation supplied from various sources. We did not attempt to verify the accuracy or completeness of any such data, information or documentation.

The Final Report (and the recommendations contained herein, and in Volume 2) has been prepared by KPMG and presented to the Government (represented by the Technical Committee) solely in connection with and for the purposes of the Study.

## **1.2 Structure of the Final Report**

The structure of the Final Report is as follows:

- Volume 1 comprises a guide to facilitate cross-checking of the outputs with the TORs and the Executive Summary;
- Volume 2 comprises the main report with recommendations;
- Volume 3 comprises the supporting appendices; and

- Volume 4 comprises the supporting manuals for the financial model and procurement, and a review of the regulatory role of State owned Oil Companies in certain countries.
- Volume 5 comprises the detailed fieldwork and analysis for the project. This is also encapsulated in the extended inception report in more detail.

## **2 Overview**

### **2.1 Background**

The recommendations that have emerged are a direct consequence of the fieldwork and analysis and of discussions with the principal stakeholders involved in this project, including government departments and oil companies directly involved in the Angolan oil and gas sector.

Our recommendations attempt to draw attention to critical areas of revenue management, transparency and regulation that require improvement to enable the Angolan government to better manage its revenues from the oil sector, and the recommendations have been developed on the basis of the following three principles:

- improved transparency and financial management;
- good governance; and
- institutional strengthening.

Some of the recommendations may be reasonably straightforward to implement, others may be more difficult due to political or administrative pressures or may require significant work on an extended timeframe.

### **2.2 Concerns by the Technical Committee**

The Consultants understand the concerns that have been expressed with regard to the recommendations relating to Sonangol Holding and also to the concept of creating a stand-alone Petroleum Revenue Management Agency.

We have been advised by some members of the Technical Committee that any potential transfer of the regulatory role from Sonangol Holding to the Ministry of Petroleum could be a disaster for the country, and comparisons have been made to a similar situation (transfer of the regulatory role) in the diamond sector in the early 1990s.

The foreign oil companies, we were advised, have been very comfortable with dealing with Sonangol Holding as concessionaire. Transferring the regulatory function out of Sonangol Holding would cause severe problems. Resource issues would result also within Ministry of Petroleum arising from any transfer of responsibilities to the Ministry.

We fully understand the arguments put forward by some of the Technical Committee members that the problems in Angola are “unique”. We have been told that Angola is not an industrialised country and cannot be compared to Nigeria, Algeria, Indonesia or Norway – where we have used Statoil in our recommendations as a successful example of the segregation of upstream and downstream oil and gas activities from a purely regulatory

function. We have also been reminded that the lack of skills within Government ministries and the BNA and that the greatest concentration of in-depth skills and knowledge is to be found within Sonangol Holding.

In support of these points, we also noted in the Government Ministries the apparent lack of any human resource strategy which would encourage young people with the requisite skills attracted by improved salaries and career prospects.

However, the Consultants believe that the emerging period of stability in Angola does represent a unique opportunity for change within the country. We would emphasise that if the key recommendations, arising from the analysis we have undertaken, are accepted in principle, it would mark the start of a process towards implementation. The detailed procedures, resources, funding strategy, planning regarding organisation and timescales would need prior approval by the Government. The resources required to assist the Government in the implementation process would also have to be considered. Above all, the commitment by the Government to change is important in order to exploit the latent power of the country and to develop a long-term strategy for the country's economic and educational development.

We would hope that our recommendations in the Final report can be used as a catalyst for agreement by the Government on the way forward, and we would be glad to have the opportunity to discuss further the recommendations or any changes that may be requested by the Committee to help in progressing the way forward.

## 2.3 Recommendations

We now turn to our recommendations, which are divided into the following 6 main categories.

- **Recommendations relating to Technical arrangements**
  - Measurement, costs and contractual recommendations;
- **Recommendations relating to Legislative, regulatory and fiscal arrangements**
  - *Petroleum Revenue Management Legislation; (Top priority)*
  - Petroleum Legislation;
  - Petroleum Account and Decree 30/95;
  - Decree 15/89;
  - Fiscal Regime;
- **Recommendations relating to Revenues Inflows and Outflows arrangements**
  - Timing of Tax Payments and related issues;

- Timing of Profit Oil payments by the Concessionaire;
- Regional Payments;
- Bonuses;
- International Loans;
- **Recommendations relating to Accounting arrangements**
  - International Accounting Standards;
  - Joint venture debate;
  - BNA Accounting issues;
- **Recommendations relating to Institutional Strengthening arrangements**
  - *Establishment/Operation of a Petroleum Revenue Management Agency; (Top Priority)*
  - *Role of the Concessionaire; (Top Priority)*
  - Issues relating to Sonangol's expansion;
- **Recommendations relating to managerial capacity enhancements and future needs**
  - Secondments from Oil Industry to the Petroleum Revenue Management Agency;
  - Training staff of the Petroleum Revenue Management Agency;
  - Financial model extension.

In terms of implementing these recommendations, we consider that the main priority should be focused on

- **Reviewing Petroleum Revenue Management Legislation;**
- **Establishing and operating a Petroleum Revenue Management Agency;**
- **Transfer of the role of the Concessionaire;**

These three recommendations should be addressed simultaneously, ideally as an inter-related programme, while the other recommendations, such as those described below relating to revenue inflows and outflows, institutional-strengthening, managerial capacity enhancements and training, would be addressed automatically within the remit and operation of the new stand-alone Petroleum Revenue Management Agency.

The remaining recommendations consisting of the accounting arrangements and technical arrangements can be addressed thereafter.

### 3 Recommendations relating to technical arrangements

In accordance with the TORS section 11.a, these represent our recommendations based on the analysis undertaken over 2001/2002 to examine the exporting of petroleum from the terminals off Cabinda. In this sense, these are technical/physical issues which can be tackled jointly by the government and Petroleum Companies.

