

**NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (NEITI)
RELEASES AUDIT REPORT ON THE NIGERIAN OIL AND GAS INDUSTRY.**

**CRITICAL PHYSICAL, FINANCIAL, PROCESS AND GOVERNANCE ISSUES
ARE BROUGHT TO THE FORE**

About NEITI

NEITI was created in 2004 essentially to develop a framework for, and ensure transparency and accountability in the reporting and disclosure, by the extractive industry companies, of revenue due to or paid to the Government. As a subset of the global Extractive Industries Transparency Initiative (EITI), the main task of NEITI is the reconciliation of payments made by extractive industry companies with receipts recorded by public agencies. In 2007, its existence was institutionalized by the enactment of the NEITI Act. By that process also, its mandate was expanded to include the following:

Ensure due process and transparency in the payments by extractive industry companies and accountability in the revenue receipts of the Government and other statutory recipients;

Ensure transparency and accountability by government in the application of resources from payments received from extractive industry companies and eliminate all forms of corrupt practices in the determination, payments, receipts, and posting of revenue accruing to the Government from extractive industry companies;

Thus, NEITI combines its international responsibility with its national legal mandate.

The main instrument for achieving the objectives of NEITI is the conduct, annually, of physical, financial and process audits by an independent firm of auditors appointed by NEITI for that purpose.

About the Audit Report

The National Stakeholders Working Group of NEITI, in March 2007, commissioned the 2005 Audit of the Nigerian oil and gas industry. In July, 2009, it released the report of the Audit conducted and compiled by the Hart Group of the United Kingdom and its Nigerian partner, S. S. Afemikhe and Company, covering the three areas: physical, financial and process. The aim of the financial audit was to ensure that all payments due to the Federal Government were duly made. The aim of the physical audit was to ascertain the accuracy of the volumetric data emanating from the industry. And a major aim of the process audit was to identify lapses and undertake measures that shall enhance the capacity of any relevant organ of the Federal, State or Local Government having physical responsibility to monitor revenue payments by all extractive industry companies to the Government.

This is the second time that a comprehensive audit of the sector is being done; the first was the audit covering the period 1999-2004 also commissioned by NEITI. The present audit covers transactions for the year 2005. The audit for 2006-2008 is about to be commissioned.

Highlights of the Audit Report

Physical Audit - Total production (terminal receipts) of crude oil in 2005 was 917.7 million barrels, approximately, 2.5 millions barrels per day. Total crude lifted was 916.9 million barrels: while the Nigerian National Petroleum Corporation (NNPC) lifted 456.4 million barrels, the oil companies lifted 460.5 million barrels. Of the NNPC share, export crude amounted to 295.5 million barrels while domestic crude was 159.9 million barrels. Total gas production was 2,190,447.1 million cubic feet, of which 795,981.8 million cubic feet (about 36%) was flared.

Financial Audit - Financial inflows from oil and gas in 2005, as reported by the auditors, was US\$37.871 billion and N19.669billion naira, out of which investment in the form of cash calls of US\$4.065 billion was made leaving a net balance of US\$33.8 billion and N19.669billion. It should be noted that some of these figures are still to be finally reconciled. For instance with respect to Petroleum Profit Tax, while the Central Bank of Nigeria (CBN) recorded US\$10,396,176,000 as received, the companies

claimed to have paid US\$10,638,047,000, a difference of US\$241.871 million. Conversely, with respect to Royalty, while CBN recorded US\$4,679,468,000 as receipts, the companies claimed to have paid US\$4,357,491,000, a difference of US\$321.977 million. NEITI is working with all the parties concerned to reconcile these and other differences.

It is noteworthy that a much greater proportion of revenue from the industry derives from the sale of crude oil and gas than from royalty and taxes from the companies. In 2005, proceeds from export of crude oil and gas amounted to US\$16.378 billion; in addition, proceeds from domestic crude oil and gas sales and related income totalled \$5.626billion (N778.9 billion). In that year the CBN reported receiving US\$15.225 billion as Petroleum Profit Tax, Royalty, Reserves Additional Bonus, Gas Flare Penalty and Company Income Tax.

Process and Governance Issues

By its Act of 2007, NEITI is mandated to obtain from any company in the extractive industry or from any relevant organ of the Federal, State or Local Government, an accurate account of money paid by and received from the company at any period as revenue accruing to the Government from such company for that period. It is also, as indicated earlier, mandated to identify lapses and undertake measures that shall enhance the capacity of any relevant organ of the Federal, State or Local Government that has statutory responsibility to monitor such revenue payments. In this respect, the Audit Report stated as follows:

Non-cooperation - Two companies did not cooperate with the audit: Cavendish and Express Oil.

Physical Audit Issues - The amount of oil produced (at the well head) is not reliably known. In 2005, DPR had no system for measuring production other than monitoring terminal receipts. And in spite of gas flare penalty, gas flaring volumes were still significant (about 36% of production) but the trend of decline in flaring had continued.

