Briefing
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NNPC Still Holds 'Blank Check'

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Prompted by low oil prices and President Muhammadu Buhari's personal resolve to tackle graft, the Nigerian National Petroleum Corporation (NNPC) has improved how it sells the nation's oil. The country's leadership can build on those gains by clarifying the financial relationship between NNPC and the state. Otherwise, oil sector corruption and waste could return to their prior devastating levels once the president leaves office or prices rise.

PROBLEMS

Under the Buhari administration, NNPC continues to withhold billions of dollars in oil sale revenues from the treasury without effective rules or oversight.

- In the second half of 2015, NNPC sales of export crude, so-called domestic crude and oil from its subsidiary NPDC totaled $6 billion. Of this amount, only $2.1 billion entered the Federation Account.
- NNPC therefore retained 64 percent of proceeds from these three types of sales. This was 10 percent higher than the withholdings under Goodluck Jonathan in 2013 and 2014.
- Some of NNPC's withholdings cover known costs, notably its share of joint venture operating expenses. The corporation has not fully explained others, especially revenues retained from domestic crude and NPDC sales.
- NNPC spending on this scale raises questions about fiscal responsibility—especially at a time when public finances are stretched and the federal government is looking to fund more of its budget with debt.
- Recent announcements on NNPC reforms and the latest drafts of the Petroleum Industry Bill do not adequately address how NNPC and the state will share revenues in future.

RECOMMENDATIONS

As the government crafts its reform plans for the oil sector, we recommend that it:

- Establish a clear, legally enforceable rule governing which revenues NNPC can keep and how they can be spent.
- Require NNPC to adopt new financial controls and transparency measures for its subsidiaries, especially around the several billion dollars retained each year from the operations of NPDC, NNPC's half-dozen oil trading subsidiaries and PPMC.
- Replace the domestic crude allocation with a fit-for-purpose mechanism for supplying the refineries with oil.

This brief follows up on the 2015 NRGI report *Inside NNPC Oil Sales: A Case for Reform.*

Recent headlines have reminded us that the Nigerian National Petroleum Corporation (NNPC) under former President Goodluck Jonathan discretionarily spent billions of dollars in public revenues, unfettered by strong rules or oversight. This problem has persisted since President Muhammadu Buhari took office.

NNPC sells several streams of crude oil. Below, we look at the three streams where NNPC fully controls the proceeds, and find that NNPC retained two thirds of the sale proceeds from them ($3.9 billion) in the second half of 2015. The government should move to curb the corporation's discretionary, unaccountable use of much-needed public funds.

In mid-March, Nigeria's auditor-general reported that NNPC withheld N3.2 trillion ($16 billion) in oil revenues from the country's treasury in 2014.[1] The Revenue Mobilization Allocation and Fiscal Commission (RMAFC) quickly piled on with a bigger number: the company retained N4.9 trillion ($25 billion) in revenues between 2011 and 2015.[2] NNPC disputed the auditor-general's claims by putting out a third set of figures, and promised that a forensic audit, due soon, would validate its position.[3] Prompting déjà vu, these findings echo the 2013 accusations of former Central Bank of Nigeria (CBN) Governor Lamido Sanusi, who alleged that NNPC had failed to remit $49.8 billion in oil sale proceeds over nineteen months, thereby kicking off a slew of claims and counter claims. In the 2015 report *Inside NNPC Oil Sales*, we further documented the scale of the problem and debunked NNPC's efforts to explain it away.[4]

In 2014, auditors for PricewaterhouseCoopers (PwC) reviewed NNPC's oil sales system, and wrote: "[NNPC has a] 'blank' cheque to spend money without limit or control. This is untenable and unsustainable and must be addressed immediately."[5] The statement remains true today. As we explain below, no agreed rules govern how much money the NNPC can keep, and how it can spend those funds. As a result, NNPC under President Buhari's administration still retains a major share of oil sale earnings and spends them at will. Until the government instates clear rules for NNPC financing, both the controversies and the underlying revenue leakages will persist.

