



NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

FINAL REPORT

Combined Executive Summary

Submission

December 2006

Information as at 20th December 2006

Presented to the National Stakeholder Working Group of the NEITI by

Hart Group

in association with

CMA Limited and

SS Afemikhe & Co

**NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY**

CONTENTS

1. Preface
2. Findings and recommendations
3. Financial audit: revenue validation issues
4. Financial audit: other issues
5. Physical audit
6. Department of Petroleum Resources
7. Licensing
8. Operating and capital expenditure
9. Government sales of crude oil
10. Downstream activities: Refineries & importation
11. Gas

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

1.0 Preface

- 1.1** The first independent Nigeria Extractive Industry Transparency Initiative audit was commissioned by the National Stakeholder Working Group (NSWG) and covered the period 1999–2004. The initiative was historic: the work required to achieve this has not previously been undertaken. The audit was undertaken by Hart Group.
- 1.2** The audit scope was set out in Terms of Reference specifying a set of tasks and deliverables grouped into Financial, Physical and Process audits. The audit work was carried out during the period February 2005 to June 2006. The findings have been reported periodically during this time.
- 1.3** The audit has produced a statement of the financial and physical hydrocarbon flows associated with Nigerian crude and gas production and a statement of refined product movements, based on aggregation of data provided by various sources, for the period 1999 - 2004.
- 1.4** Financial flows to the Federation have been reconciled and the aggregated amounts are materially correct, as defined by the terms of reference.
- 1.5** Audit work was hindered by the passage of time and by inadequate record keeping, systems and procedures. This meant that the process of reconciliation was demanding and time consuming.
- 1.6** We make a number of recommendations for process improvements. Strategic recommendations are set out in this Executive Summary. An action plan has been prepared. Government with the NSWG should undertake a project to follow up the work done during the audit and to realise the benefits from the potential improvements that have been identified.
- 1.7** This report is intended for the use of the National Stakeholder Working Group of the NEITI for the purpose of that initiative and is not to be relied upon by other parties.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

2.0 Findings and recommendations

General

- 2.1** Government should position itself to manage hydrocarbon development on a wider front than presently. In order to achieve this, a fundamental review of roles and responsibilities within Government is required. A study should be undertaken to consider how institutional structures might be rationalised and reorganised. Resource implications arising from the review will need to be addressed.
- 2.2** There needs to be clear and regular communication to the public of the forms of government involvement in exploitation of Nigeria's oil and gas reserves and the benefits which it brings. It is important, therefore, that the allocation of functions within government represents best practice and works properly.
- 2.3** There is a basic need for government, the regulators and the industry to take a holistic view of the industry and to ensure good lines of communication and sharing of information between different parties in the industry, whether government bodies or private companies.
- 2.4** It is important to recognise the inter-relationship of physical and financial data by instituting a framework in which data on hydrocarbon volumes and cash flows is regularly compared and reconciled.
- 2.5** During the audit, comparisons were made of data obtained from different sources. In many cases, this revealed differences where there should have been none, necessitating reconciliations to identify the causes and, where possible, eliminate them. It is important that regular reconciliations continue in the future. Recommendations on this subject have been made.
- 2.6** Regular publication of information is important for purposes of maintaining transparency and to provide assurance to the public that the institutional system is functioning well.

**NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY**

Physical and Financial Flows

2.7 The physical flows of crude oil and associated financial flows in the period 1999 – 2004 were: -

Million barrels	1999	2000	2001	2002	2003	2004
National Production*	772	828	862	740	844	909
Of which: Government						
Exported	367	429	397	325	385	416
Sent to refinery	66	36	84	79	44	39

* defined as Terminal Receipts

Federation net financial inflow from the sector was:

US\$ 000 million	1999	2000	2001	2002	2003	2004
Inflows:						
Crude & gas sales	6	10	10	8	11	17
Taxation	2	5	6	3	5	9
Outflow (cash calls)	-2	-2	-2	-4	-4	-3
Net inflow	6	13	14	7	12	23

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

Potential revenue losses and gains

2.8 Potential revenue losses to the government were identified during the financial audit:-

- **Possible underpaid royalty**, due partly to the lack of a clearly defined point of assessment of royalty.
- **Possible underpaid PPT**, due to a practice of self-assessment that has not been adequately validated by FIRS
- **Company payments not recorded by CBN**: there are some cases where companies have declared that they made payments but CBN has not been able to confirm receipt.

