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REGULATORY IMPACT STATEMENT (RIS)

For

THE DRAFT PETROLEUM (UPSTREAM PETROLEUM COST  
MANAGEMENT) REGULATIONS, 2025

APRIL, 2025

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## **1. INTRODUCTION**

The Petroleum Act, Cap 308 ('the Act'), provides a framework for contracting, exploration, development and production of petroleum. To operationalize the Act, the Cabinet Secretary in charge of Petroleum proposes to make Petroleum (Upstream Petroleum Cost Management) Regulations (Draft Regulations) for the the management, recovery, and reporting of costs associated with upstream petroleum operations in Kenya. The Draft Regulations are made pursuant to Section 126 of the Act which empowers the Cabinet Secretary to make regulations for the better carrying into effect of the provisions of the Act.

### **1.1. Regulatory Impact Statement**

Section 6 of the Statutory Instruments Act (Cap. 2A), (SIA) provides that if a proposed statutory instrument is likely to impose significant costs on the community or a part of the community, the regulation making authority shall, prior to making the statutory instrument, prepare a regulatory impact statement about the instrument.

This Regulatory Impact Statement was prepared in accordance with the provisions of Section 7 of the Statutory Instruments Act, Cap 2A.

## **2. STATEMENT OF OBJECTIVES**

### **2.1 General Objective**

The overall regulatory objective and justification of the Draft Regulation is to provide a framework for effective and efficient management of petroleum costs while safeguarding the equitable distribution of benefits between the government and contractors in line with the Constitutional principles and values.

2.2 The specific objectives are to:

- i. Set out detailed procedures to guide the classification, recording, and reporting of upstream costs, ensuring consistency, transparency, and accountability;
- ii. Provide for the roles and responsibilities of the Government, the Authority, contractors, operators, other licensees/ permit holders and other stakeholders in management of upstream costs;
- iii. Provide a framework to ensure that all upstream petroleum costs are duly incurred, paid, and accurately reported and in adherence to international accounting standards;
- iv. Establish clear guidelines on the priority and limits for recovering petroleum costs, including production, development, uplift, exploration, and decommissioning costs, while ensuring compliance with approved budgets and agreements.
- v. Restrict cost recovery to the specific contract area where the costs were incurred, preventing cross-subsidization between different projects or operations.
- vi. Establish guidelines for approval of expenditures exceeding approved budget thresholds and justify underutilization of allocated funds, ensuring fiscal discipline;
- vii. Set debt-equity ratios for development costs and regulate uplift provisions to ensure sustainable financing practices;
- viii. Establish guidelines for submission of monthly, quarterly, and annual financial reports, including expenditure statements, and inventory records;
- ix. Provide for the formula to calculate the share of cost oil and profit oil;

- x. Provide for a framework to enable the Authority carry out audits and inspect upstream petroleum operations, ensuring adherence to regulations and agreements;
- xi. Establish a decommissioning fund and audit contributions, ensuring adequate financial provisions for future plugging, abandonment, and site restoration;
- xii. Explicitly list non-recoverable costs (e.g., income taxes, penalties, CSR expenses); and
- xiii. Provide mechanisms for addressing discrepancies, disputes, and violations, including penalties for false reporting or non-compliance.

### **3. STATEMENT ON THE EFFECT OF THE DRAFT REGULATIONS**

The Upstream Sector lacks a comprehensive and updated regulatory framework specifically tailored for upstream petroleum operations. The following existing Regulations are outdated and insufficient to address best petroleum industry practices in upstream petroleum operations.

- i. The Petroleum (Exploration and Production) Regulations, 1984 (L.N. 193/1984); and
- ii. The Petroleum (Exploration and Production) (Training Fund) Regulations, 2006 (L.N. 132/2006).

This has led to inefficiencies in contract administration, data management, regulatory uncertainty for investors, creating gaps in enforcement and oversight mechanisms and potential environmental, health, and safety risks due to lack of an operationalizing framework.

Furthermore, these Regulations are inconsistent with the requirements of the Petroleum Act (Cap 308). The Draft Petroleum (Upstream Cost Management)

Regulations, 2025 are expected to provide a framework for the management of upstream petroleum costs duly paid and incurred.

The Petroleum Act (Cap 308) provides for accounting procedures for upstream petroleum operations in its Schedule (Appendix B). This schedule outlines the classification of expenditures, recoverable and non-recoverable costs, and financial reporting requirements, ensuring transparency and compliance with International Financial Reporting Standards (IFRS). However, the schedule itself is not enforceable.

To address the above gaps, the Draft Regulation seeks to establish a framework for the effective and efficient management of upstream petroleum costs in upstream petroleum operations. Furthermore, the proposed regulations aim to align cost management in the sector with the principles of public finance management as articulated under Chapter 12 of the Constitution of Kenya (2010).

#### **4. ASSESSMENT OF PRACTICABLE MEANS OF ACHIEVING THE OBJECTIVES OF THE DRAFT REGULATIONS**

##### **4.1. Option 1: Maintaining the Status Quo**

As noted above, the existing Regulations are inconsistent with the requirements of the Constitution 2010 (Chapter 12-Public Finance Management) and the Petroleum Act, (Cap 308) Status quo would mean that the petroleum costs are not regulated. This would mean inefficiencies in contract administration, poor data management, regulatory uncertainty for investors, weak oversight, and continued revenue losses and disputes due to the absence of an operational framework.

