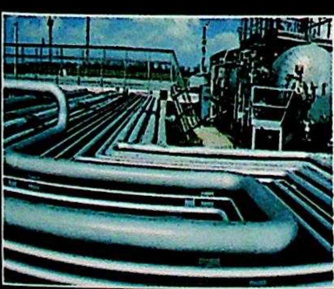
NEITI
Nigeria
Extractive
Industries
Transparency
Initiative

THE PRESIDENCY

10 YEARS OF NEITI REPORTS

WHAT HAVE WE LEARNT?



10 YEARS OF NEITI REPORTS

10 YEARS OF NEITI REPORTS- WHAT HAVE WE LEARNT?

Since inception in 2004, NEITI has produced three audit reports covering a period of ten (10) years – from 1999 to 2008. The reports contain vital information about the management of Nigeria's oil and gas sector. However, to date there has been limited public utilization of the reports and their contents. This document provides a snapshot of the three audits produced so far. It highlights: (1) given the huge increase in oil revenues since 2004, NEITI and the audit reports are more relevant today than they have ever been; (2) the government is also more financially dependent now than at almost any other time in the past; (3) Nigeria lost a total of at least 'US$2.6 billion over the 10 year period due to 'leakages'.

The Extractive Industries Transparency Initiative (EITI) is a global initiative that aims to increase transparency and improve governance in extractive industries by collecting and reconciling revenue information from the major actors in the industry, namely companies and governments.

COMPANIES
disclose payments

EITI REPORT
where the tax and royalty payments are independently verified and reconciled

GOVERNMENTS
disclose receipt of payments

Nigeria was one of the first countries in the world to take practical steps to implement the EITI and has produced detailed reports covering the oil and gas sector from 1999-2008. Nigeria has gone well behind the reconciliation and reporting of financial flows and produced a report covering production and production entitlements, a validation of the calculations underlying the flows and certain processes applied in the management of key elements in the sector.

This report aims to outline the key highlights contained within the ten years of reports that have been produced. It outlines some of the interesting questions that the ten years of reports have answered such as: what **type of revenue** does the government receive from the sector, **who pays these revenues** and **how large are they? How large were the discrepancies** between company-reported payments and government-reported receipts of payments? What processes were applied by the parties in making payments and carrying out revenue activities? How robust were these processes? **What major problems** and challenges in the sector have the reports discovered? How large are the estimated losses in revenue as a result of these problems and challenges? **How financially dependent is the government** on the sector? And most importantly: **How has this information changed over time since the audits commenced in 1999? And how have the weak processes improved since they were highlighted by the first audit?**

1. What is NEITI?

NEITI stands for the **'Nigeria Extractive Industries Transparency Initiative'.** It was launched in 2004 as Nigeria's implementation of the global Extractive Industries Transparency Initiative (EITI). It was legislated into the NEITI Act of 2007 highlighting the commitment of the Federal Government to the implementation of the initiative. To date the initiative has resulted in the publication of NEITI reports outlining three time periods: **1999-2004; 2005;** and **2006-2008.**

While most EITI-compliant countries only produce **financial** reports, Nigeria has gone further and produced two additional reports for each of these time periods: (1) **Physical** reports to check that extracted volumes are accurately reported and that each company's reported production, liftings and exports tally with the volumes the government uses for tax and royalty calculations and the volumes due to the Federation which NNPC lifts for export and domestic use; and (2) **Process** reports on how key agencies manage the sector, including licensing, how government equity oil is priced, how the government's interest in Joint Ventures (JVs) is managed and how refineries are supplied with crude, and how oil is imported.

2. Why are NEITI Reports Useful?

The NEITI reports have produced a wealth of information on the oil sector, very little of which was previously available. Not only are they a useful source of *summary information* about how the oil sector in Nigeria operates (outlining basics such as who the key players are, how they interact, how taxes are paid), they have also produced a large amount of *detailed quantitative and qualitative information* about the industry. In the process of reconciling the figures given by companies and by government, the auditors discovered a whole host of institutional weaknesses in procedures in the sector.