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DESPITE POSITIVE STEPS, MAKESHIFT PRACTICES REMAIN

Thanks to low oil prices and President Buhari's personal resolve to tackle graft, the government has made positive changes in how NNPC sells the nation's oil. Led by deputy petroleum minister and NNPC head Emmanuel Kachikwu, the new government has cut the number of passive, well connected middlemen that pocket money from sales.[6] It has canceled costly, unbalanced NNPC swap contracts[7] and sought more efficient replacements.[8] And notably, NNPC now publishes monthly financial data, and

1 Office of the Auditor-General of the Federation of Nigeria, *Highlights of Observations on the 2014 Annual Report by the Office of the Auditor-General of the Federation*, submission to the Nigerian Parliament dated March 14, 2016.

2 Camillus Eboh, "Nigeria's state oil company withheld $25 bln between 2011 and 2015 – RMAFC," *Reuters*, March 22, 2016.

3 NNPC, "Press Release - Re: NNPC Failed to Remit N3.235 Trillion in 2014 – By Auditor General of the Federation," March 16, 2016.

4 Aaron Sayne, Alexandra Gillies and Christina Katsouris. *Inside NNPC Oil Sales: A Case for Reform in Nigeria* (Natural Resource Governance Institute, 2015).

5 PricewaterhouseCoopers, *Investigative Forensic Audit into the Allegations of Unremitted Funds into the Federation Accounts by the NNPC* (2015), 16.

6 For more on this issue, see Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, 46-59.

7 NNPC, "Press Release - NNPC Cancels Contract for Delivery of Crude Oil to Refineries," August 26, 2015.

8 NNPC, "Press Release - Direct Sale-Direct Purchase to Replace Crude Swap, Takes off March – Kachikwu," February 2, 2016.

has promised a public annual report.[9] Leadership says it is seeking fixes for some of the corporation's costliest problems, not least the expensive and broken refineries and the chronic debts to its upstream joint venture (JV) partners.[10] These moves—which align with recommendations in our 2015 report—suggest a real determination to take on some of NNPC's worst practices.

At the same time, the government's announced reform plans have not yet addressed how NNPC retains revenues—the practices that led to the "missing billions" accusations of recent years. NNPC sells around 1 million barrels of oil a day to a range of buyers.[11] This oil is the Nigerian government's share of production from JVs and production sharing contracts (PSCs) with private companies, as well as from oil fields owned by the Nigerian Petroleum Development Company (NPDC), NNPC's main upstream subsidiary.

NNPC has historically divided its sales transactions into two streams: export sales to foreign buyers, and the so-called "domestic crude allocation," the roughly 445,000 barrels per day that its refineries are supposed to consume. Buyers make payments into several different NNPC-controlled accounts, and then the corporation directs the central bank to transfer funds from those accounts to the Federation Account, the central repository for public revenues that are then shared monthly between the federal, state and local tiers of government.

This simple two-part system has broken down, however. As NNPC's financial debts and operational problems have deepened, it has introduced more types of *ad hoc* oil sale transactions to work around these challenges. The makeshift transactions send large shares of oil and money flowing into higher numbers of non-transparent accounts and byzantine deals that few outside of NNPC understand. In particular, NNPC uses both export and domestic oil sale revenues to plug large funding gaps, reducing the funds available to the rest of government.

TREASURY OIL RECEIPTS STILL IN DECLINE

Under the Buhari government, transfers from NNPC's convoluted oil sales system to the Federation Account have continued to decline. After analyzing NNPC's own numbers, we estimate that during the last six months of 2015, the corporation transferred $2.1 billion in oil proceeds to the Federation Account from the three types of oil sales we examined: regular export sales, domestic crude sales, and sales of oil from NPDC fields. During that same period, however, the value of these sales totaled $6.3 billion. In other words, under the Buhari government, only one third of NNPC's oil sale revenues found their way into the country's treasury.