Therefore, the optimal benefits arising from regulating the upstream petroleum costs would not be realised.

Accordingly, the status quo is NOT A DESIRABLE OPTION.

#### 4.2. Option 3: Use of Working Manuals and Guidelines

Section 2 of the SIA defines Statutory Instruments to include guidelines, directions and regulations as statutory instruments therefore requiring comprehensive scrutiny and publication as required by Sec.4 of the SIA.

A working manual or any form of document established in the execution of the Petroleum Act (Cap 308) falls under the threshold of a Statutory Instrument and therefore has to go through the progression process as required by the SIA.

In addition, working documents could face legal challenge as they cannot be used to create offences and penalties, which are necessary for their effective application as well as challenge in court on the applicability and validity.

#### 4.3. Option 3: Developing the Draft Regulations

The Draft Regulations will establish a framework that standardizes cost classification, enforces ring-fencing of expenses, and implements auditing procedures to eliminate revenue losses while ensuring fair cost recovery. These regulations clearly delimit recoverable costs, creates a system that protects government revenue, provides investor certainty through clearly defined rules, and promotes sector-wide transparency. Furthermore, the Regulations will be binding, enforceable and universally applicable to all operators.

This is the PREFERRED OPTION since it addresses the requirements listed in the Petroleum Act Cap 308.

### 5. COST-BENEFIT ANALYSIS

| Impact/ Benefit                               | Remarks  |
|---|--|
| <b>ECONOMIC ASSESSMENT/IMPACT</b>             |  |
| 1. Attracting foreign and domestic investment | <ul style="list-style-type: none"><li>Stable legal framework provides clear cost recovery rules and standardized accounting practices to enhance investor confidence</li></ul> |

| Impact/ Benefit                        | Remarks   |
|--|---|
|  | <ul style="list-style-type: none"> <li>• Debt-equity ratio provides financial predictability for project financing.</li> <li>• Transparent procurement policies encourage participation from reputable firms.</li> </ul>  |
| 2. Energy security                     | <ul style="list-style-type: none"> <li>• Domestic production encourages local oil and gas development, reducing reliance on imports.</li> <li>• Efficient cost recovery ensures sustainable production, maintaining long-term supply.</li> </ul>  |
| 3. Government Revenue                  | <ul style="list-style-type: none"> <li>• Optimized cost recovery ensures fair allocation of profits between contractors and the government.</li> <li>• Strict reporting requirements minimize revenue leakage and enhance tax compliance.</li> <li>• Profit-sharing mechanism ensures the government benefits from high-value discoveries.</li> </ul> |
| 4. Reduced operational costs           | <ul style="list-style-type: none"> <li>• Standardized cost classification prevents inefficiencies and cost overruns.</li> <li>• Ring-fencing provisions ensure costs are only recovered from relevant projects, preventing cross-subsidization.</li> <li>• Inventory management reduces waste and optimizes resource use.</li> </ul>                  |
| 5. Compliance and accountability       | <ul style="list-style-type: none"> <li>• Independent Audit requirements reduce fraud risks.</li> <li>• Penalties for non-compliance may be a deterrent against false reporting and mismanagement.</li> </ul>  |
| <b>ENVIRONMENTAL ASSESSMENT/IMPACT</b> |   |

| Impact/ Benefit                 | Remarks  |
|---------------------------------|--|
| 6. Environmental protection     | <ul style="list-style-type: none"> <li>• Decommissioning fund: <ul style="list-style-type: none"> <li>✓ Ensures financial provisions for site restoration upon decommissioning.</li> <li>✓ Provides clarity on liability for restoration upon decommissioning. If the developer does not undertake restoration upon decommissioning within the set timelines as provided for by the decommissioning plan, the decommissioning fund may be tapped into by the relevant authority for restoration.</li> </ul> </li> <li>• Regulatory oversight reduces risks of environmental negligence.</li> </ul> |
| <b>SOCIAL ASSESSMENT/IMPACT</b> |  |
| 7. Social Economic growth       | <ul style="list-style-type: none"> <li>• Reporting requirements on payroll costs and expenditures on local goods and services will create local employment and consumption of local goods.</li> <li>• Local employment encourages hiring of Kenyan personnel and local skill upscaling.</li> <li>• Infrastructure development such as roads, airstrips, and support facilities improve local accessibility.</li> <li>• The community may benefit from any community development or social impact project by the contractor or government.</li> </ul>   |

## **6. ADMINISTRATION AND COMPLIANCE COSTS**

It is expected that the Authority and other Government agencies will incur a marginal cost in regulatory compliance and administration of the Draft Regulations.

Additionally, there shall be the resource allocation cost element in administration of these regulations.

## **7. ANY OTHER MATTERS SPECIFIED BY THE GUIDELINES**

According to Regulation 3 of the proposed Regulations, all matters prescribed for in the Regulations relate to management of costs in the conduct of upstream petroleum operations in Kenya.

## **8. COPY OF THE DRAFT REGULATIONS**

The *Draft Petroleum (Upstream Petroleum Cost Management) Regulations, 2025* are annexed herein.