The NEITI reports highlight the problems and challenges that exist in the way that *government* operates, in the way that *companies* operate and in the way in which the *two interact* with each other.

3. How Large are the Revenues From the Sector?

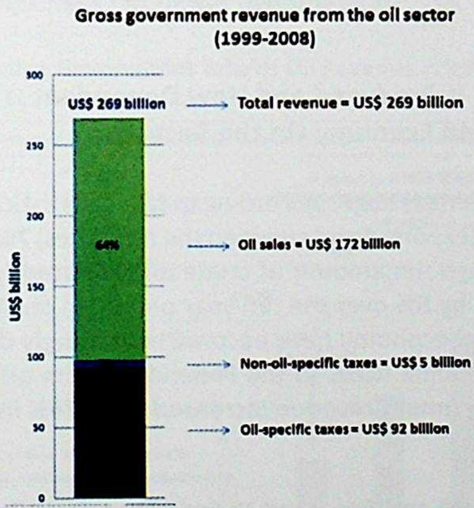
The Federal Government receives three (3) main **types of revenue** from the oil and gas sector:

- **Sales of equity oil** owned by the government;
- **Oil-specific taxes** (paid only by oil companies); and
- **Non-oil-specific taxes** (paid by all companies in Nigeria, including oil companies).

The 10 years of NEITI reports show that the Government of Nigeria through the Federation has received a total of **US$ 269 billion** from the oil sector between 1999 and 2008. Over the ten year period **US$ 92** billion has been received from **oil-specific taxes, US$ 5 billion** from **non-oil-specific taxes** from oil companies and **US$ 172 billion** has been received from the **sale of government equity oil.**

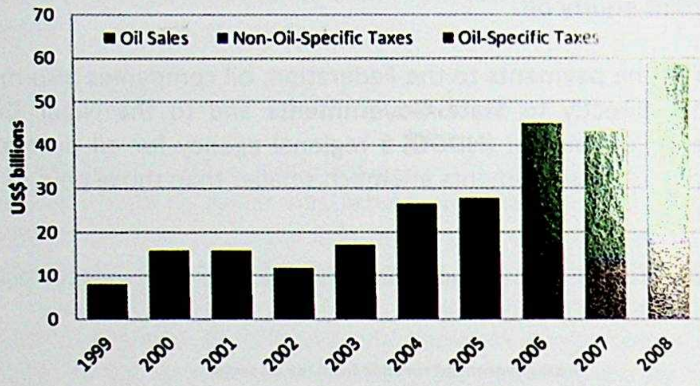
In addition to the payments to the Federation, oil companies also make contributions directly to **State Governments** and to the Niger Delta Development Commission **(NDDC)** a regional agency for oil producing areas. However, these payments are much smaller than those paid to the Federation.

Figure 1: US$ 269 billion of government revenue from the oil sector (1999 – 2008)



An interesting trend over this period of time has been the **large increase in the amount of revenue that the Government receives from sales of equity oil.** Although this revenue source has always dominated revenue flows from the sector, recent years have seen a substantial increase in this revenue source, particularly in 2008 when oil prices increased substantially.

Figure 2. Gross government revenue from the oil sector (1999 – 2008)



4. How Much Oil Is Produced and How Dependent Is the Government and Economy On the Sector?

The oil sector in Nigeria is huge. According to NNPC statistical bulletins, in 2008 Nigeria lifted (exported and supplied the refineries) **769 million Bbls** of crude oil. Although the **amount of crude oil produced in the country has only increased by 8%** over the ten year period, in terms of revenue, the government and economy have become **increasingly dependent on the sector.** Total revenue flows to the Federation from **oil and gas** as a **percentage of government revenue increased from 74% in 1999 to 90% in 2008.**

