Inside NNPC Oil Sales: A Case for Reform in Nigeria

Aaron Sayne, Alexandra Gillies and Christina Katsouris

Nigeria’s national oil company, the Nigerian National Petroleum Corporation (NNPC), sells around one million barrels of oil a day, or almost half of the country’s total production. NNPC oil was worth an estimated $41 billion in 2013, and constitutes the government’s largest revenue stream. Early in 2014, Nigeria’s central bank governor Lamido Sanusi raised an alarm that $20 billion in NNPC oil sale revenues had gone missing.

Our report picks up this story, and offers the first in-depth, independent analysis of how NNPC sells its oil. It identifies the most pressing problems—including several largely ignored by the prior government’s response to Mr. Sanusi’s allegations—and offers recommendations for their reform.

NNPC’s approach to oil sales suffers from high corruption risks and fails to maximize returns for the nation. These shortcomings also characterize NNPC as a whole. Over 38 years, the corporation has neither developed its own commercial or operational capacities, nor facilitated the growth of the sector through external investment. Instead, it has spun a legacy of inefficiency and mismanagement. Its faults have been described by a number of scathing reports, many commissioned by government itself.¹ Despite NNPC’s debilitating consumption of public revenues and performance failures, successive governments have done little to reform the company.

We find that management of NNPC’s oil sales has worsened in recent years—and particularly since 2010. The largest problems stem from the rising number of ad hoc, makeshift practices the corporation has introduced to work around its deeper structural problems. For instance, NNPC entered into poorly designed oil-for-product swap deals when it could no longer meet the country’s fuel needs. Similarly, it began unilaterally spending billions of dollars in crude oil revenues each year, rather than transferring them to the treasury, because NNPC’s actual budget process fails to cover operating expenses. Some of these makeshift practices began with credible goals. But over time, their operation became overly discretionary and complex, as political and patronage agendas surpassed the importance of maximizing returns.

These poor practices come with high costs. Average prices for the country’s light sweet crude topped $110 per barrel during the boom of 2011 to 2014. Yet during that same period, as shown below, treasury receipts from oil sales fell significantly. While volumes lost to oil theft explain some of the decline, NNPC’s massive revenue withholdings and an increase in suboptimal sales arrangements are also to blame. Mismanagement of NNPC oil sales also raises commercial, reputational and legal risk for actors worldwide: the sales involve some of the world’s largest commodity trading houses, are financed by top banks, and result in the delivery of crude to countries across the globe.

The most pressing problems with NNPC oil sales occur in five areas, described below. To arrive at this diagnosis, we reviewed published and unpublished official records, together with data from trade publications and secondary literature, and conducted dozens of interviews between 2010 and 2015. Our main report presents an overview of our findings. In annexes to the report, we further detail three topics: the domestic crude allocation, oil-for-product swap agreements, and government-to-government crude sales.

For each of the five issues, we also make recommendations for reform. In the current Nigerian context, reform is both urgent and feasible. The recent drop in oil prices has ushered in fiscal and monetary crises, particularly given the limited savings accumulated during the price boom. At the same time, demand for Nigerian crude has softened, due in part to the collapse of sales to the US. These revenue constraints come at a time when the oil sector itself sorely needs funds—as does Nigeria’s broader economy, which struggles to provide equitably for the country’s 170 million citizens.

These economic imperatives coincide with political opportunities. President Muhammadu Buhari took office in May 2015, following his election victory over an incumbent government with a very poor record on oil sector governance. Expectations are high that the Buhari government will tackle the problem of NNPC performance. The president and other high-level figures in his APC party have made statements to that effect.

We recommend that the government make the most of this window of opportunity by pursuing two tracks of reform. The first involves urgent reforms to NNPC’s management of oil sales (to “stop the bleeding”), targeting the five issues outlined below. At the same time, however, the government should also pursue a course of deeper structural reforms to NNPC (to “cure the patient”). If it does not, a new round of costly, ad hoc coping mechanisms will emerge.