#### 3.1 Safeguards against misstating of export crude volumes, tampering with the water content crude and tanker demurrage calculations or reserves

We undertook a study that included the safety and operational procedures affecting the successful outcome of oil custody transfer. Particular attention was given to making recommendations on safeguards against the misstating of export crude volumes, tampering with the water content of export crude and tanker demurrage calculations or reserves.. For this purpose, the most relevant information gathered relates to how accurately the Bill of Lading quantities are actually made and calculated. From what was observed during our series of visits, our findings are that there are several aspects requiring improvement.

##### 3.1.1.1 *Kuito FPSO*

We found that the in-line sampling system was not functioning properly due to faulty equipment as the circulating pump for the "fast loop" sampling ring was missing. It is clear that major modifications are necessary, including modifying the sample container in order that the sample level may be physically sighted at any time. There was no means by which the sample could be mixed *in situ*; an arrangement must be added so that this can be effected. The grab size was not certain or calibrated properly.

**We recommend that these items are corrected as otherwise the validity of the in-line sampler being representative of the entire parcel of product off-loaded will always remain in doubt.** The metering system control is entirely remote: there is no local back-up control. **We recommend, therefore, that the mechanical totalisers are fitted to each meter so that local readouts may be obtained in case of remote failures.**

##### 3.1.1.2 *Palanca FPSO*

Again, the metering system control is remote, with no local back-up. We recommend that mechanical totalisers are fitted to each meter so that local readouts may be obtained in case of remote failure. At the present time the meter system repeatedly fails when proved. Thus the FSO ullages and temperatures have to be relied upon to calculate the Bill of Lading.

The FSO is located in the open sea and is in constant movement often rolling and pitching moderately, thus making any physical reading inaccurate. Basing Bill of Lading quantities

on this basis is not acceptable. **We recommend that the meter repair situation needs to be addressed and corrected with the utmost urgency. We also recommend changing in-line sample management.** The sample should not be tampered with until the off-loading operation is completed. As a prudent practice when carrying out analysis tests, **we recommend a blank sample of each solvent used should also be tested at the same time to ensure that nothing is being added by these materials.**

### 3.1.1.3 *Lombo Este FSO and Malongo Terminal*

The last two points from Palanca Terminal above apply concerning the in-line sample management and the use of blank samples. Shore tank measurement methods and measurement are generally satisfactory at this terminal but, because of the constant urgent demand for tankage, there is often insufficient settling time allowed from the last tank movement before gauging takes place. **We recommend that the oil companies rehabilitate or renew the metering system as an urgent priority.** Under the circumstances seen in Malongo the metering system should be considered the primary means of measurement with manual shore tank measurement as the back-up.

**We also recommend that the whole method by which in-line samples are drawn is reviewed to comply with an internationally recognised standard.** This may mean the renewal of the existing sampling system. **We also recommend that fail safe "lock out" systems should be installed at the shore tank manifold to ensure that no mistakes or illegal manipulations continue to be made.**

## 3.2 **Safeguards against the overstating of unit costs of production, operating costs and field development costs, the inclusion of unauthorised costs in the costs recovery account and introducing undue changes in fiscalisation procedures**

The Consultant reviewed the procedures for measuring capital and operating costs. Our main findings are that operating costs (excluding abandonment) in Angola appears to be relatively low by international standards due to the mild environment, the low rig rates and the fact that work over costs, or a large part of them, are capitalised. Procedures to determine operating costs are based on operating costs at plateau production.

During the decline period the operating cost only drops by the variable element of the operating cost, which will only be a small percentage of the total. If secondary recovery techniques are adopted the operating cost can, and often does, increase during the decline period.

However, the present method of cost reporting makes it impossible to establish the fixed and variable elements of operating cost. Additionally for Block 0, where all of the costs are aggregated, the operating cost of each field cannot be established with it only being possible to

say that Area A has a higher operating cost than Areas B and C because of its relative maturity and higher level of secondary recovery.

**We recommend that Cost audits are rigorously undertaken by independent auditors (with duty of care to the Government) in order to identify gold plating by the Oil Companies and the overstating of unit costs in conflict with the provisions of the joint operating agreements.**

#### **3.2.1.1 Budget Preparation**

We recommend that budgets continue to be prepared annually for each concession/PSA commencing with partner discussions at a PPM (Partner Planning Meeting) in midyear. After budgets have been agreed with partners at a JOC (Joint Operating Committee) they are agreed with the Concessionaire, Sonangol, during early to late autumn each year. **We recommend that budgets developed continue to include the firm budget for the forthcoming budget year plus a 5 Year Plan covering the provisional budgets for the subsequent 5 years.**

#### **3.2.1.2 AFE and Fiscalisation Procedures**

Expenditure funds are released from the budget by AFE (Authorisation for Expenditure) and Fiscalisation procedures. **We recommend that AFEs and fiscalisation procedures continue to cover discrete parcels of work such as a new platform or pipeline a discrete phase of a project such as a new well cluster and can cover the current budget year plus planned concomitant expenditure in future years. We also recommend as a safeguard that AFEs must be authorised by both the JOC and the concessionaire (currently, Sonangol Holding).**

#### **3.2.1.3 Work Order Procedures**

After AFE approval the operator may need work to be undertaken by its head office. **We recommend that in order to request work from its head office the operator must raise a Work Order, and that these Work Orders must have prior approval from the concessionaire (currently, Sonangol Holding)**

### **3.3 Safeguards against concluding contracts for the procurement of goods and services without adequate competitive bidding**

Part of the study by the Consultants involved an assessment of the concluding of contracts for the procurement of goods and services without adequate competitive bidding. We

identified a number of shortcomings in the process, and therefore make the following recommendations.