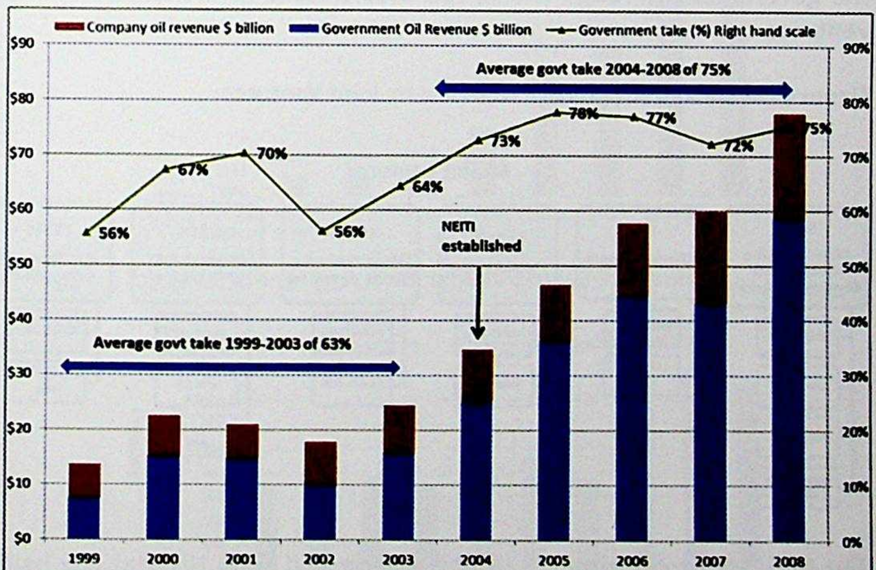
Table 1. Analysis of Oil and Gas Flows to Federation Total Revenue for the Period 1999 - 2008

	1999 US$' B	2000 US$' B	2001 US$' B	2002 US$' B	2003 US$' B	2004 US$' B	2005 US$' B	2006 US$' B	2007 US$' B	2008 US$' B
Total Flow From Oil & Gas (US$B)	8.00	15.00	16.00	11.00	16.00	26.00	34.40	44.60	43.20	58.70
Total Federation Revenue *	10.7	18.1	19.7	13.2	18.93	30.16	40.79	45.04	44.6	65.43
% of Oil and Gas Flows to Total Federation Revenue	74	82	96	83	84	86	84	99	97	90
Note*: Figures from CBN Statistical Report, 2010.										

5. What is the government take of total oil revenues generated from crude oil?

The 10 years of audited revenues show that the share of crude oil revenue that is captured by the Nigerian government has increased dramatically. Prior to NEITI establishment government take averaged 63% but with the establishment of NEITI in 2004 the average government take rocketed to 75%. There are a variety of reasons to explain why this has happened, but holding everything else equal, the contribution increased transparency seems to have had over government revenues is dramatic. Within only five years of establishment, NEITI has overseen a sector that's contribution to government revenues has nearly quadrupled.

Figure 3 Increasing Government Take of Oil Revenue (1999-2008)

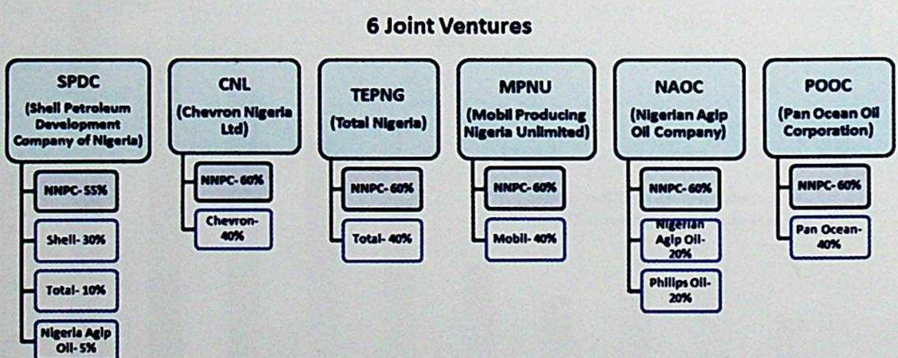


6. What Type Of Revenue Does The Government Receive From The Sector?

The **government**, through the state oil company - the Nigeria National Petroleum Corporation (NNPC), has **direct ownership of a percentage of the oil produced in Nigeria.** This arises because of the way in which oil production contracts are structured in the country: **Joint Ventures and Production Sharing Contracts.** The oil produced for government is known as **'government equity oil'.**