These issues are discussed further below.

2.9 In the period, there was an economic and financial cost due to the inefficient operation of the refineries. It is estimated, for example, that there would have been a net benefit to Nigeria in 2004 of \$120 million if the refineries had operated only at the levels achieved in 2001/02. This benefit would be higher if they were to operate at average international levels of efficiency.

Major recommendations

2.10 Detailed recommendations are set out in the accompanying reports. The major recommendations, which are discussed in more depth later in this Combined Executive Summary, are as follows:-

2.10.1 Government entities and systems require review and / or strengthening, in particular:-

- a. The Department of Petroleum Resources (DPR) needs to play a greater role in oil industry regulation
- b. The gas industry requires a regulator
- c. The Accountant General to the Federation (AGF) should exercise greater management and control
- d. The Federal Inland Revenue Service (FIRS) capacity to deal with PPT should be strengthened
- e. The support required from the Central Bank (CBN) for the future identification of oil related flows should be defined so that CBN can establish suitable reporting systems
- f. The nature of NAPIMS involvement in the joint venture companies needs to be reviewed so that best value is achieved

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

- g. NAPIMS' capacity to manage Government's upstream investments should be strengthened by implementing an investment selection model, performance measurement and benchmarking
 - h. Different funding options for Government involvements in upstream operations must be rationalised, for optimum cost of capital and Value For Money.
- 2.10.2** The timeliness of the process for granting approval of joint venture operating budgets and capital projects requires review. There is a cost to the delays which have occurred.
- 2.10.3** Much greater use should be made of IT systems to improve controls, to eliminate inconsistencies arising from duplicated information and to improve transparency by making possible a wider sharing of data.
- 2.10.4** Differences in the calculation and treatment during 1999 - 2004 of certain items for PPT, Royalty and Company Income Tax should be investigated by FIRS (taxation) and DPR (royalty) and the amount of tax and royalty due should be confirmed
- 2.10.5** Production of a hydrocarbon and gross liquids mass balance on a regular basis by the operating companies should be required, with the process overseen by DPR. The mass balance should be used to confirm volumes on which royalty and PPT are based. Consultation should be undertaken between NSWG, DPR, NAPIMS and the operating companies on how to achieve this.
- 2.10.6** The process for importation of refined products should be reviewed since under current practice and procedures, there is scope for discretionary decision making.
- 2.10.7** Measures for improving the performance of the refineries should be examined so that economic benefit to Nigeria is maximised.
- 2.10.8** The system for granting licences to upstream operators can be further improved.
- 2.10.9** The wholesale selling price for gas should be increased progressively since the current price is too low to support long-term gas development.
- 2.10.10** The procedures for sale of crude oil should be formalised and amended in certain areas.
- 2.10.11** A downstream mass balance should be introduced as a monthly requirement from January 2007.
- 2.10.12** There should be a formal process to review volumes of PMS imports against amounts approved by the Government. A comparison between the actual and approved volume of PMS imported during the period August – December 2004 revealed that actual imports exceeded the amount approved by more than 700,000 tonnes.

**NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY**

3.0 Financial Audit

Findings

3.1 The audit reviewed the computation of royalty payable.

- The law on royalty does not clearly specify how the crude oil volume is to be determined. It should be amended.
- Calculations of royalty liabilities by the auditors differed from company figures.

3.2 The audit reviewed the computation of PPT payable.

- a. Comparison between the reconciled physical hydrocarbon balances and the declared volumes for PPT purposes materially agreed.
- b. Comparison of the deductions claimed by companies for PPT purposes against the expenditures in their audited accounts revealed in some cases differences which the companies have not explained.