### 3.3.1.1 *Sealed Bids*

**We recommend that for contracts estimated to cost more than \$150,000-250,000 (depending on PSA) sealed bids must be invited. The detailed procedures adopted can vary from company to company but in essence they should be similar.** There is a list of contractors, agreed with the concessionaire, Sonangol, who are pre-qualified to undertake specific types of work and these companies are automatically on the bidders list for the type of work for which they are pre-qualified.

The bidders list for each invitation to tender, valued at over US\$750,000 must be agreed by the concessionaire, Sonangol, who has the right to add or delete contractors from the list provided they do it within 15 days of submission. The concessionaire is present during the opening of all sealed bids and signs them prior to referral to the contracting department for detailed analysis.

The contracting department analyses the bids and makes its recommendation for contract award to the sealed bid committee (or in the case of TFE the Contracts Department). The contract is then either awarded or returned to the contracting department for more detailed analysis. The concessionaire, Sonangol, must approve a contract prior to award. They have 21 days from submission either to approve an award or make alternative recommendations.

None of the operators ask the contracting department to produce a control estimate prior to tender invitation. They rely on the budget or AFE as a control estimate. Asking a contracting department to produce a detailed cost control estimate before the invitation of tenders could be a useful discipline to adopt.

### 3.3.1.2 *Negotiated Contracts*

There are circumstances where it is desirable to enter into a negotiated contract. This can happen when there is insufficient time to invite tenders for the work or where there is only one practical bidder, for example the fabrication yard at Lobito for small structural work.

**In these circumstances, we recommend that the contracting department requests permission from the Sealed Bid Committee, or the contracts department, to negotiate a contract.** Having received the necessary authority the contracting department can then negotiate a contract. **We recommend, however, that authorisation must still be obtained from the sealed bid committee, or the contracts department, to enter into the contract after negotiation.**

### 3.3.1.3 *Purchasing Procedures*

Purchasing procedures are adopted for the purchase of materials, such as linepipes, fittings drillpipe and casings and equipment, eg pumps and compressors. Bills of Material (BOMs) are used to requisition materials and equipment, either from local suppliers or from the operators central purchasing office. Since very little industry materials and equipment are available in Angola this means purchasing virtually everything via central purchasing office.

**We recommend that the Central Purchasing Offices obtain quotations from suitably qualified suppliers and, after approval of the quotations, places orders for the materials and equipment on behalf of the operator.** Following this process enables the benefits of bulk purchasing to be passed on to the operator.

**We also recommend that the best practices for procurement process are adhered to. As part of the TORs we have provided a Procurement Manual (see Volume 4) for review and comparison with current practices for procurement within the Government and Sonangol.**

## 4 Recommendations relating to legislative, fiscal and contractual arrangements

### 4.1 Petroleum Revenue Management Legislation

A review of existing Petroleum Legislation is required to determine whether any new law or regulation is needed to establish the Petroleum Revenue Management Agency together with its objectives and operational responsibilities. Thereafter, if required, a new law should be drafted to establish the Agency setting out its powers, duties and roles including how it will be funded in order to attract the requisite skills. **As such, we recommend that the Government establishes a legal taskforce charged with this above review and, if appropriate, to draft the new legislation within a pre-agreed timescale. This task force should be chosen by the Deputy Prime Minister and should report to him on progress on a regular basis.**

### 4.2 Petroleum Legislation

A new draft Petroleum Law has been circulated at a senior level in government and within the National Assembly. The law has been drafted to reflect new concepts and practices in international and Angolan petroleum law.

The consultants undertook an initial review of the draft law and concluded that, taken as a whole the law gives the government (or its agent) discretionary powers which many investors would regard as being rather too great. **As such, the consultants recommend that further work by legal and industry specialists should be undertaken to re-examine the law in the light of these findings.** Specifically the review should take into account the perception of political risk from the investor's perspective.

### 4.3 Petroleum Account and Decree 30/95

The Central Bank is responsible for executing the monetary policies of the government including control of the money supply, and maintaining the exchange rate through open market operations in order to determine the interest rates for the country. It is also responsible for managing the foreign currency reserves of Angola, and negotiating, raising, servicing and repaying loans taken out on the Governments behalf.

Decree 30/95 stipulates that it is obligatory for export sales to be processed through the BNA. We understand this to mean that the BNA must be advised in advance of all export sales and that the related proceeds in foreign currency must flow through the BNA. Our findings suggest that at present this is not the case. As a result the BNA has no meaningful control over the flow of foreign currencies. Most of the foreign currency reserves were created by the tax flows from the foreign oil companies but these taxes are now progressively being paid through the commercial banks.

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The consultants have discovered that Sonangol does not process all of its cash calls or taxes via the Petroleum Account. The company considers that there is no need for an intermediary institution to account for these activities as it maintains that the extra layer of accounting represented by the Petroleum Account within the BNA has led to inefficiency in the past and even loss. The consultants acknowledge the problems faced by Sonangol, but as a result of the company's unilateral action the BNA is unaware of the values of export sales and the foreign currency generated and the related effect on Angola's balance of payments.

The BNA has, over the years, been providing credit to commercial organisations which it is not empowered to do. For example, when Sonangol has been unable to pay (or credit) the BNA with the value of the cash call, the BNA has in reality paid the cash call on behalf of Sonangol and in effect has therefore loaned the funds to Sonangol in order for it to pay its cash call obligation. This situation has in fact occurred in the past. Under Decree 30/95, the BNA is not permitted to give credit to any commercial enterprise and is eroding its responsibilities as the Central bank by so doing.

It is apparent that legislation which has been properly enacted, such as decree 30/95, is not being adhered to. **The consultants strongly recommend that the law should be enforced and that all parties must conform to the requirements of decree 30/95.**

The BNA should perform an exercise in order to determine at an agreed cut off date the balances in its books that are outstanding with the commercial entities. Senior management should agree a programme of settlement of these balances. They should create a senior team dedicated to perform this exercise within a specific time scale. They should be given specific written guidelines and their team leader should report progress to an agreed top manager at regular intervals and complete the exercise by an agreed date.