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2 Federal Budget Office 4th Quarter Budget Implementation Reports, 2009-2013; Platts data.
A few cross-cutting points underlie our recommendations:

- NNPC oil sales are Nigeria’s largest revenue stream and face severe problems. Fixing them should come first in the reform queue, before revisiting upstream contracts with international oil companies.

- Repairing oil sale governance does not require omnibus legislation like the Petroleum Industry Bill (PIB). Rather, a bold and targeted agenda with a one-to-two-year timeline better suits Nigeria’s political timetables.

- When overhauling oil sales, the government should prioritize simplicity throughout. Current governance problems thrive on byzantine arrangements which only a handful of people understand.

- The bad practices that undermine NNPC oil sale performance all have political interference at their root. Only sustained leadership from the very top will shift incentives towards performance and away from patronage.

TARGETING URGENT PROBLEMS WITH NNPC OIL SALES

The Domestic Crude Allocation (DCA)

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<th>Problems</th>
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<td>• The DCA has become the main nexus of waste and revenue loss from NNPC oil sales. In 2013, the Federation Account (Nigeria’s treasury) received only 58 percent of this oil’s $16.8 billion value.</td>
<td>The government should eliminate the DCA, which creates more problems than it solves.</td>
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<td>• The DCA was designed to feed Nigeria’s refineries, but in practice NNPC exports three quarters of the so-called domestic crude.</td>
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<td>• NNPC’s discretionary spending from domestic crude sale revenues has skyrocketed, exceeding $6 billion a year for the 2011 to 2013 period.</td>
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<td>• NNPC’s explanations for how it spends the revenues it retains are incomplete and contradictory, and the spending (such as on the fuel subsidy and downstream operations) delivers poor value for money.</td>
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The domestic crude allocation (DCA) has become the main nexus of waste and revenue loss from NNPC oil sales. The government allocates around 445,000 barrels per day to NNPC in so-called “domestic crude.” NNPC sells this oil to the Pipelines and Product Marketing Company (PPMC), one of its subsidiaries. PPMC is supposed to send the oil to Nigeria’s four state-owned refineries, sell the resulting petroleum products, and pay NNPC for the crude it received, and then NNPC is supposed to pay the government. In practice, the refineries only process around 100,000 barrels per day. NNPC ultimately re-routes most DCA oil into export sales or oil-for-product swaps, and payments enter separate NNPC accounts, which NNPC officials then draw upon freely. Annex A contains a full discussion of the DCA.

The DCA facilitates some of NNPC’s worst habits, and no longer serves its intended purpose. NNPC’s discretionary spending from domestic crude returns has reached runaway, unsustainable levels, averaging $6 billion a year between 2010 and 2013.
Especially now that Nigeria faces major budgetary and savings shortfalls, unchecked off-budget spending on this scale threatens the nation’s economic health. In 2004, NNPC retained around $1.6 billion, or 27 percent of the DCA’s full assessed value. By 2012, the amount had jumped to $7.9 billion—or 42 percent of the value of the domestic oil for that year.

The DCA revenues spent by NNPC deliver poor value for money. A large portion of NNPC’s withholdings is spent on fuel subsidy payments, which are vulnerable to misappropriation and excessive spending. KPMG for example found that in three years, NNPC paid itself roughly $6.5 billion to fund the subsidy on 15.6 billion liters of products that “apparently were not available to the Nigerian market.” NNPC has also spent hundreds of millions of dollars in DCA revenues on pipeline protection, but levels of theft from some crude oil pipelines have risen—in some cases by over 500 percent in a year. Since 2011, NNPC has spent as much as $7.52 per barrel to transport oil to the refineries by ship under an opaque, multi-vessel arrangement (as compared with $0.03 per barrel in pipeline fees), yet refinery outputs during the period did not improve.