3.3 In summary, the differences arose in the following areas:-

	<u>Agency for follow-up</u>	<u>US\$ millions</u>
Royalty assessment issues	DPR	113
PPT Assessment issues:		
Operating costs	FIRS	1802
Intangible Drilling Costs	FIRS	522
Fixed Asset additions	FIRS	-583
Non-Associated Gas costs	FIRS	499
Excess Investment Tax allowance	FIRS	156

Detailed analysis and reconciliation is required which requires better information than the companies in several cases provided to us. There are substantial sums at stake. We have indicated the agency which should now follow these matters up.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

3.4 The audit reviewed the making and payment of Cash Calls in respect of the Federation investment in upstream Joint Ventures.

The way in which Reserves Additional Bonus (RAB) was set off between Chevron and NAPIMS was examined. An allegation had been made that \$52,608,000 had been incorrectly treated. On the basis of the work carried out, we conclude that the amount was properly set off against cash calls.

3.5 Following receipt of the audit report about PTDF and further information from DPR, the payment of signature bonuses has been further reconciled. A supplementary report will be prepared in due course.

3.6 The audit checked the correspondence of payments of Petroleum Profits Tax, Royalty and Gas Flare Penalty between amounts declared by companies as having been paid and amounts reported by CBN as having been received. In the templates initially returned, there were differences between the amounts reported by the companies as paid and the amounts reported by the Central Bank as received. Overall, the Central Bank recorded receipts less than the companies say they paid. Audit work was curtailed in order to meet a timetable.

The auditors, the companies and CBN subsequently carried out further work at the behest of Mr. President and succeeded in identifying and clearing most of these differences. The net remaining difference is \$7.9 million, representing 0.01% of transactions over the 6 year period.

There remain 9 payments which companies say they have made where CBN has been unable to find a record of receipt. The companies have not provided evidence to enable these payments to be traced further. These payments amount to \$8.8 million.

CBN reports 2 receipts with a value totalling \$1.8 million which the companies have not been able to trace to their records.

The overall net position is:

	Reported by CBN, not by company	Reported by company, not by CBN
	US\$ millions	US\$ millions
PPT	0.9	1.4
Royalty	-	7.9
Gas Flare Penalty	0.5	-
Net difference		7.9

**NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY**

The differences affect the following companies:

Reported by Company but not by CBN				Amount
Company	Month	Year		\$000
Royalty				
Panocean	January	1999		161
Amni Oil	July	1999		540
Express Oil	June - December	1999		1,468
Amni Oil	February	2000		321
Moni Pulo	November	2003		3,034
Continental Oil	February	2004		2,000
Con Oil	April	2004		385
				7,909
PPT				
Amni Oil	January - December	1999		318
Chevron/COCNL	October	2003		565
				883

Reported by CBN but not by Company				
Company	Month	Year		Amount
				\$000
PPT				
SPDC		2004		1,354
Gas Flare Penalty				
Mobil	January	1999		470

Continental Oil and Con Oil have made additional payments pending determination of the cause of the differences.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

Recommendations

- 3.7** DPR should engage with the companies to resolve differences on royalties. DPR should determine a practical definition of royalty, in accordance with legislation, and agree the royalties due for each year in the period 1999 – 2004.
- a. DPR should in future review the conformity of royalty payments to reconciled hydrocarbon production for each year.
 - b. DPR should take responsibility for the assessment and filing of royalties payable on the upstream companies.
 - c. DPR should more actively monitor payment of royalty to ensure that producers make timely payment. DPR should always issue a receipt for payment received.
 - d. FIRS should obtain explanations from the companies for the differences on PPT and calculate the PPT due for each year in the period 1999 – 2004, raising revised assessments as applicable. It is understood that FIRS has commenced this review.
 - e. FIRS capacity in dealing with PPT should be strengthened. FIRS has made progress in 2006 in improving the way in which companies present their computations of PPT.
 - f. CBN should examine the remaining differences between its records and the companies' records and report promptly to NEITI and the AGF on its findings, for any necessary action.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