A government working group was created in 2001 to review the workings of the Petroleum Account and decree 30/95. The result was a proposed draft new decree, which sought primarily to remove the BNA from its present role as intermediary with regard to the Petroleum Account. As far as the consultants are aware this draft decree has not passed into law, and its tenets are disputed by the BNA.

**We would argue that the recommendations from this working group be considered carefully and impartially before finalising any decree to replace 30/95.** While it is important to ensure that Sonangol does not suffer loss through the administration of the Petroleum Account, it is as important that any new decree affecting the original purpose of the Petroleum Account and its continued existence does not prejudice the role and responsibilities of the BNA as guardian of Angola's foreign currency reserves, controller and administrator of the government debt.

**We would recommend that further work is required in this area. A dedicated Government team should be established charged with reviewing the workings of decree 30/95 under which the operations of the BNA, Sonangol and the Ministry of Finance operate.** The team, which ideally should be comprised of senior experts who are independent of the three entities, should suggest revisions where necessary after reviewing their findings with the three entities. The review team should have the backing of a Government remit and report back to an agreed top Government official. The overall objective will be to have modern legislation that supports the current Government strategy

for the conduct of business that the BNA, Ministry of Finance and Sonangol undertake as instruments of the Government.

#### 4.4 Decree 15/89

Decree 15/89 approves the mechanism by which Sonangol submits the revenues received in its capacity as concessionaire to the government. Sonangol is entitled to retain up to 10% of the revenues in order to meet its operational costs, the balance being transferred to the state within a period of two months together with payment of PIT.

Although the legislation states that up to 10% may be claimed by the Concessionaire the Concessionaire does not claim less than the maximum allowed of 10%.

The consultants were unable to obtain from the Tax Directorate sight of an invoice or equivalent form of billing which under good accounting practice would be submitted by the concessionaire detailing the concessionaire's time and internal costs incurred to support the operating costs. Should operating costs invoiced be less than the maximum 10% allowed under the legislation the balance should be remitted to the Ministry of Finance.

Further, Sonangol nets off the commission against the profit oil due first before remitting it to the Ministry of Finance. The Ministry of Finance therefore receives the net 90% of the profit oil due and only the one transaction is needed to record this "short cut".

**The consultants strongly recommend that the Concessionaire must submit an invoice to the Tax Directorate to support its operating costs.** In doing so the Concessionaire would be conforming to normal principles of international accounting and supporting the process of transparency. **Further the consultants recommend that the payment of the gross profit oil to the Ministry of Finance, and the raising of the commission charge should be represented by two separate transactions.**

#### 4.5 Fiscal Regime

The Angolan fiscal regime is particularly complex. Separate regimes exist for Association contracts in Concession areas and Production Sharing agreements. Within each of these regimes a further layer of complexity exists with different vintages of contract applying to both regimes. Under the Association contracts in Block 0, Area A differs from Areas B and C, regarding the allowances available for Petroleum Transactions Tax. Onshore, both Congo and Kwanza areas differ in relation to the rate of royalty applied.

The complexity and cost of administering such a regime can be particularly burdensome. A significant level of skilled resource is required to administer the full regime effectively. The fact that each PSA is negotiated separately is time consuming and costly. The burden will fall significantly on Sonangol and the regulating ministries such as the Ministry of Petroleum and the Ministry of Finance. The complexity must greatly increase the difficulty of revenue administration, transparency and maintaining sufficiently skilled resources. Implementing

measures to enable a sound and efficient management of the fiscal and legislative regime is an important issue that must be addressed by the government.

The negotiation of sophisticated production sharing agreements will increase in future as the Angolan oil sector expands. The consultants found that the Ministry of Finance does not have a sufficient understanding of the impact of these contracts in terms of sensitivity to oil prices and costs or how they contribute to government revenue by capturing economic rents.

We do acknowledge that the old association contracts have been modified over the years, principally at the request of investors, and that to re-examine these would in all probability be impractical.

**However, we do recommend that a review of the present Production Sharing regime should be undertaken by independent specialists with the aim of making recommendations to simplify the system. The review should examine the possibility of defining a model contract. The review should also examine the regimes effectiveness in targeting economic rent and consider its sensitivity with regard to oil price, the cost environment (including incentives to gold plate and the impact of uplifts), international competitiveness and the Angolan investment climate. The review would be tasked with advising on the form of a single model contract that would meet, as far as possible, the requirements of an optimal system of petroleum taxation and production sharing<sup>1</sup>.**

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<sup>1</sup> The key characteristics of an optimal fiscal system should incorporate the following objectives:

1. To achieve for the government a high overall level of government tax/revenue, consistent with further encouragement of the exploration and development of fields that are viable on a pre-tax basis.
2. To avoid distorting behaviour such as premature abandonment, over-investment or gold plating.
3. To achieve for the government at least part of the fiscal revenue comparatively early in an oil or gas field's life.
4. To establish an 'appropriate' degree of project risk sharing with the operator via the fiscal system.

In order to achieve these objectives an optimal fiscal system should provide for the following.

- The system should be targeted on economic rents. As such it should be inherently sensitive to variations in the oil price, the size of oil or gas fields, field development costs, and operating or production costs.
- In addition the system should permit the recovery of costs plus an 'adequate' return on the risked investment
- An optimal fiscal system should avoid any gold plating incentives and ensure that no premature abandonment of a field is created due to the fiscal terms devised.
- Finally, an optimal fiscal system should be manageable and straightforward to administer, with reasonable compliance costs.

## 5 Recommendations relating to Revenue Inflows & Outflows arrangements

### 5.1 Timing of Tax and Profit Oil payments

Current legislation states that the timing of tax payments, including Petroleum Income Tax, is made not later than the last day of the second month following the month during which the oil lifted. During 2000 Sonangol made monthly liftings and sales. However, the Tax Directorate only received payments of Sonangol taxes in three months of the year. This suggests that current legislation regarding the timing of tax payments is not being adhered to.