The 6 Joint Ventures that are currently in operation in the country **dominate production and contribute the bulk of oil revenues. They contribute 88.6% of oil-specific taxes** paid by oil companies in 2008. Apart from SPDC, where the government has a 55% stake in production, the government (through NNPC) has a **60% stake in the other 5 joint ventures.**

Figure 4 Ownership structure of Nigeria's six Joint Ventures



The two largest contributors (Mobil Nigeria and Total Nigeria) pay half of all of the Petroleum Profits Tax (PPT), Royalty and NDDC payments received by the Government during the period. The largest contributor

(Mobil Nigeria) alone contributes 29.3% of these taxes and has been the largest tax contributor all of the years from 1999-2008, apart from 2004 and 2005 when Shell Nigeria made the largest tax contributions. In 2008, Mobil paid

Six Production Sharing Contracts (PSCs) signed in 1993 (except Addax) have also come on stream during the 10 years, and are contributing an increasing share to production.

Figure 5 Ten largest contributors of PPT, Royalties and NDDC Payments in 2008 (US$m) – Red columns are JVs and blue columns PSCs

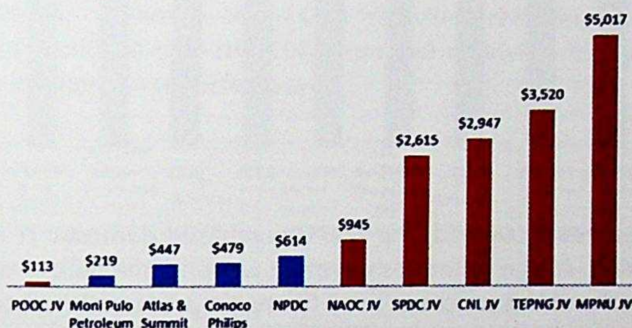
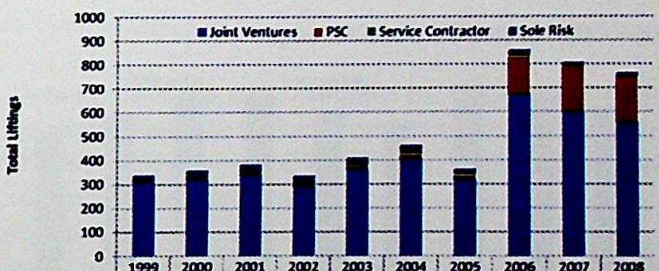


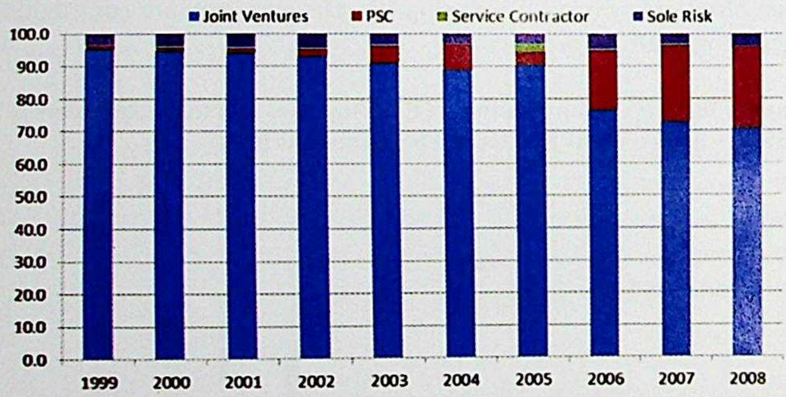
Figure 6 Crude oil lifting (export) by type of production contract



