NEITI Nigeria Extractive Industries Transparency Initiative

THE PRESIDENCY

NEITI AUDIT REPORT 2006 - 2008

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...Promoting transparency, enabling prosperity

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2006 - 2008
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CONTENTS

The Nigeria Extractive Industries Transparency Initiative (NEITI) has become a catalyst for the application of the principle of transparency and accountability in the management of Extractive industries in Nigeria. Its Periodic audits have opened up, widely, a hitherto opaque industry to public scrutiny.

INTRODUCTION

The Nigeria Extractive Industries Transparency Initiative (NEITI) is a national subset of an international movement, known as the Extractive Industries Transparency Initiative (EITI). The EITI was established in June 2003 to achieve sustainable development and poverty reduction in resource-rich countries plagued by the phenomenon of 'resource curse'. It does so by promoting transparency and accountability in the management of revenues accruing from extractive industries.

Nigeria began implementation of the Initiative in 2004, and on May 28, 2007, a specific law was enacted to enforce the implementation of the Initiative in the country. This was the NEITI Act, 2007. EITI is an international multi-stakeholder movement with participation of country representatives from government and their agencies; oil, gas and mining companies; institutional investors, local civil society groups and international non-governmental organizations.

The objective of the EITI Association is to make the EITI Principles and the EITI Criteria the internationally accepted standard for transparency in the oil, gas and mining sectors. The underlying philosophy of the EITI Association is the belief that strengthened transparency of natural resource revenue can reduce corruption; and that prudently managed revenue from extractive industries can transform economies, reduce poverty, and raise the living standards of entire populations in resource-rich countries. There are today over 40 member countries including Nigeria. The EITI International Secretariat is based in Oslo, Norway.

Benefits of NEITI Industry Audits

NEITI commissioned the first ever comprehensive Process, Physical and Financial audits of Nigeria's Petroleum Industry for the fiscal years 1999-2004. Following the success of the first audit, NEITI conducted another audit in 2005.

The 200 6- 2008 Audit Report is the third circle of audit in the series. It was conducted by two reputable audit firms of Chartered Accountants namely; Hart Nurse Ltd and S.S. Afemikhe & Co.

There are several broad benefits:

- Creation of a new consensual framework for reporting and disclosure of payments and receipts in the extractive industry sector

- Generation and publication of accurate data and credible information through NEITI Industries Audits on flows of revenue, physical volumes of production and governance or management process practices in the oil and gas as well as solid minerals sector.

- Widening acceptance of the necessity for due process and transparency in the payments made by the extractive industry companies to government and other recipients following NEITI's dissemination of the Audit Reports. Improved credit rating of Nigeria and higher level of credibility for the government within the international community.

- Empowering civil society, the media and the public with information and data to hold government and companies to account.

METHODOLOGY OF THE AUDIT

Reconciliation of the financial and physical flows was carried out from data collection templates that were completed and returned to the auditors by the companies and government agencies.

Government information for Petroleum Profit Tax, Royalty, Signature Bonuses, and Withholding Taxes to the Federation and Company Income Tax were taken from templates submitted by the Central Bank of Nigeria and other relevant agencies.

Information on oil and gas sales was supplied by the Nigerian National Petroleum Corporation (NNPC) and confirmed with the Central Bank of Nigeria (CBN).

Information on Pay As You Earn (PAYE), Withholding Taxes to States and Education Tax was provided by the companies and does not require confirmation with the relevant receiving government entities.

In the case of flows to the Niger-Delta Development Commission (NDDC), data was taken from the templates provided by them (NDDC).

Materiality Standard for Reporting:

The Audit was conducted with specific requirement for meeting the EITI standards in assessing how the components of government financial transactions reconcile with financial data of covered entities.

While the Consultant was obliged to report all discrepancies, he was however, not required to investigate discrepancies if the aggregate value of such discrepancies within an individual financial flow is less than $5Million.

For physical flow, the Consultant was obliged to report discrepancies pertaining to specific transactions where the difference exceeds 5,000 barrels equivalent and its nature.

To that effect, the audit considered materiality level for reporting the aggregate revenue and investment flows to the federation at 0.5% of the annual aggregate value of all flows within the audit scope. However, further reconciliation work is still being carried out.

HIGHLIGHTS

From the audit report the total financial inflows to the Federation from the oil industry for the period 2006-2008 was $148.832billion ($44.687billion for 2006, $43.781 billion for 2007 and $60.364billion for 2008).

However, the following areas recorded unreconciled differences between what was paid in by companies and what was declared as received by government.