Moreover, NNPC administers the DCA with few rules and weak oversight, causing chronic confusion. Debates abound on whether NNPC can legally retain DCA revenues, as seen in the controversy about whether it had permission to withhold several billion dollars annually for a kerosene subsidy that a prior government had slated for elimination. There is no contract between NNPC and PPMC for DCA sales, despite their huge value. In terms of reporting, NNPC’s explanations about where the money goes are incomplete and contradictory: past audits showed the corporation claiming hundreds of millions of dollars in duplicated or undocumented expenses—$2.07 billion in nineteen months, PwC found. We saw no evidence that NNPC includes the amounts

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3 2004-2012 data is from NEITI financial audit reports. 2013 data is from the 2013 NNPC Annual Statistical Bulletin; NNPC Report: Reconciled Receipts of Domestic Crude Cost, January 2013-date; and, NNPC Report: Computation of Revenue from Domestic Crude Oil Receipts, January 2013 to Date.
5 PwC, Investigative Forensic Audit into the Allegations of Unremitted Funds into the Federation Accounts by the NNPC (“the PwC report”), February 2015, p.17.
7 PwC report p.13.
actually paid by buyers of domestic crude in its reports to other government agencies. Controversies and competing claims, such as those kicked off by Sanusi’s accusations that the treasury was “missing $20 billion,” thrive in such a context.

### Revenue retention by NNPC and its subsidiaries

**Problems**
- NNPC has invented a makeshift system for financing its operations, and is discretionarily retaining ever-growing sums.
- NNPC’s five oil trading subsidiaries have acquired no independent trading capacity, but act as passive middlemen on large sales volumes (144,010 barrels per day in 2012, worth $5.9 billion). NNPC does not disclose what happens to the commissions earned by the subsidiaries on these sales.
- Available records indicate NNPC retained revenues from the sale of 110 million barrels of oil over ten years from one block controlled by its subsidiary NPDC, worth an estimated $12.3 billion.

**Recommendation**
The government should develop an explicit revenue collection framework for NNPC that facilitates more predictable financing and reigns in discretionary spending.

Most countries adopt an explicit set of financing rules for their national oil companies. Nigeria, by contrast, allows NNPC to cobble together funds from different sources, usually outside of formal budget processes. Along with retaining billions each year in DCA oil sale revenues, NNPC withdraws funding intended for joint venture cash calls to cover unrelated expenses—off-budget spending that totaled $4.2 billion from 2009 to 2012. Some of NNPC’s subsidiaries also retain their revenues, or transfer them to NNPC’s central accounts. NNPC has also sourced third-party financing to cover further expenses at unknown costs to the nation. This makeshift system at once impoverishes NNPC and gives it far too much discretion to retain ever-growing sums.

In the area of oil sales, the retention of revenues by two sets of NNPC subsidiaries raises particular concern. The first are NNPC’s five oil trading subsidiaries, headquartered mostly offshore. Originally set up to market crude and products for NNPC, after decades they function like passive middlemen, flipping the crude allocated by the corporation to experienced trading houses like Vitol or Glencore. NNPC routed 144,010 barrels per day through two offshore subsidiaries, Duke and Calson, in 2012 – oil worth $5.9 billion. Neither NNPC nor the subsidiaries themselves disclose how much they earn or how they distribute their earnings.

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<thead>
<tr>
<th>Company (country of incorporation)</th>
<th>NNPC ownership stake</th>
<th>JV partner</th>
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<tbody>
<tr>
<td>Duke Oil Company Inc. (Panama)</td>
<td>100 percent</td>
<td>none</td>
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<tr>
<td>Duke Oil Services Ltd. (UK)</td>
<td>100 percent</td>
<td>none</td>
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<tr>
<td>Calson Ltd. (Bermuda)</td>
<td>51 percent</td>
<td>Vitol</td>
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<tr>
<td>Hyson Ltd. (Nigeria)</td>
<td>60 percent</td>
<td>Vitol</td>
</tr>
<tr>
<td>Napoil Company Ltd. (Bermuda)</td>
<td>51 percent</td>
<td>Trafigura</td>
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NNPC trading companies