4.0 Financial Audit: Other Issues

Findings

- 4.1** Much of the financial audit work carried out had not previously been undertaken. The work was hindered by the passage of time, which meant that archived records had to be retrieved, and by inadequate record keeping, systems and procedures.
- 4.2** This was made more difficult by reliance on decentralised, largely paper based systems, particularly by government bodies. The use of suitable, secure IT systems to provide consistent data to various users and to analyse this data was limited or non-existent for the period under review.
- 4.3** The flow of information currently consigns the Accountant General of the Federation (AGF) to a purely reactive role, where he is unable to exercise any effective control or authority.
- 4.4** DPR did not assert any authority to assess and collect royalty liabilities during the review period.
- 4.5** FIRS was not proactive in assessing and collecting the PPT liabilities of the companies. The regime in the period under review amounted to unregulated self-assessment. This is not appropriate considering the significant financial flows involved
- 4.6** There is no indication that the crude volumes according to the records of the Federal Inland Revenue Service (FIRS) had been reconciled with any information produced by a hydrocarbon mass balance, such as was undertaken for the NEITI audit.
- 4.7** The record keeping systems used by FIRS were inadequate and require improvement. For example, FIRS did not maintain its records on a double entry system, nor did it maintain a proper cashbook nor keep any ledger. Since FIRS keeps only single entry records no Control Account is maintained. FIRS needs a reliable system for ensuring that companies are properly assessed and do pay their tax liabilities on a timely basis. The system observed for the period up to 2004 was not suitably designed to achieve this.
- 4.8** CBN maintained such an accounting and archiving system as it deemed necessary to fulfil its role as banker to the Federation. This however was not such as to enable it to provide the detailed data required for an audit such as this, nor to enable it to fulfil an imposed role to substitute for deficiencies in the systems that should have been maintained by the Accountant General of the Federation, in monitoring and managing incoming flows to the Federation.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

Recommendations

- 4.9** In order to maintain transparency into the future, it is important that the reconciliations of data held by different entities are performed on a regular and timely basis.
- 4.10** A review should be undertaken of government accounting to determine what changes may be required to improve transparency and the provision of information. The aim of any such reform should be to put the AGF in a position actively to manage the financial flows associated with the oil and gas sector. The system should be reformed to put the AGF in a position of management and control.
- 4.11** New information structures are required to achieve this, including a wide-ranging review of the information and management systems of the key sources of revenue, namely:
- The sale of equity crude (COMD)
 - The management of petroleum resources (DPR)
 - The management of taxation (FIRS)
- 4.12** The functions of receipt and custody of the revenues (CBN) have to be included in the review but changes in CBN should not alone be expected to provide the solution.
- 4.13** The Revenue Mobilisation Allocation and Fiscal Commission has been given, by the constitution, the senior role in the monitoring of revenues. However, its practical activity in this area has to date been limited, in effect, to participation in the FAAC and to issues of allocation (expenditure). The Commission maintained that it had not achieved access to NNPC. The Commission appears to be under-resourced to extend its reach to the monitoring of flows from the oil and gas sector, beyond its present activities. If it were desired to empower the Commission to deepen its activities it would be necessary to strengthen its capacity.
- 4.14** The Accountant General of the Federation should have prompt access to current information, to enable him to timely perform his record keeping function. On the basis of our work on the 2004 records, there is a need for steps to be taken to streamline CBN and AGF processes and eliminate the gap between the parties.
- 4.15** CBN should not be put in the position of having to provide the timely and reliable management information that is required for ordinary Government management of flows from the sector.
- 4.16** Generally there is scope to make much greater use of IT systems to improve controls, to eliminate inconsistencies arising from duplicated information and to improve transparency by making possible a wider sharing of data.
- 4.17** A process review of the accounting and information systems at FIRS should be undertaken. We have been informed that FIRS has recently asked CBN to open a large number of separate accounts, which may assist in controlling what is received at CBN. This appears to be recognition that the previous arrangements were not satisfactory. The process review should confirm that this planned new system may realistically be expected to deliver the quality of control that is commensurate with the value and importance of these financial flows.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