- **Royalty in 2006**: companies paid in $4,457.9million while government received $4,418.5million leaving an unreconciled difference of $ 39.4 million. The difference in what companies paid in 2007 and 2008, and what government received was found to be below the set materiality level.

- **Signature bonuses:** From 2006 to 2008, the companies paid a total of $1,470.80million to government, while government received $1,523.3million as bonuses. This leaves a difference of $52.5million.

- **Non-Financial Flows from Oil and Gas:** Income from oil in settlement of Royalty and Petroleum Profit Tax(PPT) given by the Report was as follows:

2006	2007	2008	Total
$Millions	$Millions	$Millions	$Millions
-	1,673.9	6,577.8	8,251.7

The Audit observed that the legal basis for PSC, Royalty, and PPT calculations were in dispute between NNPC and the contractors and before an arbitration panel. This transcend to cost and fiscal entitlements with a possible contingent liability of up to $8billion if NNPC loses the arbitration.

Equally of interest in the report are the findings, recommendations and the remedial issues. For details of the report, please visit our website: www.neiti.org.ng

FINDINGS

Non-Cooperation

- NLNG, Cavendish and Shebah Exploration & Production Company Limited did not co-operate with the audit. They have been served notices to invoke section 16 of the Act.

Under Assessments/underpayments

- NNPC owed the Federation for domestic crude the sum of N842.7 billion as at 31st December, 2008.

- NNPC deducted the subsidy claims of N816.55 billion directly from the domestic crude proceeds before remitting the balance to the Federation Account without authorization.

- NNPC receiving $3.789 billion dividends from NLNG for 2006-2008 did not confirm payments were made to the Federation account.

- Audit recalculations of royalty for the years 2006-2008 estimate an underpayment of $2.33billion arising from subjective interpretation of volume, pricing and API

(American Petroleum Institute grading variable).

- Underassessment of $690 million in Petroleum Profit Tax due to Pricing mechanism used (Realizable Price instead of Official Selling Price)

- Due to discrepancies between annual PPT returns and Annual Financial Statements there has been an underassessment of $424.6 million in the determination of PPT value.

- Operating Expenses (OPEX) indicate a possible under assessment of $364.9 million.

Physical Audit Issues

- Production and lifting data reported by DPR, other companies (including NNPC) and terminal operators was inconsistent.

- There is a long-running dispute between NNPC and PSC operators as to the calculation of cost oil, tax oil and royalty oil under the PSCs; this has meant that the parties cannot agree on the entitlement to amounts being lifted by NNPC and the Contractors.

- The Production Sharing Contracts signed do not make any provision for how the parties should treat gas available for commercial exploitation, except to require that the parties define a separate agreement. No such agreements have been concluded. Where gas is already used in commercial production, such as in Bonga, the absence of an agreement may result in a misstatement of the Federation's income.

- Crude Oil from newly producing fields is subject to Trial Marketing Period (TMP). Cargoes are lifted by both NNPC and the operator. There is no agreed process on how the proceeds of sale during the TMP are managed.

- NNPC / PPMC provided data on importation and inland distribution but it was not possible to confirm the overall mass balance because of a number of inadequacies in that data.

RECOMMENDATIONS

A thorough review of the institutional arrangements and relationships is required; NEITI acknowledges the proposed reforms in the Petroleum Industry Bill (PIB).

The following recommendations from the Auditors are noteworthy:

- The OAGF should make greater use of IT systems to improve controls, to eliminate inconsistencies and improve transparency by making possible a wider sharing of data on a timely basis.

- The DPR should confirm reconciliation and recovery from the companies the sum of $2.33 billion in additional royalties resulting from determination of fiscal value using Official Selling Price mechanism.

- Conclude all arrears of royalty reconciliations so that all outstanding royalty payments are calculated and all arrears are collected.

- Provide a defined standard on the point at which production is measured for royalty purpose.

- Strengthen the systems of recording, publishing and monitoring infrastructure benefit flows associated with the granting of oil and gas licenses.

- Seek technical assistance to establish and maintain a database of license holders and license areas.

Federal Inland Revenue Service (FIRS)

The FIRS should:

- review the PPT returns of Chevron and Mobil from 2005-2008

- review underassessment summing up to $690 million arising from the misapplication of MOU 2000 in the determination of fiscal value for PPT

- establish a new fiscal regime to replace MOU in conjunction with NNPC and JV partners

- review all underassessment summing up to $424.6 million arising from calculations and tax claims on Intangible Drilling Costs (IDC), Education Tax Fund and Gas Flaring Penalty
- review underassessment of $364.9 million from Operating Expenses (OPEX) with the

companies and raise revised assessments as applicable

- Issue a policy statement addressing the issues of principle, including the interpretation of legislation.