8 NEITI Oil and Gas Financial Audit Reports, 2009-2011 and 2012.
The other subsidiary which warrants scrutiny is the Nigerian Petroleum Development Company (NPDC), NNPC’s main upstream division. Available records suggest that when the corporation sells oil from blocks owned by NPDC—which produced a reported 80,243 barrels per day in 2013—it does not forward the resulting proceeds to the treasury. The revenues it holds on to are substantial: in its review of the Sanusi accusations, PwC sorted through three sets of conflicting figures, and estimated total earnings from NPDC oil sales at $6.82 billion over a 19-month period in 2012 and 2013.9 NPDC does not need such large withholdings: the majority of its blocks are developed under contracts—including one service contract and several Strategic Alliance Agreements—that require private partners to cover its share of operating costs. NNPC has not explained how the funds it retains are spent.

A case in point is offshore OML 119, a NPDC block governed by a service contract. NNPC sold around 33,000 barrels per day of OML 119’s Okono grade crude in 2014. Our research found no evidence that NNPC forwarded to the treasury any revenues from sales of Okono crude between 2005 and 2014, volumes which totaled over 100 million barrels with an estimated value of $12.3 billion. In other words, the corporation has provided no public accounting of how it used a decade’s worth of revenues from an entire stream of the country’s oil production.

The government should develop a new, legally mandated mechanism for funding NNPC operations. A successful financing model would be established in law and resolve the conflict between the country’s constitution and the NNPC Act concerning revenue withholdings; create a binding budgetary process for NNPC with adequate checks and balances; and place strict limits on extra-budgetary spending. Clear rules on revenue retention by subsidiaries are also needed.

### Oil-for-product swap agreements

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<tr>
<th>Problem</th>
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<tbody>
<tr>
<td>- NNPC channeled oil worth $35 billion to swap deals between 2010 and 2014.</td>
<td>The government should direct NNPC to wind down all OPAs and should not sign any more such deals. Future swaps should be competitively awarded refined product exchange agreements (RPEAs) with stronger terms.</td>
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<tr>
<td>- In 2015, nearly 20 percent of the oil sold by NNPC has been traded for petroleum products via poorly structured deals with two companies.</td>
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<tr>
<td>- Recent offshore processing agreements (OPAs) contained unbalanced terms that did not efficiently serve Nigeria’s needs. We estimate that losses from three provisions in a single contract could have reached $381 million in one year (or $16.09 per barrel of oil).</td>
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<td>- Swap imports are vulnerable to downstream rackets around Nigerian fuel transportation, distribution and sales.</td>
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The corporation has provided no public accounting of how it used revenues from an entire stream of oil production.

Currently, NNPC routes around 210,000 barrels per day, or one-tenth of the country’s entire production, through deals with unacceptably high governance risks. Seven swap deals have been signed since 2010; we discuss these deals in detail in annex B.

9 PwC Report p.85, 87.
Currently, NNPC operates two 90,000-barrel-per-day OPAs. We find that this type of deal is less suitable for Nigeria than its alternative, the RPEA. An OPA’s higher complexity makes it more opaque—and more open to abuse. Whether Nigeria receives good value depends on many technical factors that are difficult to negotiate and monitor. OPAs supply a wide slate of products when NNPC only requires two, gasoline and kerosene. Also, the structure of the OPAs, which envisions the oil being refined by a particular refinery, does not align with their actual operations. Moreover, our analysis of two OPA contracts, the 2010 deal with SIR/Sahara and the 2015 deal with Aiteo, reveals a number of underspecified, unbalanced provisions. We estimate Nigeria may have lost up to $381 million in a single year of operations (or $16.09 per barrel), if just three of the inappropriate provisions were fully exploited. RPEAs better suit Nigeria’s needs: traders that hold RPEAs deliver specified products that equal the value of the crude they receive, minus agreed fees and expenses.