NNPC reported retaining $3.9 billion—or 64 percent—of the value of the oil sold through these three types of transactions. As seen in the figures below, this was 13 percent more than the corporation's withholdings under Goodluck Jonathan in the first half of 2015, and 10 percent higher than the share withheld in 2013 and 2014. Go back a decade, and the numbers nearly flip: in 2005, NNPC sent 68 percent of its oil sale earnings to the Federation Account and kept only 32 percent.

NNPC reported retaining $3.9 billion—or 64 percent—of the value of the oil sold through three types of transactions.

9 "NNPC Monthly Performance Data," accessed March 29, 2016.
10 Julia Payne, "Nigeria in talks with oil majors to repay debt, invest in refineries," Reuters, February 14, 2016.
11 For more information on the basic mechanics of NNPC oil sales, see Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales,* 16-19.

Item	2005	2013	2014	2015 Q1-2	2015 Q3-4
Sales					
Regular export	16.303	8.206	7.846	1.804	1.361
NPDC†	1.088	3.401	3.353	1.06	1.219
Domestic crude	8.743	16.818	15.675	4.341	3.433
Total value (a)	26.134	28.425	26.874	7.205	6.013
Federation Account remittances					
Regular export*	12.161	3.165	4.243	0.608	0
NPDC†	0	0	0	0	0
Domestic crude	5.578	9.822	8.212	2.902	2.147
Total transfers (b)	17.739	12.987	12.455	3.51	2.147
NNPC withholdings from sales, (a) - (b)					
Amount withheld	8.395	15.438	14.419	3.695	3.866
Percentage of total sales value withheld	**32**	**54**	**54**	**51**	**64**

Value of selected NNPC oil sales versus Federation Account transfers, selected periods ($ billions)

Sources: NNPC Monthly Financial and Operations Reports; NNPC August 2015 Submission to the NEC Ad-Hoc Committee on Management of Excess Crude Account Proceeds and Accruals into the Federation Account; NNPC Annual Statistical Bulletins; NEITI financial audit reports; NRGI, *Inside NNPC Oil Sales*, Annex A

* *figures may include some revenues from sales of condensates, natural gas liquids and gas feedstock*

† *figures calculated by multiplying total NPDC liftings by an average reference oil price for the period*

NB: *figures in chart do not include NNPC alternative finance liftings or PSC tax and royalty oil sales*