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Sole Risk	24.3	30.9	36.4	35	28.6	28.7	18.9	24.27	18.81	16.46
Service Contractor	1.1	1.1	1.1	1.2	3	9	8.5	5.9	2.51	2.7
PSC	4.2	6.6	8.4	11.7	16	19.3	18.9	159.27	189.32	188.95
Joint Ventures	310.3	321.2	337.6	288	362.1	404.5	316.8	672.08	598.77	556.22

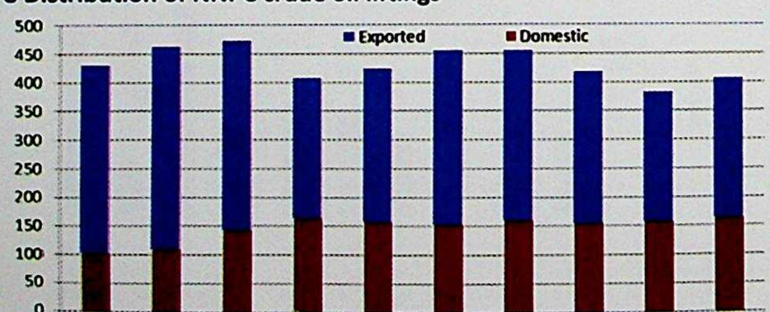
During the period, total production of oil from Nigeria has fallen by around 100m barrels per annum, but the proportion of production coming from the new contractual arrangements (PSCs) has increased, while the proportion coming from joint venture operations has declined.

Figure 7 Production by operation as percentage of total



Over the ten years covered, the NNPC purchased domestic crude from the Federation. As the refineries were not working, the bulk of the crude was exported and the proceeds used to import products for distribution. The total domestic crude, the proportion exported and that used by the local refineries are set out in the table below.

Figure 8 Distribution of NNPC crude oil liftings



	(mbbls) 1999	(mbbls) 2000	(mbbls) 2001	(mbbls) 2002	(mbbls) 2003	(mbbls) 2004	(mbbls) 2005	(mbbls) 2006	(mbbls) 2007	(mbbls) 2008
Exported	327	353	330	244	267	303	295.4	263.0	224.51	242.53
Domestic	103	109	143	163	157	152	159.8	154.8	157.31	163.66

7. How Large Were The Discrepancies Between Company-Reported Payments And Government- Reported Receipts of Payments?

Much of the work of the reports involves reconciling figures provided by companies and those provided by the government. The table below summarizes the main discrepancies from each report between revenues reported as being received by the Central Bank of Nigeria (CBN) and those reported as being paid by oil and gas companies.[1]

The numbers indicate the size of the discrepancies in US$ million and Naira million. **Negative net differences** indicate that **companies reported paying higher revenues** than CBN reported receiving. Positive net differences indicate that the **CBN reported receiving higher revenues than the companies reported paying.**

	1999 -2004			2005			2006-2008		
	Reported by CBN not company US$'m	Reported by Company not CBN US$'m	Net Differences US$'m	Reported by CBN not company US$'m	Reported by Company not CBN US$'m	Net Differences US$'m	Reported by CBN not company US$'m	Reported by Company not CBN US$'m	Net Differences US$'m
PPT	0.9	1.4	-0.5	143	151.8	-8.8	0	0	0
Royalty	0	7.9	-7.9	258.7	169.8	88.9	53.1	79.4	-26.3
Gas Flare Penalty	0.5	0	0.5	0	0	0	0	0	0
Total	1.4	9.3	-7.9	401.7	321.6	80.1	53.1	79.4	-26.3

There are five key areas worth noting from these discrepancies:

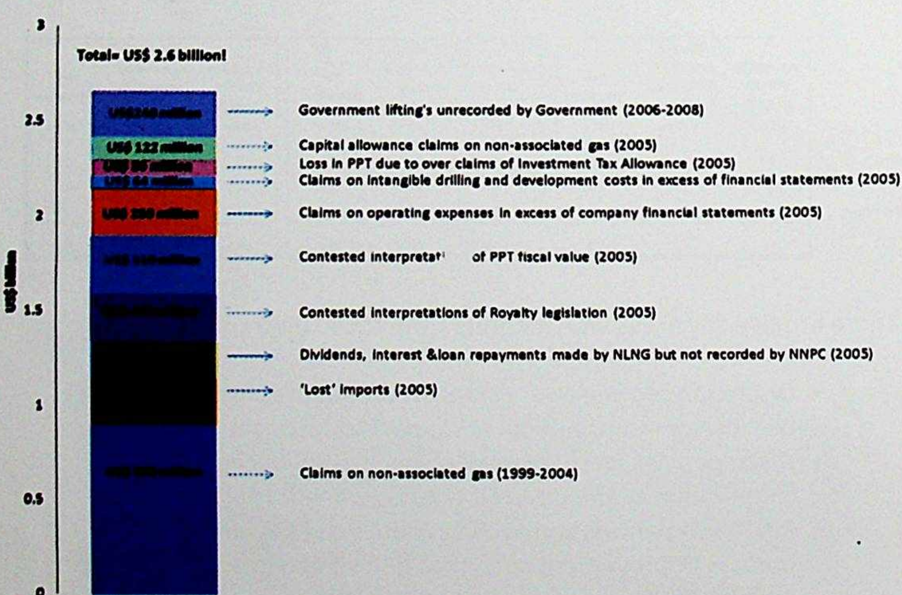
- Discrepancies were very **small in the first report** (1999-2004) because of intense political support to reconcile differences;
- Discrepancies were relatively high in 2005 because the cooperation of the covered entities waned;
- PPT discrepancies continue to reduce as FIRS embark on process improvement such that PPT differences were zero in 2006 to 2008; and

[1] Note that the totals for the 1999-2004 and 2006-2008 report are aggregated

* Discrepancies in **Royalty** payments are fairly large across *all* reports.

* Two revenue streams (NDDC payments and Signature Bonuses) have shown larger discrepancies as a result of process reconciliation (in the case of NDDC payments) and highlighted a payment system that is not very transparent (in the case of Signature Bonuses).

There were other discrepancies noted in the reports, most notably PPT and Royalty under assessments. These discrepancies over the 10 years total US$ 2.6 billion and the main ones highlighted in the reports are shown below. While they represent only around 1% of the entire revenues received by government over this 10 year period, it would have been a welcome addition to consolidated revenue.



It is important to note, however, that these are **only the potential losses that the auditors could readily quantify and estimate.** The reports highlight a large number of additional problems and challenges in the oil sector, many of which are likely to cause losses in revenue for the government but are currently impossible to estimate.

While the discrepancy numbers are useful, the process of reconciling numbers (and the problems that the auditors encountered along the way) has allowed the auditors to uncover a large number of problem areas in the governance of the oil sector and in its revenue streams.

An example of this is the **Domestic Crude Value Reconciliation** exercise which highlighted the building up of debt owed by NNPC to the Federation Account.[2] Subsidy payments should normally be made from the CBN through the Petroleum Support Fund on the approval of the Accountant General of the Federation (AGF) based on claims approved by the Petroleum Products Pricing Regulatory Agency (PPPRA). However, the reconcilers observed that NNPC deducts the subsidy claims directly from the domestic crude proceeds before remitting to the Federation Account as shown below. The red arrow shows how debts build up, to the point they reach N842.7 billion at the end of 2008 (large red oval).

	NBn 1999	NBn 2000	NBn 2001	NBn 2002	NBn 2003	NBn 2004	NBn 2005	NBn 2006	NBn 2007	NBn 2008
Opening Balance as at 1st January		32.6	36.7	38.7	66.4	94.8	281.7	654.8	[illegible]	812.9
Add cost of crudes supplied to NNPC	78.3	96.3	136.1	323.9	409.7	759.7	1,145.3	1,258.5	1,[illegible]31.2	1,809.4
	78.3	128.9	172.8	362.6	476.1	854.5	1,427.0	1,913.3	2,[illegible]97.2	2,622.3
Less :										
-Subsidy Deduction								-219.7	-236.6	-360.2
Total Payment to the Federation Account	-45.7 -45.7	-92.2 -92.2	-134.1 -134.1	-236.2 -236.2	-381.3 -381.3	-573.8 -573.8	-772.2 -772.2	-1,037.6 -1,257.3	-1,037.7 -1,[illegible]74.3	-1,419.4 -1,779.6
Bal Due to Federation A/C as at Dec	32.6	36.7	38.7	66.4	94.8	280.7	654.8	656.0	812.9	842.7