- 4.18** FIRS should in future be proactive in securing correct volumes for the use in the calculation of PPT liabilities and should issue assessments on the companies.
- 4.19** FIRS should follow up the crude volume differences and link in closely with the physical volume data to be prepared by DPR so that these outstanding issues are resolved.
- 4.20** FIRS should include independent companies within the scope of its collection activity.
- 4.21** Each company should submit a statement to DPR and FIRS reconciling its annual PPT and royalty computations to its audited accounts.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

5.0 Physical Audit

Findings

- 5.1** The compilation of a statement of hydrocarbon flows by year and by individual shareholder was a totally new exercise for the oil and gas industry in Nigeria. Industry metering practices and reporting methods have not been geared to routine production of this information during the review period, although this has begun to change recently.
- 5.2** Hydrocarbon volume mass balances were developed by companies and presented to us. All companies presented net volume balances, and most companies presented gross liquid balances (including water and losses). However, it proved difficult to determine the reliability of the gross balances.
- 5.3** The methodology of preparing a mass balance by calculating back from terminal receipts is inherently not suitable to derive the amount of unaccounted oil.
- 5.4** An upstream hydrocarbon balance was produced based upon the information provided by the oil companies and NNPC. It was not possible from this information nor from subsequent discussions with the oil companies to address the question of unaccounted oil.
- 5.5** There may be expenditure implications for JVs if additional metering points are required. There is a range of issues on definitions and practices to be applied in arriving at the reported mass balance. These, and the timing of implementation, should be agreed on an industry-wide basis.
- 5.6** Export volumes have been agreed between DPR and the companies and NNPC. The audit has materially verified the volumes of crude exported by NNPC.
- 5.7** Volumes used by the companies for Royalty and PPT were reconciled between the hydrocarbon flows and the taxation and royalty returns. The position, however, is very complex due to the arrangements for unitisation and product swaps between companies. Some company data differed from the mass balance.
- 5.8** The PPT Act appears to have been overridden in practice by agreements such as the MOU, Production Sharing Contracts and carry agreements. It is unclear how such non-statutory agreements can have this effect.
- 5.9** Gas investment and incentives, have contradictions and appear inconsistent with the PPT Act and Company Income Tax; these should be investigated and resolved.
- 5.10** The conduct of the physical audit indicated shortcomings in both DPR and company record keeping that were hard to resolve after the passage of time.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

Recommendations

- 5.11** Arrangements for monitoring the entire hydrocarbon and liquids balance of the sector, from wellhead to terminal / refinery should be reinforced. We recommend that DPR should spearhead this.
- 5.12** A suitable information system mainstreamed into the companies' information and reporting systems, needs to be established to provide the mass balance data on a routine basis, without resorting to ad hoc exercises. We recommend that a dialogue be opened involving NSWG, DPR, NAPIMS and the companies (OPTS might facilitate this) to agree how to proceed.
- 5.13** Guidelines / Standards should be established for preparation of formal mass balance statements.
- 5.14** A reconciliation of export liftings between DPR and companies should take place regularly in order to identify inconsistencies in the records and adjust them on a timely basis.
- 5.15** Each company should submit an annual statement to DPR and FIRS reconciling its PPT and royalty self assessments to the annual mass balance and DPR guidelines (to be prepared).
- 5.16** Annual audited cost reports submitted to NAPIMS should include the mass balance, prepared in accordance with relevant standards.
- 5.17** External auditors should be required to report annually on the hydrocarbon mass balance. The form of report requires discussion. A compilation report may be appropriate. This requires discussion with the industry and auditors.
- 5.18** Responsibility for regulation of gas should be defined. Heavy regulation is not required but the present system suffers from lack of regulation.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

6.0 Department of Petroleum Resources

Findings

- 6.1** During the review period, there was no overall process for agreement of crude export volumes and there was no certification of the total export or other volumes reported by each company and used for royalty/PPT computation purposes.
- 6.2** The Department of Petroleum Resources (DPR) did not maintain centralised computerised records for most of this period, which made it difficult to obtain an overall picture of hydrocarbon volumes. At the time of our audit, DPR was working on agreeing the export volumes for 2005 with each producing company, on a centralised basis.