**The consultants recommend that the Tax Directorate should ensure that existing legislation regarding the timing of tax payments and arrears including any penalties, is adhered to. Tables should be prepared showing over each 12 months the timing of taxes progressively received during these 12 months.** The timing of taxes due versus taxes paid can be compared then on an ongoing basis and arrears calculated for the submission of penalty claims to the oil companies concerned.

### 5.2 Timing of Profit Oil Payments by the Concessionaire

The consultants discovered that Sonangol does not remit to the Ministry of Finance the government share of profit oil on a timely basis. In 2000 only three payments of Profit oil were made during the year (April, June and December according to the records of the Ministry of Finance). Sonangol should pay to the government Profit oil due on a timely basis consistent with the legislation.

Further the consultants were unable to identify, from the year 2000 analysis, the allocation between the government share of Profit oil and Sonangol's equity share. Sonangol should provide adequate back-up and supporting information to satisfy the Tax Directorate of the accuracy of the allocation of Profit oil between the government and Sonangol<sup>2</sup>.

The consultants were also unable to prepare from the information in the year 2000 fiscal reports, a meaningful composite analysis of profit oil due from each block, and as a consequence, the respective share of each company, including Sonangol P&P. This is required in order to match the total of such analysis, in gross terms, with the equivalent Profit oil sold by Sonangol on behalf of the Government. **The Consultants recommend that detailed workings to support the above calculations should be prepared by the Concessionaire and form part of the back-up submitted when the Concessionaire submits transfers of Profit oil over to the Tax Directorate. This would assist the process of accounting transparency.**

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<sup>2</sup> In the year 2000 two sources of Profit oil were obtained by the consultants from the Ministry of Finance. The consultants were unable to reconcile the two figures, nor were they able to reconcile either of these with the Profit oil received as recorded in Sonangol's Fiscal Reports.

### 5.3 Regional Payments

The foreign oil companies operating in Cabinda and Zaire provinces make regional payments to the provincial governments of Cabinda and Zaire. These payments are made under a side agreement between the companies and the government of Angola. Payments are monthly and are made direct by the oil companies to the provincial governments via accounts at commercial banks. The Ministry of Finance adjusts its PIT income accordingly.

The Ministry of Finance also adjusts its PIT income to allow for ad-hoc expenditures by the Ministry of Petroleum such as stamp duties, some consultancy and other emoluments all of which are paid for out of the PIT income set aside for this purpose.

The consultants do not view the current system of regional payments as being completely transparent. The consultants did not get sight of the side agreement, and although these payments are registered as a deduction of PIT income in the Tax directorates records the Ministry has no control over these payments or how they are used by the provincial governments.

**The consultants recommend that a system of regional payments should be administered centrally. The Provincial governments of Cabinda and Zaire should submit an annual budget of expenditures with an indication of how these expenditures will be used. Regional payments would then be administered by the appropriate government authority. However, the consultants do acknowledge the political implications that this issue raises.**

### 5.4 Bonuses

Currently all bonuses, whether signature, exploration, commercial discovery or production bonuses are paid directly to Sonangol. The Consultants understand that the Tax Directorate of the Ministry of Finance does not record bonus payments in its aggregation of annual tax receipts. This is an anomaly that the consultants recommend should be addressed. **The consultants recommend that all bonus payments should be made direct to the Ministry of Finance via the BNA.**

In more recent production sharing contracts it is stipulated that some bonus payments are designated for community and social development projects to be defined by Sonangol. In the time available, the Consultants were unable to find any record of which Community and Social projects benefited from these bonus payments. It is important for transparency that such projects are publicised, and that supporting information is available to back-up the costs of implementing and running these projects.

We believe that Sonangol is not the appropriate vehicle for engaging in the identification and funding of such projects. **The consultants recommend that funding should be through Central government, and that the appropriate levels of expenditure should be channelled through the relevant planning authorities or Ministries responsible.**

## **5.5 International Loans**

The Consultants received information on some of the loans relating to the Cabinda and Petrol Project enabling them to determine the amount of capital and interest that was paid by the Government (or Sonangol as their representative) in 2000. However, they were unable to assess the amount or volume or value of production of petroleum that was collateralised against each of the loans. The consultants do not view the current system of record keeping of international financing loans collateralised against production as being completely transparent, and therefore **recommend that the Government develops a database and recording system which will allow the identification of international financing collateralised against existing and future petroleum production.**

## 6 Recommendations relating to Accounting Standards

### 6.1 International Accounting Standards

Both the BNA and Sonangol prepare their financial accounts in accordance with Angolan accounting standards. However, these are required only to satisfy basic local fiscal requirements and do not address the requirements of financial transparency.

The majority of companies use International Accounting Standards (IAS). For many commercial companies reporting to IAS is critical when entering the financial markets to secure loans. Financial information has a significant role in presenting an entity to interested parties. Both Sonangol and the BNA in conforming to government strategy, require ongoing and increasing access to international sources of financing whether it is in the form of international loans or joint venture projects with foreign companies.

Current and potential lenders find it difficult to understand the way financial information is currently presented. From their point of view the information falls short of what they require to take a balanced view. Consequently it is difficult or impossible to make meaningful financial decisions, and profitable opportunities will potentially be lost. This also has a negative impact on the business goodwill which the international lending institutions have towards Angola.

**The consultants strongly recommend that Sonangol and the BNA implements IAS as soon as possible.** It is understood that new accounting legislation was to be introduced in January 2002, based upon generally accepted international accounting standards. We would hope that both the BNA and Sonangol are committed to the process of moving over the next 12 months towards upgrading their internal accounting processes and organisation, and the skills of their accounting personnel, in readiness to fulfil the requirements for accounting transparency imposed by the current legislation.