The Nigerian National Petroleum Corporation (NNPC)

NNPC should:

- settle domestic crude liability of N842.7 billion

- adhere to due process in accessing subsidy deductions out of crude oil proceeds

- carry out a comprehensive documentation system of the records and reconciliation of volumes and value of PSCs and Carry transactions

- design a system that suitably controls gas income to the Federation

- Confirm remittance of $3.789billion (dividends from NLNG) to the Federation account.
- strengthen controls over product importation and distribution

- Specify a unique methodology for managing crude sales during a Trial Marketing Period.

NEITI through IMTT will ensure that the above are carried out.

FINANCIAL FLOWS TO GOVERNMENT

Financial flows to Government from the oil and gas sector captured by the EITI reconciliation are set out in the table below. In addition, companies make contributions to NDDC, as well as payments to government (both Federal and States) which are not sector specific – e.g. PAYE, some withholding taxes. These payments are also set out in this section.

Flows are primarily received in US dollars, where flows have been received in Naira or other currencies; they are expressed in the table below in US dollars, converted at the average exchange rate for the year.

	2006 US $m	2007 US $m	2008 US $m	Grand Total (2006-2008) US $m
Proceeds from crude oil and gas sales	27,176.7	29,200.6	41,217.0	148,832.90
PPT	10,626.7	8,084.7	10,961.4	29,672.80
Royalty	4,418.5	3,895.9	5,478.0	13,972.40
Signature Bonuses	985.1	510.0	28.2	1,523.30
Withholding taxes	450.2	676.4	775.1	1,901.70

VAT	89.6	216.2	398.1	[illegible]
PAYE	0.4	0.9	1.8	[illegible]
Education Tax	430.1	522.7	698.4	1,651.20
Company Income Tax	137.3	193.9	215.3	546.50
Dividends & Loan interest from NLNG	0.0	0.0	0.0	0.00
Sub-Total – Federation	**44,314.6**	**43,301.3**	**59,773.3**	**147,389.20**

Withholding taxes	5.2	32.3	62.4	99.90
PAYE	106.3	150.7	195.8	452.80
Sub-Total - States	**111.5**	**183.0**	**258.2**	**552.70**

Contributions to NDDC	261.0	297.0	333.0	891.00
Total	**44,687.1**	**43,781.3**	**60,364.5**	**148,832.90**

These flows are before cash calls are deducted.

Cash Calls

	2006	2007	2008	Total
Cash Calls	**$Millions**	**$Millions**	**$Millions**	**$Millions**
Financed from oil receipts	4,175.00	4,451.00	4,955.00	13,581.00
From BIS	213.00	1,300.00	26.00	1,539.00
Total Cash call	4,388.00	5,751.00	4,981.00	15,120.00

Note: The above table shows that in addition to amounts taken from oil receipts during 2006-2008, cash calls were settled by direct funding totaling $1,539m from the Bank of Settlement, Switzerland during the period 2006-2008.

Subsidy Payments

	2006 ₦ Billions	2007 ₦Billions	2008 ₦Billions	Total ₦Billions
Subsidy on imported products	219,728.40	236,641.07	360,184.60	816,554.07

B: PROCESS FLOWS

Oil Block Sales

Process (Bid Round – Oil Block Sales)	2006	2007	2008
No of Blocks Involved	18	45	-
No of blocks awarded	16	14	2

C: PHYSICAL FLOWS

Physical Production	2006 Mbbls	2007 Mbbls	2008 Mbbls	Total Mbbls
Joint Venture with Government	656.67	582.27	540.08	1,779.02
Production Sharing Contracts (PSC)	159.24	191.61	193.75	544.6
Service Contractors (SC)	4.05	4.00	3.44	11.49
Sole Risk (SR)	38.24	23.99	27.98	90.21
Total Production (a)	858.20	801.87	765.25	**2,425.32**
Average Daily Production (Per 365-day year)	**2.35**	**2.20**	**2.09**	

Crude Oil Lifting

Crude lifting in Million Barrels	2006	2007	2008	Total
Total crude lifted by NNPC (for the federation)	417.89	381.82	406.18	1,205.89
Oil Companies' Share (lifted by companies)	443.00	427.45	358.15	1,228.6
Total Crude Lifted (b)	860.89	809.27	764.33	**2,434.49**
Terminal Adj.(Stock +se/-se)	-2.69	-7.40	0.92	-9.17
Utilization of federation Share				
Exported by the Federation	263.04	224.51	242.53	730.07
To NNPC for domestic use	154.85	157.31	163.66	475.82
Total Crude lifted by the Federation	417.89	381.82	406.18	**1,205.89**

Note: Total annual production fell by100 million Barrels per annum, but the proportion of production coming from the PSC has increased, while the proportion from Joint Ventures has declined.