Recommendations

- 6.3** DPR should be proactive in securing agreement on crude volumes with all the companies and should take the lead in producing a hydrocarbon mass balance. Where necessary, its statutory powers should be strengthened and its staffing should be reviewed to enable it to achieve this.
- 6.5** DPR acts as the regulator for the export of crude oil and the import of refined products. A regulator is required for the gas industry. Co-ordination between the regulators will be required, for the purpose of reporting on hydrocarbon flows (oil and gas).
- 6.6** DPR should be strengthened to enable it to fulfil its strategic role in the industry. Recommendations such as this have been made by others but such recommendations have not been implemented. It should be appreciated that strengthening is essential to maintaining control over, and improving management of the sector.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

7.0 Licensing

Findings

7.1 The current Nigerian oil and gas regime and licensing policy was examined and compared to the situations in the United Kingdom, Norway and other comparator countries. This review identified areas where improvements may be made.

Recommendations

7.2 The Petroleum Act should be updated, after consultation with industry, to take account of perceived omissions (gas), ambiguities and lack of clarity.

7.3 The lessons of the 2005 bid round should be absorbed. The improvements in transparency should be enshrined in law and the limits of ministerial discretion should be defined narrowly.

7.4 The declared Bid Round Schedule should be adhered to, by ensuring that all necessary elements are in place at the time the bidding round is announced.

7.5 The prequalification process for Local Content Vehicles should be strengthened and made more transparent: a list of pre-qualified companies should be publicly accessible. International Companies should be free to undertake due diligence on LCVs and choose their own partners.

7.6 The bidding criteria should be reduced to a market signature bonus and local content so that transparency in the bidding process is increased.

7.7 The quantity and quality of publicly available data should be improved to facilitate transfers of licences and provide transparency in the bidding process

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

8.0 Operating and Capital Expenditure

Findings

- 8.1** Procedures for budgeting, justification of capital expenditure and procurement were reviewed in the light of best (international) practice. It was noted that the IOCs generally have well documented procedures in place which are generally followed with the aim of achieving maximum value from the projects in which they invest.
- 8.2** NAPIMS does not have a procedure for allocating investment capital between competing projects.
- 8.3** The process for approving JV budgets has diverged from that set out in the JOAs. There is increased bureaucracy without correspondingly increased control and the timescales for expenditure approval have become longer. The 2006 annual operating budget had not been approved at the time of our visit in the middle of March.
- 8.4** Approval for capital projects is also subject to a lengthy process, taking up to 24 months from preparation of the advertisement to award of contract.
- 8.5** Long timescales for approval and late approvals make forward planning difficult, giving rise to operating inefficiencies and increased costs. They also make delivery of capital projects in a timely fashion more difficult at a time when the Government is seeking to increase production rapidly.
- 8.6** NAPIMS has the benefit of working closely with the IOCs in the joint ventures in Nigeria. It sees itself as the manager of the Government's investment rather than as an operational partner, seeking to learn and adopt best practice. NAPIMS should consider using its operational knowledge of different JVs in Nigeria to benchmark costs and processes, with a view to ensuring it maximises the value of its investment.

Recommendations

- 8.8** Consideration should be given to increasing levels of authority delegated to NAPIMS staff as a way to speed up capital projects, increase transparency and ensure that best value is obtained for the money invested.
- 8.9** NAPIMS should adopt suitable evaluation models and procedures to enable it to rank projects against one another, so that investment funds can be allocated in order of priority of best returns. NNPC NAPIMS, like the IOCs need to take a global view of their portfolio. Funding is the biggest constraint faced by NNPC NAPIMS. NNPC NAPIMS therefore needs to prioritise new projects so that the best are approved and others are deferred or dropped.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