**Sonangol and the Bank of Angola should also adopt Financial Consolidation in accordance with International Accounting Standards (IAS).** This permits companies to develop a reporting system that will satisfy the qualitative characteristic of financial reporting. Developing a reporting system based on the values of financial information which is already standard practice amongst the international companies with whom Sonangol deals, will ensure that Sonangol will be able to compete with the rest of the world on similar terms

**The consultants also recommend that the government, initiated by Sonangol and the BNA, implement a review team to assess the transition to the new accounting legislation during 2003.** A small working committee of key accounting personnel, with representation from Sonangol and the BNA, should be charged with monitoring the implementation of the new legislation and ensuring that upgrades to the accounting organisation, accounting skills and the processes necessary to conform with, at a minimum, the new chart of accounts and related accounting presentation requirements, are achieved.

A key test will be to produce financial statements for 2003 which are representative, trustworthy, comprehensive and easy to understand. While the new legislation may not fully consider the best accounting practices for banks nonetheless the new rules should be

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considered as a catalyst for a review of the current deficiencies in banking accounting practices and the operational deficiencies which affect accounting procedures.

An early start should be made on this fundamental work as currently the BNA and therefore the government are unable to produce meaningful numbers to show the amount of total government debt that is outstanding nor the amount of foreign currency reserves that may be available.

As a result of the new period of political stability coupled with the rapid expansion in Angola's oil and gas industry Angolan organisations have good reason to develop their activities to meet the standards followed by international business. For example, the importance of Sonangol to Angola in its capacity as state oil company and also as an equity partner in international joint ventures, makes it imperative that the group develops an accounting and reporting system that is in accordance with the international accounting standards (IAS) followed by the international business community with which it does business

The new political stability gained since the ceasefire should encourage further expansion of business activity in Angola especially in the oil and gas industry. Sonangol, as state oil company and equity partner in international joint ventures is uniquely placed to gain more respect and influence as an international player. A key to fulfilling this potential is for Sonangol to adopt the most important of the internationally accepted methods of accounting and reporting.

## 6.2 Joint Ventures debate

Sonangol has established a number of Joint Ventures with oil industry contractors to supply goods and services to the oil industry. We would argue that there are potentially serious conflicts of interest where Sonangol is acting as a contractor supplying goods and services to the oil industry, as an oil exploration and production company, and as Concessionaire. All contracts with a Sonangol joint venture company should be on an arms length basis. Although we did not find evidence that contracts have been awarded to Sonangol when they were not the lowest evaluated tenderer, the possibility for Sonangol to exert pressure on operators to award contracts to a Sonangol Joint Venture must exist. In the interests of transparency this should be avoided.

As with all companies whose primary objective is to provide goods and services in Angola, **we recommend that Sonangol's joint venture companies should be registered in Angola and be subject to Angolan taxation and foreign exchange regulation. Payment for the services provided by Sonangol's joint venture companies should be made in local currency into bank accounts in Angola. Any foreign exchange payments made by the joint venture should be made through the Bank of Angola in the normal way.**

### **6.3 Accounting Issues at the National Bank of Angola**

The BNA's accounting for the transactions relating to oil financial flows has been deficient. Unfortunately, the creation of the Petroleum Account was not accompanied by improvements in the cycle of the flow of documents required by the BNA to support, for example, the accurate and timely booking of accounting transactions to the Petroleum Account and the detail financial controls required for monitoring individual movements of loans. Problems include lack of definition of responsibilities, lack of accounting organisation and overall lack of accountability.

We believe that the BNA has made substantial progress in reducing these accounting deficiencies in recent years although problems still persist especially within the operational areas of the bank.

However, the foregoing internal issues and problems has a serious impact on the quality and transparency of the financial statements of the BNA. An audit was completed of the financial statements for the year 1999. However these do not support the transparency of the results or indicate whether the reported numbers give a true and fair position regarding the profit or loss and assets and liabilities of the bank.

**We therefore recommend that the BNA improves its accounting for transactions relating to oil financial flows.**

## **7 Recommendations relating to Institutional-Strengthening Arrangements**

### **7.1 Establishment and Operation of a Petroleum Revenue Management Agency**

The rationale for the establishment and operation of a PRMA is threefold: First, it is a more visible and transparent entity and can operate as a separate, autonomous body outside the mainstream civil service. Second, its operational performance can be sustained and measured more easily and effectively because its functions are separate. Third, it is not currently encumbered with a 'memory' that may restrain or inhibit the adoption of best practice operational procedures and processes allied with the employment of well-trained and motivated Angolan staff.

The two main functions of the Petroleum Revenue Management Agency would comprise the:

- Reconciliation process of the petroleum taxation revenues to and among the State entities (such as the Ministry of Finance, BNA and Sonangol);
- Financial monitoring process (which includes the process of forecasting petroleum revenues as well as assisting the Government in preparing future budgetary policy and planning).

#### **7.1.1 Reconciliation process**

One key activity of the Agency is to reconcile recording differences in taxes paid and received. Analysis previously undertaken highlighted clear discrepancies between taxes and profit oil receipts recorded as having been paid to the government, as per the fiscal reports, and with the records of equivalent receipts of taxes and profit oil payments recorded by the Tax Directorate, the Accounts Department of the Ministry of Finance, and the Bank of Angola. We believe that these differences largely arise due to the difficulty in reconciling original tax payments made in US dollars to these US dollar amounts later translated back from the Kwanzas. The problem is exacerbated due to the highly inflationary environment in Angola and the effect that this has on the timing of the translation of dollars to Kwanzas and vice versa. In order to reduce this problem, the banks would report immediately on receipt to the Petroleum Revenue Management Agency the dollar value, paying company and date of receipt of all taxation payments made by the oil companies.