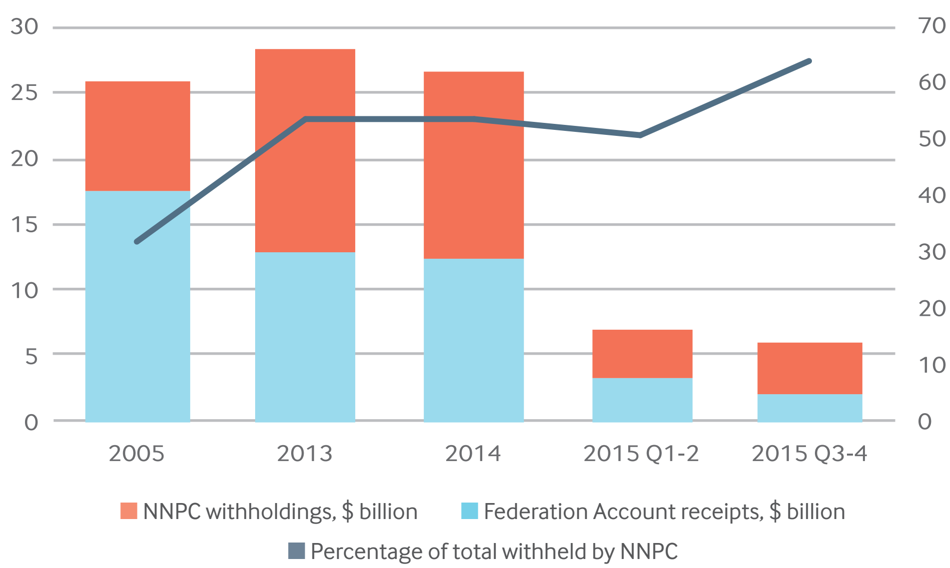

Figure 1. NNPC withholdings of selected oil sale revenues

These numbers require some explanation and caveats. For NPDC and domestic sales, limitations in the available data forced us to use average exchange rates and oil prices to calculate some of the totals, rather than actuals. We did not include all types of NNPC oil sale transactions, choosing to leave out those where NNPC sells the oil but the proceeds go into accounts not fully under its control. Biggest among these are PSC "tax oil" and "royalty oil" sales (proceeds that likely enter the Federation Account), and barrels sold under JV alternative finance deals that re-pay debts that NNPC has taken on from its company partners. For 2015, NNPC valued the oil from these three types of sales at $4.42 billion.[12]

12 NNPC, *Financial and Operations Report: January 2016* (2016), 11.

WHERE DOES THE MONEY GO?

We show above that three types of NNPC oil sales were worth $6 billion in the second half of 2015, but only $2.1 billion from these sales entered the Federation Account. While NNPC does not disclose enough information to conclusively say what happens to the remainder, we can offer some tentative explanations for each of the three types. They paint a stark picture of how expensive the Nigerian oil sector has become to the nation.

Export sales. Of the $1.4 billion in regular export crude sales (see table above), the full amount went to pay JV cash call liabilities, rather than entering the government budget. This is *in addition to* the $1.1 billion worth of oil that NNPC routed through alternative finance arrangements during this period to pay JV debts.[13] It makes some sense that operating expenses from the JVs now consume a larger relative share of NNPC's oil sale proceeds, because operating costs have not dropped as precipitously as oil prices have over the last two years. However, the fact that operating costs consumed all the returns from an entire class of oil sales dramatically illustrates the unaffordability of the JVs.

NPDC sales. NNPC sold oil from NPDC-owned fields worth an estimated $1.2 billion in the latter half of 2015. NPDC remains one of the Nigerian petroleum sector's great black boxes. Some of this oil may have gone to the subsidiary's strategic alliance partners, two companies that are paid in oil for purportedly shouldering some of NPDC's financial burdens. NPDC may keep the rest, or transfer it to its parent, NNPC. The subsidiary produced a sizeable 110,000 barrels of oil per day in the last six months of 2015.[14] But we have seen no evidence that proceeds from NPDC oil sales enter the treasury. Instead, they are spent in an unknown manner. In one especially questionable case, we found evidence that NNPC has retained all earnings from the offshore Oil Mining Lease (OML) 119, a field owned wholly by NPDC that produces around 30,000 barrels per day of Okono grade crude. This stream of oil was worth an estimated $12.3 billion over the past decade.[15] Leadership has talked about "re-kitting" NPDC so that it controls an even larger share of total production, meaning that the scale of unaccounted-for money could increase.[16]

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Domestic crude sales. Of the $3.4 billion worth of "domestic crude" that NNPC reportedly sold in late 2015, some went to the refineries, some to the crude oil-for-petroleum product swap agreements,[17] and some to export buyers. Over the same period, NNPC said it transferred $2.1 billion from domestic sales to the Federation Account—or $1.3 billion less than the total value of domestic crude sold. This means that NNPC withheld 46 percent of available domestic crude revenues in its first months under President Buhari. Contrast this with the 35 percent kept back in the opening half of 2015:

13 Ibid.

14 NNPC, *August 2015 Submission to the NEC Ad-Hoc Committee on Management of Excess Crude Account Proceeds and Accruals into the Federation Account* (2015), 5-14.

15 For more on withholdings of proceeds from NPDC crude sales, see Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, 38-41.

16 Michael Eboh, "Indigenous operators produce 6% of Nigeria's oil," *Vanguard (Nigeria)*, December 15, 2015.

17 For more detailed analysis of issues with NNPC's swap deals, see Aaron Sayne, Alexandra Gillies and Christina Katsouris, *Inside NNPC Oil Sales*: Annex B: NNPC's Oil for Product Swaps (2015).