Nigeria will likely continue using oil-for-product swap agreements until its debts to fuel importers are brought under control or it solves its refining woes. During this period, NNPC should improve the structure and execution of the swaps. Specifically, NNPC should close out the OPAs with Sahara and Aiteo as soon as possible, and should not sign any more OPAs. RPEAs should be used for future swap deals. However, to obtain fair returns for Nigerian citizens, NNPC should award the RPEAs through competitive tenders to capable companies; and ensure that the RPEAs contain certain updated terms—particularly on fuel pricing—and that they contain stronger reporting and oversight requirements. Annex B details these recommendations.

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Critically, traders holding NNPC-PPMC swap contracts deliver fuel into the existing supply chain for Nigerian fuel imports. As the 2012 fuel subsidy scandal revealed, the complexity of the supply chain serves a number of entrenched, lucrative rackets around shipping, distribution and sales of fuel. These include smuggling, selling locally refined products back to NNPC at import prices, over-charging for deliveries, and outright theft. The 2012 fuel subsidy investigations focused mainly on the mismanagement of standard import contracts, but we find that swap imports carry many similar risks. Unless the worst rackets around fuel imports are eradicated, the swaps will hemorrhage considerable amounts of fuel and money no matter how they are structured.

The abundance of middlemen

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<tr>
<td>- Nigeria is the only major, stable world oil producer that sells crude mostly to traders rather than end-users.</td>
<td>NNPC should stop selling oil to unqualified companies, whether Nigerian or foreign, and improve its due diligence standards.</td>
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<td>- NNPC enters into term contracts with unqualified intermediaries that capture margins for themselves and create reputational risks for legitimate market players while adding little or no value to deals.</td>
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<td>- NNPC also sells to governments that do not refine the crude they buy. These deals have featured a glut of unnecessary middlemen, and prompted corruption scandals in five buyer countries.</td>
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The marketplace for NNPC crude is uncommonly crowded with intermediaries. By our count, Nigeria is the world’s only major oil producer (i.e., with average outputs of well over 1 million barrels per day) that sells almost all of its crude to middlemen, rather than end-users (with the exception of highly unstable countries like Libya). Over 90 percent of the barrels NNPC allocated in 2014 went to trading companies rather than end-users.

The names on NNPC’s lists of approved buyers, numbering 43 in 2014, include a small group of large, experienced Nigerian and foreign commodity traders and many low-profile, inexperienced “briefcase companies.” This latter group poses especially high governance risks. For instance, some reportedly help buyers of the oil to avoid taxes and channel payments to politically exposed persons (PEPs). Involving middlemen who serve no commercial function creates a marketplace with greater commercial, reputational and legal risks for its legitimate participants, which include some of the world’s leading trading houses, banks and refiners. Past NNPC oil sales to the governments of Zambia and South Africa are good examples: in both, NNPC sold to intermediaries that lacked basic capacities, which led to corruption scandals in those countries. (See annex C for a full discussion of these government-to-government deals.)

Going forward, NNPC should stop selling oil to companies, whether Nigerian or foreign, that never sell their allocations to refiners; that routinely sell to big trading companies that are already NNPC term customers; or that have ties to PEPs. To further protect against favoritism, patronage and inappropriate payments, NNPC should grant its next round of term contracts through openly competitive and rule-bound procedures that include a strict pre-qualification process, robust due diligence checks, and restrictions on the use of offshore vehicles by buyers. The corporation should also publish written rules for parceling out cargoes each month to buyers and stop allocating export contracts for more crude than it has to export. This will help end the monthly jockeying for allocations that occurs now, which is highly prone to corruption. Over the medium term, NNPC should rework its buyer selection process to secure more reliable global demand for Nigerian crude, and to sell more oil directly to refineries.

### Corporate governance, oversight and transparency

#### Problems
- NNPC reporting to other government agencies and the public on oil sales is patchy and regularly contains contradictions.
- The corporation’s own internal recordkeeping systems and processes are disorganized and secretive.
- The corporation lacks basic checks and balances—for example, no published annual reports, weak audit functions and a board chaired by the petroleum minister.

#### Recommendation
The presidency should lead a program of transparency and accountability reforms for NNPC, and empower oversight actors to scrutinize the corporation’s decisions.