Domestic Crude Oil Distribution

Domestic Crude Distribution	2006	2007	2008	Total
Refinery Supply	41.66	18.38	41.32	101.36
Domestic Export	113.19	138.93	122.34	374.46
Total Domestic Crude Lifted	154.85	157.31	163.66	475.82

Note: The refineries utilized only 21% of the domestic allocation for the period 2006 - 2008 while the balance of 79% was exported.

Gas and Feedstock Sales

Gas and Feedstock	2006	2007	2008	Total
Gas sales (mt)	681,879	543,151	683,390	1,908,420
Feedstock sales (mbtu)	477,530,338	618,846,253	633,114,777	1,729,491,368
Total products supplied to PPMC from imports (tonnes) PMS	5,306,156	5,931,780	4,678,437	15,916,373
Total products supplied to PPMC from imports (tonnes) DPK	1,131,270	1,422,228	998,490	3,551,988

NOTES TO THE UNRECONCILED FINANCIAL FLOWS

1. Royalty Receipts and payments Analysis

Year	Govt $m	Company $m	Difference $m
2006	4,418.5	4,457.9	-39.4
2007	3,895.9	3,905.9	-10.0
2008	5,478.0	5,454.8	+23.2
Total	**13,792.4**	**13,818.6**	**- 26.2**

Explanation of Table 1: From the table above, there was a total difference of $26.2 million between what companies claimed to have been paid to government as royalty in 2006 and what government declared that it actually received. Most of the above differences were payments confirmed to the companies' bank statements/swift copies/payment receipts but not traced to CBN statements.

2. Signature Bonus Receipts and Payments Analysis

Year	Govt $'m	Company $'m	Difference $'m
2006	985.10	955.0	30.1
2007	510.0	487.7	22.3
2008	28.20	28.1	0.1
Total	**1,523.3**	**1,470.8**	**52.5**

Explanation of Table 2: Government recorded higher figures than the companies because some companies did not report the signature bonuses they paid.

3. Petroleum Profit tax receipts and payment analysis

Year	Govt $'m	Company $'m	Difference $'m
2006	10,626.7	10,626.7	-
2007	8,084.7	8,084.7	-
2008	10,961.4	10,961.4	-
Total	**29,672.8**	**29,672.8**	-

Note: All payments by companies for petroleum profit tax were reconciled to receipts by the Government in the years under review.

GOVERNMENT AGENCIES COVERED BY THE AUDIT

- **Federal Inland Revenue Service (FIRS)**
  The Petroleum and International Tax Department (PITD) of FIRS is responsible for assessing and collecting PPT and other direct taxes from the joint ventures, production-sharing contractors and sole risk operators.

- **Department of Petroleum Resources (DPR)**
  Has overall responsibility for regulating the industry. It approves exploration licenses, drilling programmes, development and production activity, and capital equipment imports. It also monitors and collects royalties, and compiles production data used in the calculation of PPT. It is part of the Ministry of Petroleum.

- **Central Bank of Nigeria (CBN)**
  Is Nigeria's banker, depository for royalties, PPT and other direct taxes; it also provides collection information for reconciliation with the tax assessments of Federal Inland Revenue Service.

- **Office of the Accountant General of the Federation (OAGF)**
  The Office of the Accountant to the Federal Government is the "owner"/manager of Federal Government Accounts with the Central Bank which keeps in custody all revenue remitted to Federation Account from the proceeds of Extractive Sector businesses and transactions.

- **Nigerian National Petroleum Corporation (NNPC)**
  NNPC is state-owned oil company that manages Nigeria's interest in the oil and gas sectors through the joint venture partners and the following subsidiaries:

  - **Crude Oil Marketing Division (COMD)**
    The COMD is responsible for verifying production and sales data, and for establishing a representative price for tax purposes for different crude oils based on market realisations.

  - **National Petroleum Investment Management Services (NAPIMS)**
    Manages the government's upstream investments in joint ventures, approves capital expenditure, purchase contracts, monitors operating and financial results

from NNPC's joint ventures with international firms and production-sharing contracts. NAPIMS also receives management reports and audited accounts from the upstream companies, which positions it for review and audit of Petroleum Profits Tax (PPT).

- **Pipelines and Products Marketing Company (PPMC)**
  Transports crude to refineries, imports and distributes petroleum products.

- **Revenue Mobilisation, Allocation and Fiscal Commission (RMAFC)**
  Constitutionally empowered to monitor revenues and allocate them to Federal, State and Local Governments.