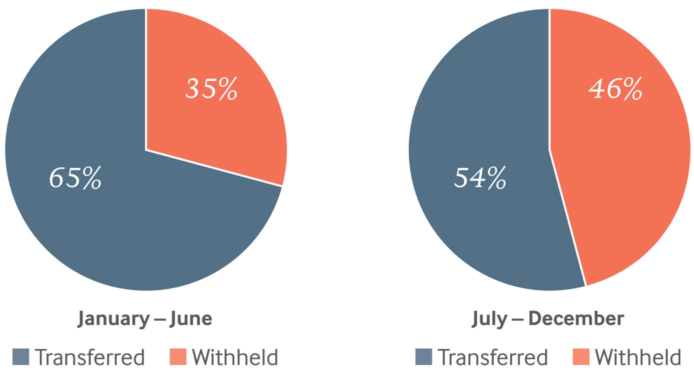

Figure 2. NNPC withholdings of domestic crude sale revenues, January-June versus July-December 2015

NNPC officials claim that the corporation keeps domestic crude revenues to recoup four types of downstream costs: subsidized fuel sales, crude oil and fuel lost from its pipelines, and outlays for pipeline protection and maintenance. As with the JV cash calls, a sizable portion of these expenses may be legitimate and necessary. But our August 2015 report documented at length how NNPC's explanations for its domestic crude sales withholdings have been contradictory and incomplete, leaving large sums unaccounted for.[18]

For each of the three types of sales, the makeshift practices described above do explain how at least some of the "missing" funds are spent. However, corruption may also be a cause. Under the previous government, these same discretionary practices allowed officials to divert public money. Enabled by the absence of rules, the executive ordered NNPC to spend money off-budget on items that look unrelated to the oil sector. For example, the auditor-general found that in 2014 NNPC released N36.4 billion ($186 million) to the office of then national security adviser Sambo Dasuki, purportedly for "water projects."[19] Dasuki is now in court over charges that he funneled $2.1 billion to power brokers and election propagandists using bogus arms procurement contracts.[20] We have seen records showing that Dasuki's office received more than $2 billion in off-budget cash from NNPC, including funds meant for the JVs.[21] Meanwhile, soldiers fighting Boko Haram went without basic equipment;[22] by March 2016 management said that NNPC's debts to its JV partners topped $5.1 billion.[23]

Corruption aside, allocating $3.9 billion in six months to NNPC expenses of unknown priority raises serious questions about fiscal responsibility. This is especially true at a time when public finances are already stretched. Despite collapsed oil prices, parliament has pushed through a record N6.6 trillion ($30 billion) budget for 2016.[24] First details of its spending-intensive economic recovery plans are starting to emerge, with N350 billion ($1.76 billion) in capital outlays promised for the next three months.[25] Maximizing all revenue streams, including from oil, is imperative to the success of such an ambitious plan.

Allocating $3.9 billion in six months to NNPC expenses of unknown priority raises serious questions about fiscal responsibility.

18 Aaron Sayne, Alexandra Gillies and Christina Katsouris, *Inside NNPC Oil Sales: Annex A: The Case for Eliminating the Domestic Crude Allocation* (2015).
19 Hassan Adebayo, "How NNPC dubiously paid N36.4 billion water projects money to ex-NSA Dasuki's office – Audit Report," *Premium Times*, March 15, 2015.
20 Julia Payne, "Nigeria fraud case puts Buhari's anti-graft drive in the dock," *Reuters*, January 19, 2016.
21 NNPC, *Payment Instructions to the Central Bank of Nigeria, Banking and Payment System Department* (2014-2015).
22 Kevin Sieff, "The Nigerian military is so broken, its soldiers are refusing to fight," *Washington Post*, May 10, 2015.
23 Chineme Okafor, "Kachikwu: Nigeria is Targeting 2.4mbpd Oil Output in 2016," *This Day*, March 14, 2016.
24 Camillus Eboh, "Nigerian parliament approves 2016 record budget," *Reuters*, March 23, 2016.
25 Alexis Akwagyiram, Camillus Eboh and Ulf Laessing, "Nigeria plans to spend $1.7 billion in next quarter to revive economy," *Reuters*, March 22, 2016.