[2] NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE 2006 - 2008 RECONCILIATION APPENDICES VOLUME 1, pages 40 to 44.

The above figures show the following:

i) NNPC deducted N219.7billion, N236.6billion and N360.2 billion from proceeds of domestic crude in 2006, 2007 and 2008 respectively (see black circles). These deductions from the Federation Account total N816.5 billion for the three years.

ii) The debt that NNPC owes the Federation account for cost of domestic crude purchased has steadily increased over the years (second line);

iii) As at 31 December, 2008 N842.7 billion was owed by NNPC to the Federation;

iv) Of this total, N254.69billion was outstanding within the credit period of 90 days and N588billion had remained outstanding for more than 90 days; and

v) N354 billion of this debt above 90 days was held back by NNPC from 2004 and 2005 to cover subsidy owing to NNPC by the Federation on the approval of the President.

8. What Other Major Problems In The Sector Have The Reports Discovered?

In addition to the discrepancies, some of the major problems that have been consistently identified in the reports include:

- The **actual amount of oil produced in Nigeria is not known.** Oil is measured at terminals but not at well heads of flow stations. Around 10% of oil is estimated to be lost or stolen between these points resulting in lost revenue for the government.

- **Some aspects of tax legislation in Nigeria are unclear** and this has led to beneficial interpretations of taxes by oil companies resulting in reduced revenue for government both from PPT and Royalty payments. The tax regime of the sector is one characterised by **'unregulated self-assessment'.**

- **There are interpretation differences between NNPC and PSC contractors regarding how the PSC agreements and legal incentives should be applied which is now in arbitration.** This has potential to significantly impact Federation revenue depending on the outcome of the arbitral proceedings.

- **In the absence of complete records being kept by the OAGF, the reconcilers rely on the records of The Central Bank of Nigeria (CBN) whose records are not strictly maintained for the purpose of the EITI reconciliation.** This has created challenges as CBN is the depository for Royalties and PPT and the main provider of information on tax collections for reconciliation with tax assessments of the Federal Inland Revenue Service (FIRS).

- **Tax assessments submitted by two companies do not match their own internal audited financial statements.** The reports indicate that companies are overstating several costs in tax assessments. This implies that companies may be abusing capital allowances in an attempt to reduce their tax liabilities.

- Information management and **IT systems in government are not sophisticated** enough to deal with financial information flows from the sector.

- The **NNPC** is both the buyer and seller of oil which creates a **conflict of interest** and results in lost revenue for the Government.

- **Government agencies** suffer from a general **lack of skills and capacity** particularly compared with international oil companies.

- **Accounting for Signature bonuses receipts are not transparent**

- **The Accountant General of the Federation (AGF) can act only reactively** and does not have the power to proactively address problems in the revenue collection system.

9. Why Is It Important For NEITI To Continue Producing Reports?

Prior to the publication of NEITI reports, little was known of the oil and gas sector in Nigeria. NEITI reports have provided the most detailed information that exists to date on the oil and gas sector in the country. **Without these reports, Nigerian citizens would have little information on the size of the sector or the nature and extent of problems and challenges that exist in the management of revenue streams** from it. The ten years of reports have shown large increases in government revenue received from the oil sector and government's consequent increased dependence on these revenues over this period. **This trend highlights the importance of continued production of NEITI reports.** Transparency in management of increasingly large oil revenues through the provision of information is hugely important for citizens to be able to hold government to account.

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Nigeria Extractive Industries Transparency Initiative

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