- 8.10** A ranking process should be created in NNPC NAPIMS based on project economic parameters (such as IRR, NPV, PIR, discounted cost/bbl, etc) or a combination of economic and other parameters, such as those leading to the achievement of the National Aspirations. Different parameters should be scored, weighted then used to rank projects.
- 8.11** Operating budgets should be approved promptly and within the timescales set out in the JOA. The senior representative, on OPCOM, of each company and of NNPC NAPIMS should be of a sufficiently senior level or with delegated authority to be empowered to approve the annual work programme and budget at the OPCOM level. Should NNPC NAPIMS share of the budget not be eventually fully approved then any shortfall will be alternatively funded.
- 8.12** Alternatively, as a top down process, NNPC should be allocated a budget each year, together with authority and independence to manage their programme within that budget. NNPC would be responsible to Government to meet targets and goals and be fully accountable. NNPC NAPIMS would be wholly responsible and accountable for allocating budgets to the JV partners.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

9.0 Government Sales of Crude Oil

Findings

- 9.1** The process for selling crude oil operates generally satisfactorily and is structured similarly to most oil producing countries.
- 9.2** The process however is not documented, leaving opportunities for departures from established procedures. In particular, there is no defined process for determining who should be included on the list of entities entitled to lift Government crude. Since 1999, the list has remained stable but four additional organisations were added. Transparency is lacking as to how this was decided.
- 9.3** Crude Oil Marketing Department did not provide a complete list of contract holders.
- 9.4** There appears to exist wide discretion at senior levels. The audit findings however did not suggest that the discretion had been abused in the period under review.
- 9.5** Cargoes allocated to Calson (Bermuda) Ltd, an NNPC 51% subsidiary, are frequently assigned directly to Vitol, 49% owner of Calson, due to lack of financial capacity within Calson.
- 9.6** The process for crude lifting has operated satisfactorily during the period and no instances of distress cargoes were noted.
- 9.7** Pricing options available to lifters appear generous.
- 9.8** The standard NNPC sales contract contains some wording anomalies.

Recommendations

- 9.9** The relationship between Calson (Bermuda) Ltd and Vitol, should be reviewed.
- 9.10** In the interests of transparency, the criteria to be applied in deciding the identity of those who may acquire a contract to lift oil should be specified and publicised more clearly. The list of approved lifters should be refreshed periodically.
- 9.11** Procedures governing the sale of equity crude should be formally determined and set out in writing.
- 9.12** The standard NNPC sales contract should be reviewed and updated.
- 9.13** The process for setting the Official Selling Price may be improved. The NNPC standard sales contract and documented pricing procedure should be made available on the internet.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

10.0 Downstream Activities

Findings

- 10.1** The system of authorities, procedures, controls and audits in place in PPMC since the fourth quarter of 2004 (following the Buba Report) was examined, with a particular focus on the process for importation of refined products.
- 10.2** The importation process, including the tendering, contracting and procurement practices, falls short of current good practice standards, and it is questionable whether they fully protect FGN interests. A review of the procedures and approvals processes found that, in many areas of the process, such written procedures as exist are inadequate, either because they do not impose adequate control or because they do not address areas which should be documented.
- 10.3** The current written procedures are marked draft and we were informed that they have not been approved by the Board of NNPC. Since they set authority levels for PPMC Directors, it is essential that they are approved by NNPC. These procedures grant scope for discretionary management decision making on the pricing of importation contracts which appears unnecessarily wide.
- 10.4** A comparison was made between the actual volume of PMS imported during the period August – December 2004 and the amount which had been approved for import. It was noted that actual imports exceeded the amount approved by more than 700,000 tonnes. PPMC has said that this arose due to the refineries not meeting their contribution to the forecast supply/demand balance. We were told that the excess had been approved, although no evidence of this was provided.
- 10.5** The refineries utilisation was extremely poor during the period compared to design capability and international standards. Savings on imports of PMS in 2004 could have amounted to at least \$120 million.
- The refineries averaged approximately 41% utilisation, which is less than half the average world performance over the same period (approx. 85%). This appears attributable to management processes in the refineries.
 - Had the refineries only operated at their peak level of performance achieved during 2001 and 2002, there would still have been a significant shortfall of production of PMS in the period. However the savings on imports of PMS in 2004 could have amounted to at least \$120 million.