It would be the responsibility of the Agency to aggregate these dollar totals monthly and compare them with the quarterly and monthly forecasts of taxes receivable in dollars for the year concerned as calculated by the financial model. The monthly reconciliations would be aggregated at year-end into a master or consolidated reconciliation of all taxes paid over the previous twelve months. The work of the Agency would also then compare dollar taxes due and paid by the oil companies for the past year as per the fiscal reports with its records of

taxes received in dollars as reported by the banks. The Agency would then be responsible for following up and reconciling differences on a timely basis.

The Agency would also compare the daily lifting reports of all the Oil companies as prepared by independent inspectors, such as Saybolt, with the reported volumes and sales invoiced values of oil sold by Sonangol and the foreign oil companies. This data should be compared with the equivalent data produced annually (currently by Ernst Young) in their fiscal declarations for each company.

The Agency would require statutory powers of investigation that would enable it to carry out the various activities proposed without hinderance.

### 7.1.2 Financial Monitoring process

The other main activity of the Agency is to take responsibility for the financial monitoring system of State revenues. One important instrument in this process is the Financial model that has been developed to model and compare revenue flows to different State bodies, backcast petroleum revenues, forecast petroleum revenues to the State, and to assist the Government in preparing its budgetary policy and planning. Currently, the Financial Model provides forecasts of petroleum revenues five years ahead to the Ministry of Finance, and the responsibilities of the Agency would include liaising with the Angolan petroleum industry in order to obtain periodic updates of forecast reserves, costs, revenue income and taxes, and comparing forecast taxes with actuals received as confirmed from the reconciliation process.

**Given the importance of the reconciliation and financial monitoring and modelling process in supporting increased transparency, improved financial management and accountability, the Consultants recommend that the Government establishes a stand-alone Petroleum Revenue Management Agency.**

The design and implementation of the agency requires further work, and it is also proposed that the Government investigates the opportunities for assistance from the donor community to establish the Agency.

We therefore recommend that the Government supports a study to design the blueprint for Petroleum Revenue Management Agency. Such a study would encompass options and recommendations for;

- the appropriate Institutional form or structure;
- primary and secondary legislation required to establish the Agency;
- the necessary powers, role and duties of the Agency;
- design of business and reconciliation processes and procedures;
- management data and information systems (MIS) and IT requirements of the Agency;
- recruitment of senior, middle and junior staff of the Agency;
- review of the sources of funding of the Agency; and

- the development of an implementation plan to establish the Agency.

Subject to the Government's endorsement of the findings of the blueprint, **it is recommended that the Government then proceed to the implementation of the Petroleum Revenue Management Agency.**

## Transfer of Role of Concessionaire to the Ministry of Petroleum

Sonangol is the national Concessionaire. The Concessionaire retains the rights for all exploration and production activities in Angola, and as such has a number of responsibilities and obligations. Together with other representatives of government (Ministry of Petroleum, Ministry of Finance and the Bank of Angola) it is the Concessionaires responsibility to regulate the industry, and to ensure that the requirements of Angolan petroleum law are adhered to.

Law 13/78 provides that Sonangol can become an equity field participant, partnering with foreign companies on an equity basis in the exploration, development and production of oil and gas. Sonangol has an exploration and production company (Sonangol P&P) for this purpose and participates in several blocks. However, Sonangol Concessionaire (represented by Sonangol Holding) also has equity in several blocks, most notably the largest producing block, Block 0. We are unaware of any programme or plan for the completion of the transfer to Sonangol P&P of the equity shares in blocks still held by Sonangol Holding.

In Indonesia, Pertamina, like Sonangol, was the appointed concessionaire but also engaged directly in production and in the provision of various contracting services. Recently, decisions have been taken in Indonesia to clearly separate these functions with the intention that Government will become the regulator. The reason for this was due to increasing difficulty in accounting for its ever-growing range of complex activities and lack of resulting transparency. In Norway, too, there is a powerful state company, Statoil. It, essentially, functions as an oil company. The detailed regulatory work is undertaken by a separate body, the Norwegian Petroleum Directorate. Transparency is, therefore, assured due to the clear segregation of responsibilities

Sonangol's role of equity partner in petroleum exploitation and as concessionaire is conflicting. It is vital that for efficient and transparent operations Sonangol's dual roles are separated. Segregation of activities will also make it easier for Sonangol to account more accurately for its oil and gas activities. This, in turn, will be an important step towards adoption of International Accounting Standards. **The consultants recommend that the government separate the dual functions of Sonangol with the intention that the government becomes the Concessionaire and regulator.**

One way in which this might be achieved is to transfer the role of Concessionaire from Sonangol to the Ministry of Petroleum. This would be a logical move and would result in the combined functions of the Ministry of Petroleum being more closely aligned with those of equivalent ministries in many foreign countries with oil and gas resources. Such a move would allow Sonangol to concentrate on its oil and gas exploration, development and

production activities, and to introduce improved accountability and financial management. This would include the segregation of the upstream and downstream segment, and potentially the transference of Sonangol's non-core business into a separate division.

Transferring the role of Concessionaire would require a significant strengthening of the existing Ministry of Petroleum. **We recommend that an independent review should be undertaken of the current function and structure of the Ministry of Petroleum with respect to resources, people (their roles, skills, and salaries), deployment of information technology, staff turnover, and regulatory effectiveness.** The purpose of the review and subsequent implementation of strengthening measures would be to prepare the Ministry to take over the role of Concessionaire from Sonangol.

**We also recommend that the review should investigate the necessary funding required to implement these changes, including an examination of the justification of the 10% Profit oil commission fee, currently retained by Sonangol to cover its operational costs. The review should examine the most effective method by which the government share of Profit oil is sold for export. For example, it may be more transparent for the government to allow the foreign oil companies to sell its share of Profit oil on the government's behalf.**

## 7.2 Issues relating to Sonangol's Expansion

In addition to its role as Concessionaire, Sonangol is an expanding company that has an increasingly complex business structure. Sonangol has an exploration and production company and it has a dominant position in the downstream oil and gas business, principally in refining and marketing. Sonangol also has other business interests inside and outside of Angola, and various non-core 'oil related' business interests such as telecommunications, insurance, aviation and commercial banks. The growth and expansion of Sonangol's activities and interests are occurring without a proportionate increase in accountability of the group's ever more complex transactions. From Sonangol's standpoint it is becoming progressively more difficult to measure accurately the cash flows being generated in any one part of the business and the long and short-term demands for financing to sustain these cash flows.