It would almost certainly be cheaper for Nigeria to pay for its budget by better controlling NNPC spending than through outside borrowing. Nigeria's debt-to-GDP ratio—while low by African standards—is rising steeply. The federal government already expects to spend over one third of 2016 revenues servicing its debt, especially high-interest loans from local banks.[26] The Finance Ministry has floated plans to fund this year's appropriations with a further $5 billion in loans from the World Bank and other lenders.[27] These lenders, along with Nigerian stakeholders, should ask hard questions about the blank check enjoyed by NNPC before giving a green light to new debt.

WHAT SHOULD BE DONE

Clarifying the financial relationship between NNPC and the state may be the single most important component of the Buhari administration's oil sector reform campaign. Doing so would allow the Presidency to boost treasury receipts now and build long-term safeguards against corruption and inefficiency in the future.

To minimize the sorts of public financial problems Nigeria struggles with, most countries choose an explicit rule for financing their national oil companies. For instance, Malaysia's Petronas retains profits on earnings, but transfers royalties and export duties to the state, as well as paying a set tax rate on its own profits. This provides the government with some predictability in its revenue receipts and enables it to monitor Petronas' performance, while narrowing the scope for debate on the year-to-year variation in dividend payments. In Kazakhstan, the exploration and production subsidiary of the national oil company follows the same tax rules as private companies, and targets dividend payments to its state and non-state shareholders at 15 percent of profits. In Ghana, the Petroleum Revenue Management Act allows the national oil company to retain revenues covering its "equity financing costs" and additional amounts approved by parliament, but these cannot exceed 55 percent of the net cash flow from government assets in any given year. These systems do not eliminate uncertainty, but they constitute a clear and practical approach that enhances predictability, limits discretion, and reduces risks of over-retention by the national oil company – especially when paired with effective cost monitoring.

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NNPC, in contrast, cobbles together funds for its operations by withholding billions of dollars each year from oil, gas and fuel sales on *ad hoc*, largely off-budget bases. A long-standing misalignment between language in the 1999 Federal Constitution and Section 7 of the 1977 NNPC Act leaves this money in legal limbo. The annual budget process does not give the corporation nearly enough money to cover its costs. Paradoxically, this way of doing business at once impoverishes NNPC, leaving it chronically indebted and short of operating funds, and gives it far too much discretion over huge stores of public funds.[28]

We estimate that the Buhari administration could net several billion dollars more per year for the treasury—even with currently low oil prices—if it included the following steps in its oil sector reform plans:

First, the government should put in place a clear, legally enforceable rule governing which revenues NNPC can keep. Decades of efforts at reforming and "restructuring" NNPC have avoided this step. Early in March, Kachikwu said that the corporation

26 Chijioke Ohuocha, "Nigeria to spend 35 pct of revenues servicing debt in 2016," *Reuters*, March 3, 2016.
27 Alexis Akwagyiram, "Nigeria plans up to $5 bln borrowing from sources including Eurobonds: finance minister," *Reuters*, January 22, 2016.
28 For more on this point, see Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, 34-36.

would soon be "unbundled" or "restructured" into as many as seven divisions and "30 independent companies with their own managing directors."[29] This announcement could be a rational, early step toward turning NNPC into a more appropriately-sized, profit-driven firm. However, the proposal did not explain how the new companies would fund their operations or share their earnings with the government.

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Such a rule is also missing from the current plans to break the long-delayed Petroleum Industry Bill (PIB) into smaller pieces for passage. Drafts of a first, senate-led installment are already making the rounds; Senate leadership says debate will start soon. The new bill envisions an NNPC split into two partially privatized companies: the Nigeria Petroleum Assets Management Company and a national oil company.[30] The latest drafts talk variously about these entities retaining unspecified shares of earnings, charging the government "management fees," receiving federal budget appropriations to cover some un-enumerated costs, and paying dividends to the Federation Account based on policies to be agreed down the road. Although they contain more detail than past versions of the PIB, their provisions do not offer a consistent, adequately defined picture of how NNPC and the state would split revenues.