- **Crude Oil Reconciliation Committee**
  The CORC performs the actual reconciliation of crude oil revenues along with the Central Bank of Nigeria.

- **Petroleum Products Sales Reconciliation Committee**
  Reconciles revenues received from petroleum products sales and revenues received in relation to government allocations of crude oil to NNPC for the purpose of meeting domestic petroleum product demand.

- **Niger Delta Development Commission (NDDC)**

  NDDC was established as a regional development intervention agency for the oil producing communities and areas. The oil companies pay it 3% of their annual operating budget to invest in development projects in the nine states that are covered by NDDC.

- **Petroleum Technology Development Fund (PTDF)**

  The Petroleum Technology Development Fund (PTDF) is a parastatal of the Ministry of Petroleum Resources dedicated for the purpose of development, promotion and implementation of petroleum technology and manpower development through research and training of Nigerians in the fields of engineering, geology, geosciences, management, economics and relevant fields in the petroleum and solid minerals industry in Nigeria or abroad.

COMPANIES COVERED BY THE AUDIT

Joint Venture (JV)

Joint Venture is a cost sharing arrangement between two or more mineral interest owners, which is referred to as Joint Venture Partners with one of the partners as the operator. Their relationship is governed by a written agreement called the Joint Operating Agreement (JOA). All the parties share in the cost of Operations which is agreed annually and financed through cash calls.

Each partner can lift and separately dispose its interest share of production subject to the payment of Petroleum Profit Tax (PPT) and Royalty.

Companies under Joint Venture Agreements:

- Chevron Nigeria Limited (40% - Govt. 60%)
- Elf Petroleum Nigeria Limited (40%-Govt.60%)
- Mobil Producing Nigeria Unlimited (40%-Govt.60%)
- Nigerian Agip Oil Company (NAOC) (40%-Govt.60%)
- Panocean Oil Corporation (40%- Govt.60%)
- Shell Petroleum Development Company (SPDC)(45%- Govt.55%)

- Texaco Overseas (Nigeria) Petroleum Company (40%- Govt.60%)

These companies are in joint venture business with Nigeria through the NNPC.

Production Sharing Contracts

These are agreements between the NNPC and a company that is usually called the contractor. The entitlements to oil produced under the PSCs differ from JV arrangement. The Government is entitled to royalty as a first call on production; then development costs are recovered by the contractors. Any PPT is then settled to the State by the contractor and the remaining oil is shared between NNPC (for the Government) and the contractor under agreed percentages set out in the PSC.

Companies under Production Sharing Contract:

- Nigeria Agip Energy Ltd
- Star Deepwater Petroleum Ltd
- Addax Production Development Nigeria Ltd
- Shell Nigeria Exploration & Production Co Ltd
- Esso Exploration & Production Ltd
- Addax Petroleum Exploration Nigeria Ltd

Sole Risk

This is a funding arrangement which applies to marginal field operations where the operator is solely responsible for the funding and therefore, bears all the risks and rewards. They are however, expected to pay the mandatory Royalties and Taxes as applicable.

Sole Risk Operators:

- Amin International
- Atlas petroleum
- Brass Exploration Unlimited
- CAMAC
- Cavendish
- Conoil Producing/Continental Oil & Gas
- Dubri
- Express Petroleum
- Moni Pulo
- Mid Western Oil & Gas
- Niger Delta Petroleum Resources
- Newcross Petroleum
- Platform Petroleum
- Sheba Exploration & Production Co Ltd
- Waltersmith Petroman

Service Contract

This is a petroleum production arrangement under which the title for Oil Prospecting License (OPL) is held by one party, while the operator is designated the service contractor and provides funds required for exploration and production work over a period of time.

Service Contractors:

Agip Energy and Natural Resources Ltd (AENR)

ACRONYMS

OAGF	Office of the Accountant General of the Federation
NNPC	Nigerian National Petroleum Corporation
NDDC	Niger Delta Development Commission
NEITI	Nigerian Extractive Industries Transparency Initiative
FIRS	Federal Inland Revenue Service
NLNG	Nigeria Liquefied Natural Gas
CBN	Central Bank of Nigeria
EITI	Extractive Industries Transparency Initiative
PPT	Petroleum Profit Tax
OPEX	Operation Expenses
PPMC	Pipelines & Petroleum Marketing Company
MOU	Memorandum of Understanding
IDC	Intangible Drilling Costs
PSC	Production Sharing Contracts
SC	Service Contractors
SR	Sole Risk

VAT	Value Added Tax
DPR	Department of Petroleum Resources
SPDC	Shell Petroleum and Development Company
NSWG	National Stakeholders Working Group

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