As a consequence of poor refinery performance, there was a requirement to import DPK and AGO products. With better refinery performance, Nigeria could have been exporting DPK and AGO.

- 10.6** PPMC has completed templates for imports, exports and movement of refined products as three separate exercises that were undertaken in 2005, June 2006 and December 2006. The first templates were insufficiently complete to be able to produce a mass balance. The templates produced in June were aggregated but PPMC has now stated that

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

there were inaccuracies in the information and that the aggregation should accordingly be disregarded. On 15 December, PPMC provided a summary mass balance; this did not have detail by product or information on volumes of imports and there was no explanation of what the differences were from the previously supplied information. Additional information presented on 19 December quantified the product loss (from all causes) at 3.7 million tonnes over the 6 years period.

Additional work is required to validate the volume flows and process by which these have been gathered in view of the changes to the numbers and the fragility of the information systems from which they have been prepared.

- 10.7** There were significant differences between the quantities of crude reported within NNPC as supplied to the refineries and the quantities reported as received by the refineries. There is no evidence of a regular process of reconciliation. After investigation by NNPC, data was amended and the reported differences now amount to 2.8m barrels, representing 0.8% of the crude supplied to the refineries. PPMC has said that differences arise due to product loss in the pipeline between the terminal and the refinery. No details of incidents have been provided in support, nor does this explanation cover occasions (1999) when PPMC reported more product received than COMD reported as dispatched.
- 10.8** The large increase in product imports has overwhelmed the jetty facilities that were not designed to support the level of product imports.

Recommendations

- 10.9** Written procedures should be developed covering all aspects of the tendering and importation process and levels of authority should be formalised. This should include the periodic setting of the price for imported products.
- 10.10** Alternative models of price setting for imported products should be considered, such as calling for bids for specific lots (limited by volume) at specific prices, and building up the supply from the cheapest first (this can be expected to be effective provided that the pool of suppliers is sufficiently large).
- 10.11** The internal auditors should review operation of the procedures periodically.
- 10.12** Reports should be introduced to monitor volumes of product imported against approvals given. This could be achieved by presenting a statement of how previous approvals have been allocated each time requests for future import approval are made.
- 10.13** Systems for measurement, recording and control of physical movements of refined products and crude feedstock for the refineries require improvement. All areas should be examined, including
- imports
 - crude oil volumes sent from terminals to refineries and volumes received by refineries
 - movement of product from jetties to depots and between depots
 - reconciliation of crude oil into the refineries with production/output

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

AUDIT OF THE PERIOD 1999-2004

EXECUTIVE SUMMARY

- 10.14** The economic argument for improving refinery utilisation is compelling. There is considerable advantage, even in the relatively short term, in allowing the refineries to spend money on efficiently managed maintenance projects and back-up systems for which a clear economic case can be made to protect refinery output.
- 10.15** An operational review of the receiving facilities should be carried out to determine whether their capacity is being used as well as it can be and whether their state of repair and maintenance is adequate.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE
AUDIT OF THE PERIOD 1999-2004
EXECUTIVE SUMMARY

11 Gas

Findings

- 11.1** The gas markets and process for gas marketing were reviewed, with the focus being on upstream producers, NGC, large process users such as NLNG, NAFCON and resellers such as Shell Natural Gas and Gaslink.
- 11.2** The subsidized prices at which gas is currently sold are too low to support long-term gas development.
- 11.3** Charges to users for gas remain unpaid, which distorts the market and reduces the effective cost of using gas as a fuel.
- 11.4** The current culture of long-term contracts has meant that, in the main, good processes, approvals and audit trails are in place.
- 11.5** There were some metering differences upon analysis of NLNG and NGC gas purchases from the Producers.

Recommendations

- 11.6** Wholesale gas prices should be increased and the charges made for gas need to be collected from users promptly, with sanctions applied for late or non payment.
- 11.7** There needs to be a statutory framework and a regulator governing the upstream gas industry.
- 11.3** There is a need for consideration of a restructuring of the Nigerian gas industry, perhaps involving the separation of NGC from NNPC.
- 11.4** The accuracy of metering generally needs to be addressed.