The increasing range of investments and cross ownership of interests inside and outside Angola and within the private and public sector make it imperative for Sonangol to account for its overall assets and liabilities in a manner to permit the group to measure the profitability or otherwise of its individual activities and to identify, segregate and value its assets and liabilities relating to its oil and gas upstream and downstream activities. It should in the same manner be able to segregate its non oil and gas related activities and have the ability to measure the profit and loss and value of the associated assets and liabilities.

**We recommend that a programme be implemented for the complete transfer of the oil field assets and equity interests of Sonangol as Concessionaire (represented by Sonangol Holding) to Sonangol P&P. The programme should outline a detailed timetable of transfer.**

## **8 Recommendations relating to Managerial Capacity enhancement and future needs**

### **8.1 Secondments to the Petroleum Revenue Management Agency by the Oil Industry**

Almost all of the skills required are already prevalent in Angola within the foreign oil companies. Most Production Sharing Contracts stipulate that a percentage of recruits into foreign companies operating in Angola under specific contracts must be Angolan. We recommend that in future the government should agree the right to monitor and audit the training of these Angolans. The government can then be certain that the training of Angolan nationals is focused.

An option would be for the Government to ensure that new contracts are drawn up which stipulate that after, say, two years training within an oil company environment, each Angolan national is, according to their contract, required to spend a further two years working for government at the new Revenue Management Agency. At the close of this period the individual is free to choose his or her future employment. The period spent in government could be funded by the oil company.

Until such a scheme can be implemented and the first recruits taken onboard the consultants recommend that Angolan national secondees from, and supported by, the oil industry be contracted into the Petroleum Revenue Management Agency to help strengthen them, along with the best internal appointments. These secondees and internal recruits will require training, initially by independent consultants, but later by experienced professionals within the Agency. Secondees would be appointed on a rotational basis, funded by the oil companies.

We believe that the foreign oil companies would be willing to support and fund a scheme that leads to improved transparency, financial management and administrative accountability with the Ministries, and that enables a more efficient management of the sector.

Such a scheme would also give the government time to formulate its own strategy for administering the Revenue Management Agency and to devise a human resource policy for strengthening resources and long-term skills.

### **8.2 Training for the Petroleum Revenue Management Agency staff**

In the Revenue Management Agency, accounting and finance staff will be required to establish datasets of taxes due and paid. They should be able to interrogate the data and undertake a forensic examination of the discrepancies and gaps arising. They should be able to discuss findings at a senior level within government and with industry, and to follow recognised procedures for reconciling the data.

Technical staff will be required to maintain, modify, edit and execute the Financial Model. When applicable they will be required to construct new programme modules and to build into the Financial Model the terms relating to newly negotiated contracts. Technical staff

should also be capable of liaising with the oil industry regarding data requirements – reserves data, production, liftings and cost data. These staff will coordinate closely with the Ministry of Petroleum, which must also have full access to, and be able to use, the Financial Model.

Senior staff will direct the ongoing reconciliation process and the employment of the Financial Model. Such staff will be fully aware of the wider application of the Financial Model to assist in the management of the macro-economy. They will be experienced professionals with excellent communication skills. They will be seen to be representing government in a prestigious position.

At present the consultants recognise that government does not have all of the requisite skills available to immediately implement the strengthening measure outlined above. This will take time. However, it is critical that in order to sustain the momentum of work already achieved under the diagnostic project the government must not delay in addressing the capacity building problem. **We recommend that a training programme is developed for the staff of the Petroleum Revenue Management Agency prior to its establishment and operation.**

### 8.3 Financial Model Extension

The Financial Model forecasting petroleum revenues comprises a series of complex spreadsheets. To edit these requires a reasonable technical and working knowledge of Microsoft Excel. More importantly, the Financial Model contains many complex tax calculations. To understand and modify these requires a thorough appreciation of the individual concession and contract terms in Angola, and experience of constructing complex spreadsheets and macros in Microsoft Excel.

**We recommend that further work be undertaken on the Financial Model to improve and enhance its capability, to make it more accessible to non-specialist users and to provide tailored reports that provide the information necessary for effective reconciliation and revenue management.**

Specifically, **we recommend that the model be hosted on a government intranet site with restricted access for priority users with web-based inputs.** Even with these enhancements it will be important that dedicated technical skilled resources are utilised to operate, maintain, and update the model, and to generate detailed reports. Further development of the Model such as that required to incorporate new PSA and fiscal terms will require technical specialists with strong economic modelling skills and a thorough understanding of the new contract terms, and their computation.

In addition to the technical skills required to operate and maintain the Financial Model it is critically important that managerial skilled resources are utilised to direct its operation, and communicate outputs to Ministers and relevant authorities. It is particularly important that senior managers are able to communicate effectively with Sonangol and the foreign oil companies when requesting data or challenging discrepancies.

In order therefore to exploit the Financial Model to its full potential senior managers must have a clear understanding of its wide-ranging functionality, and be able to communicate inputs and outputs with senior and experienced Ministerial, and oil company personnel.

**We recommend that the Financial Model be employed by the Petroleum Revenue Management Agency as part of the process of connecting data inputs and projections of current and future oil industry activity, with established procedures for reporting and reconciling revenue flows.**

To achieve this and to sustain the Financial Monitoring system in the longer-term, **we recommend the development of the Financial Model, in parallel with the establishment and operation of the Petroleum Revenue Management Agency and the appointment of the requisite skills discussed above is necessary.**