A successful financing rule for NNPC would strike a balance between allowing the corporation to carry out its business effectively, and capturing funds for the state. Striking the right balance is a dilemma many oil-producing countries face, and there is no one-size-fits-all answer. The model chosen in Nigeria should reflect the industry role intended for NNPC going forward, and be based on realistic assessments of the revenues needed to fulfill those aims. If well designed, the rule could also introduce incentives for more efficient NNPC performance, especially if paired with stronger cost control systems, due diligence processes, audit functions and—eventually—some sell-offs of underperforming assets. However, given the current situation, major gains would result from simply providing NNPC with a model for revenue retention that is less prone to leakage and abuse of discretion. The predictability of a clear, workable model would help NNPC in other areas, such as renegotiating fiscal terms in upstream contracts and accessing capital markets.

Second, and in parallel given its urgency, we recommend that the government require NNPC to adopt new financial controls and transparency measures for its subsidiaries. This applies not only to NPDC, but equally to the corporation's half-dozen oil trading subsidiaries, none of which disclose what they earn or how they share earnings. There likewise is no public accounting for the money that NNPC's downstream arm, the Pipelines and Product Marketing Company (PPMC), takes in from selling refined products. This includes the billions of dollars in gasoline imported each year through oil-for-product swaps.[31]

Third, the domestic crude allocation should be eliminated as a separate pot of oil and money. Its current operation looks almost nothing like its intended purpose. The government should eliminate the domestic allocation, and then agree to a new way of supplying oil to the refineries as part of its efforts to find new ownership and management structures for them. NNPC could remain the largest, or even sole supplier under several different models. These include tolling, where NNPC would grant the

29 Chineme Okafor, "President Approves NNPC's Restructuring into Seven Units, 20 Companies," *This Day*, March 9, 2016; NNPC, "Press Release - FG Moves to Unbundle NNPC into 30 Companies," March 3, 2016.

30 Nigerian Senate, *Petroleum Industry Governance and Institutional Framework Bill* (2015), Sections 46-47, 63; *Petroleum Industry Governance Bill* (2016), Sections 47-48, 65.

31 For more on revenue withholdings by NNPC subsidiaries, see Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, 36-41.

refineries operational independence and lease refining capacity from them in exchange for crude; repurchase agreements, under which the corporation would buy crude from its upstream partners on behalf of the refineries; or further inter-company sales, with volumes capped at the refineries' actual needs instead of 445,000 barrels per day—an amount that far exceeds the small volumes (often under 100,000 b/d) they can process.[32] If NNPC continues to do oil-for-product swaps, it could simply allocate parts of its regular export sales to those deals.

WHAT TO WATCH FOR

Anyone looking for a barometer to assess the government's efforts at overhauling NNPC should closely follow the revenue retention issues outlined in this brief. In particular:

- Will the size of NNPC's reported withholdings from oil sale earnings shrink?
- Will the government adopt an explicit, enforceable rule governing which revenues NNPC can withhold, either in the PIB or elsewhere in its reform plans?
- Will NNPC announce new financial controls and transparency measures for its subsidiaries, especially NPDC, the trading companies and PPMC?
- Will NNPC replace the domestic crude allocation with a less costly and opaque alternative?

President Buhari and his team clearly are working toward a cleaner oil sector, both now and as part of his political legacy. Much of the new administration's focus so far has been limited to replacing unethical officials and tracking stolen funds. The leadership can build on gains made to date by clarifying the financial relationship between NNPC and the state. Otherwise, oil sector corruption and waste could return to their prior devastating levels once the president leaves office or prices rise.

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32 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales,* 33; Federal Ministry of Petroleum Resources, *Report of the Refineries Special Task Force* (Kalu Idika Kalu, chair) (2012).