NNPC’s management has a history of resisting outside scrutiny. The corporation discloses very little about its finances and operations, even though more than half of public revenues flow through it. Officials from other government bodies say they cannot independently verify or challenge the oil sale figures provided by NNPC. Past reviews described NNPC’s internal oil sale data management practices as disorganized, secretive and inaccurate. For example, one government task force found two separate sets of oil sale books that diverged at times by more than $100 million per year. Corporation officials have faced few consequences for mismanagement—at most, they tend to be retired or transferred to other posts.

Reforms in several areas can help reverse this trend. To reduce perceptions of impunity, the government should commission independent performance audits of areas of concern, including: the DCA; oil-for-product swaps; NPDC oil sales and related operations; NNPC’s oil trading subsidiaries; the refinery crude oil transport arrangement; and the JV cash call account.

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11 Author interviews, officials from CBN, Finance Ministry, Auditor-General’s Office, FAAC and NEITI, 2010-14. NNRC Benchmarking Report Sec.2.2.10.
Transparency and accountability must also advance. The government should require NNPC to regularly disclose detailed and prompt cargo-by-cargo data on all its crude oil liftings, and issue a 2015 annual report that includes its audited financial statements, operational data, the financial positions and earnings of its subsidiaries, and disclosures on quasi-fiscal spending. Independent audits should occur regularly, and NNPC should publish the resulting reports. Moreover, we recommend that NNPC establish clear work programs and performance benchmarks, so that oversight actors like the National Assembly, auditor-general, and others can then assess whether those benchmarks are regularly met. The NNPC board should meet regularly, include independent members, and have a chair other than the petroleum minister.

**SOLVING NNPC’S UNDERLYING PROBLEMS**

As we argued at the outset, maximizing full returns from NNPC oil sales will depend on pursuing two trajectories of reform – the measures described above, and a broader agenda of NNPC restructuring. Without the latter, the Buhari government will end up relying on a range of stop-gap measures, and NNPC’s performance will plateau at best.

The high oil prices of the early 2000s allowed NNPC to “muddle through,” as extra cash flows masked the inadequacies of its various short-term workarounds. Now that this luxury has ended, the Nigerian government should revise the NNPC joint venture cash call system; eliminate the fuel subsidy; remove NNPC as a commercial player from the downstream sector; tackle crude oil theft; and develop and implement a road map for restructuring and commercializing NNPC. The final section of the main report offers deeper analysis and recommendations on each of these points.

Nigeria can no longer afford to leave NNPC’s dysfunctional and costly oil sales system as it is. The status quo, characterized by convoluted, under-policed deals with weak commercial justifications, has cost Nigeria revenues that it needs for its development priorities. The reforms recommended in this report would significantly increase the returns to the Nigerian government from the sale of its crude oil, even at today’s lower prices. More broadly, improved oil sale functions would help create a solid foundation for remaking NNPC into a company that serves Nigeria’s citizens, rather than the interests of a privileged few.
Overview of NNPC Oil Sales

The Nigerian government’s share of production
1,005,770 b/d in 2013, worth approx. $41B, consisting of:
- JV equity oil 639,983 b/d
- PSC profit oil, and PSC in-kind tax and royalty payments 285,544 b/d
- NPDC liftings 80,243 b/d

Export sales 507,629 b/d, worth approx. $20.8B
Domestic crude allocation (DCA) 435,106 b/d, worth approx. $17.8B

Federation Account (₦)

NNPC/CBN Crude Oil Account (₦)

Various project-related accounts ($) and (₦)

Excess Crude Account (₦)

Note: Lifting volumes taken from 2013 NNPC Statistical Bulletin. The lifting figures do not always align, e.g. adding the three types of government crude does not equal the same amount as adding the export sales and the domestic crude volumes. All valuations are estimates, computed using the average oil price of $112/bbl (2013 average Platts reference price for Forcados grade crude). Federation Account transfer data for domestic sales taken from NNPC submission to FAAC.