Management Challenges Connected with Low Capacity of Regulatory Agencies -

The auditors could not confirm signature bonus payments in the year 2005; there was a difference of US\$116 million between what the DPR reported and what the companies claimed. The management of signature bonus in 2005 was not transparent. DPR, OAGF, CBN and PTDF were not able to incontrovertibly confirm the signature bonus payable by the oil companies in 2005, and reconcile it with what was actually received. The DPR did not rigorously verify the royalty returns computed by the companies, such as SPDC, Continental Oil, Phillips, among others. In consequence, a comprehensive royalty validation could not be obtained by the auditors. Similarly, the FIRS accepted company self-assessment of PPT without adequate verification and validation. As a result, short falls in the companies' liabilities to the Federation were estimated, by the auditors, at over US\$242.9 million for royalty and US\$309.9 million for PPT. These amounts have to be verified, confirmed and recovered. Furthermore, Mobil Producing Nigeria Limited and Chevron Nigeria Limited were not able to support their PPT return costs with their JV audited financial statements and underlying records. This needs to be investigated by the FIRS, in cooperation with NEITI, to ascertain how they compiled their PPT returns in the past and the steps that should be taken to address the situation in the future. In respect of NNPC payments for domestic crude, the audit established that NNPC owed the Federation the sum of \$4.73billion (N654.8 billion), which is N3.2 billion more than what was shown by NNPC records as at 31st December, 2005. The NNPC says it is withholding the sum of N222.4 billion as outstanding subsidy payments due to it. The NNPC needs to upgrade its accounting systems to improve its handling of crude oil marketing. Also, NLNG reported having paid US\$ 207 million in dividends, interest, and loan repayment to NNPC but NNPC has not confirmed having received this. As in the upstream, there are management challenges in the downstream as well. For instance, with respect to refined product importation and distribution, pipeline losses were estimated by the auditors at US\$239 million. The Petroleum Products Marketing Company (PPMC) did not offer an analysis of the causes in terms of vandalism, thefts, leaks, evaporation, etc. The system of measuring and recording refined product receipts and pipeline movements is not consistently applied and cannot be relied upon. It requires upgrading to international best practices.

In general, financial information systems in the sector are not adequate for the purpose of controlling financial flows from the sector. The Accountant General of the Federation needs to exercise greater management and control over the revenue flows in the sector.

Among the other statutory recipients of oil revenue, the Niger Development Commission (NDDC) received due attention from the auditors. They stated that payments by companies, as reported by the Commission, summed up to US\$135 million and N8.36 billion. However, the companies reported to the auditors, payments of US\$120 million and N8.2 billion. Besides, the amount calculated by the companies as due to the Commission for 2005 was less than the amount arrived at from the calculation of the NEITI auditors, by US\$50.615 million and N1.2 billion. The difference arises from misinterpretation of the NDDC Act. The companies will be asked to pay the difference. Also, the NDDC finances are to be audited. With respect to the Joint Development Zone, linking Nigeria with Sao Tome and Principe by treaty, Nigeria has a 60% stake in the zone. The EITI process is yet to be applied to the zone. NEITI has started dialogue with the STP counterpart to mainstream the EITI process in the JDZ.

Disbursements and Application of Resources:

One of the functions of NEITI is to ensure that all fiscal allocations and statutory disbursements due from the Federal Government to statutory recipients are duly made. However, although the auditors and the secretariat have some figures on disbursements and fiscal allocation, the data available so far are incomplete and unreliable. The figures on direct financial flows from the companies to the states compiled by the auditors and put at US\$24,628, 000 and N24.325billion were described by them as "not confirmed" and "incomplete". The audit process started before the coming into force of the Act; hence the auditors mandate did not embrace this aspect of the NEITI mandate. This gap will be filled in the templates for the 2006-2008 audits.

Action by NEITI

The report of the audit of the oil and gas industry for the year 2005 has disclosed a lot of data and information that call for urgent attention and action by all stakeholders. It has been considered and approved by the NSWG, presented to the Federal Executive Council for noting and to get a Presidential and Ministerial buy-in for the implementation of the key recommendations, and disseminated to the National Assembly and Office of the Auditor-General for the Federation, as required by law. By this press release, the highlights are being presented to the public. Round table discussions, public fora and other forms of debate will now be organized by NEITI. More important, NEITI will take action, including activating the relevant provisions of the NEITI Act, 2007, to ensure that the benefits due to the Nigerian government, agencies and above all the people of Nigeria, from the industry duly accrue to them, in accordance with the principles of transparency, accountability, and sustainable development. While NEITI acknowledges the historical importance of the on-going reform in the petroleum industry encapsulated in the Petroleum Industry Bill and supports it, immediate steps need to be taken to remedy the institutional, governance, process and capacity deficiencies in the sector. NEITI will facilitate this process of remediation, working in collaboration with all stakeholders.

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11th August, 2009.