

## **FAAC POST MORTEM SUB-COMMITTEE**

### **REPORT ON DEDUCTIONS FOR PRIORITY PROJECTS, COST OF COLLECTION AND PAYMENT OF SUBSIDY BY NIGERIA NATIONAL PETROLEUM CORPORATION (NNPC) BEFORE PAYMENT OF 13% DERIVATION TO OIL PRODUCING STATES.**

#### **1.0 INTRODUCTION**

1.1 You may recall that at the Federation Account Allocation Committee (FAAC) meeting held on Friday, 20<sup>th</sup> August, 2021, the issue of deductions made by NNPC on Priority Projects, Under-Recovery and Cost of Collection before computing 13% derivation to Oil Producing States was discussed. Some members observed that Mineral Revenue is derived after deductions on Priority Projects, Cost of Collection and others have been made while in the case of VAT Revenue, deductions were made on the gross VAT revenue. This practice may indicate that the Oil Producing States were being shortchanged. FAAC directed the Sub-Committee to examine the matter and report back to it.

2.0 Consequently, an Ad-hoc was set up to examine the issue. The Terms of Reference as adopted by the Ad-hoc Committee were as follows:

- a) To examine the legal provision (if any) which empowers NNPC to make deductions on the Federation Revenue;
- b) To determine whether it is appropriate for NNPC to deduct funds for Priority Projects, Under-Recovery/Subsidy and Cost of Collection from Federation Revenue generated before computing the 13% Derivation to Oil Producing States;
- c) To determine when the deductions from the Priority Projects and value Shortfall started and how much is outstanding in favour of the Oil Producing States;
- d) Advise FAAC on appropriate procedures for further deduction(s) from revenue by NNPC in line with the Revenue Allocation Act and the 1999 Constitution of the Federal Republic of Nigeria (As Amended).

3.0 Presentations made at the meeting hinged on the fact that the deductions in contention may have been authorized by relevant provisions of the Financial Authorities or by Mr. President. Hence, after extensive deliberations, Members of the Ad-hoc Committee resolved as follows:

- a) Write to NNPC to request evidence of approval for deduction made in respect of Government Priority Projects, Under-Recovery and Cost of Collection, etc.
- b) Request OAGF to submit evidence of statutory guidelines for deductions made on proceeds from Oil and Gas in the Federation Account.

3.1 The aim of the above request from NNPC and OAGF were:

- a) To determine whether it is appropriate for NNPC to deduct funds for Priority Projects, Under-recovery and Cost of Collection from revenue generated before computing the 13% derivation to Oil Producing States is computed;
- b) To determine when the deductions from Priority Projects and Value Shortfall (Subsidy) started and how much is outstanding in favour of the Oil Producing States (if any);

## Appendix 3

**4.0** In response to the request for additional information, NNPC made a submission through a letter dated 24<sup>th</sup> September, 2021, while the OAGF provided the following information:

- a) 2021 Fiscal framework (Revised 2020-2022 Medium Term Fiscal Framework);
- b) North East Development Commission Establishment Act, 2017; and
- c) A letter from the Attorney-General of the Federation and Minister of Justice addressed to the Honorable Minister of Finance, Budget and National Planning on the North East Development Commission Take-off:- Need for Immediate Funding to Commence Operationalization of the Commission.

### **5.0 Analysis and Deliberation on Submissions made by NNPC and OAGF**

**5.1** The Committee in considering the submissions made by NNPC and OAGF on the subject matter as well as Section 162 (2) of the Federal Republic of Nigeria as it affects the 13% Derivation for Natural Resources noted the following:

- a) Provision for Budget Oil production volume, budget benchmark price, average exchange rate was outlined in the 2021 Fiscal framework;
- b) Gross Federation Account inflows were classified into Oil revenue and Non-Oil revenue;
- c) The Oil revenue comprises of Profit from Crude Oil and Gas sales, Petroleum Profit Tax on Oil and Gas, Oil and Gas royalties, concessional rentals, Gas flared penalty, Miscellaneous Revenue, Exchange Gain, Incidental Oil revenue. While the Non-Oil revenue includes Corporate Tax, Company Income Tax, NLNG Tax, Stamp Duties, Value Added tax, Import, Excise Duties and Fees, Surcharge, Tax Amnesty, FGN Independent revenue;
- d) Deductions on Oil revenue included Cost Recovery (cost associated with production), Budget Oil production volume net incremental Oil production for Repayment Arrears (RA), Fiscal deductions (base JV cash calls + PEF +MCA + RA), other Federally funded Upstream Projects (Government Priority Projects), 13% Derivation, Special Federation transfers and Police Trust Fund;
- e) Deductions on Non-Oil revenue were cost of collection, transfer to North East Development Commission (NEDC) and Police Trust Fund;
- f) Deductions on VAT were Cost of Collection and transfer to North East Development Commission (NEDC) ;
- g) Net Oil and Gas revenue is derived after cost associated with production and other deductions are charged before 13% derivation is computed;
- h) Net VAT revenue is arrived at after cost of collection, transfer to North East Development Commission (NEDC) have been deducted.

### **5.2 North East Development Commission Establishment Act, 2017**

Section 14 Subsection 2 (a-c) of the North East Development Commission Establishment Act, 2017 stipulates as follows:

- a) "in each financial year, an appropriation of at least 10% annual statutory allocations due to the Member States of the Commission from the Federation Account as the contribution of the Federal Government to the Commission".
- b) "a sum of at least 10% of the Ecological Fund annually for a period of 10 years".
- c) "a sum equivalent to 3% of the annual VAT collection as first line charge, to accrue to the Commission for a period of 10 years, notwithstanding the provisions of any other law"

## Appendix 3

### 5.3 **A letter from the Attorney-General of the Federation and Minister of Justice addressed to the Honorable Minister of Finance, Budget and National Planning on the North East Development Commission Take-off: Need for Immediate Funding to Commence Operationalization of the Commission**

- a) In interpreting Section 14 Sub-Section 2 (a to c) of the North East Development Commission Establishment Act, 2017, the Attorney-General stated that the Act above is clear enough to allow for literal interpretation of same and that the Ministry is of the opinion that no special directive of Mr. President is required for the implementation of the clear provisions of the Section.
- b) The Fiscal Framework and the North East Development Commission Establishment Act, 2017 empowers the deduction of funds for the Commission on gross VAT revenue.

### 5.4 **NNPC SUBMISSION**

- a) Contained in NNPC submission was the 2021 Appropriation Act and NNPC Act, Chapter N123, laws of the Federal Republic of Nigeria 2004 and Deductions made in respect of Value Shortfall.
- b) That deductions for Priority Projects are clearly captured in the 2021 Appropriation Act and NNPC is only obligated to comply and implement accordingly;
- c) That in consistent with applicable laws, the Corporation is mandated to remit the net revenue due to the Federation Account, however, the responsibility of revenue distribution to the three tiers of Government and computation of 13% derivation is outside the purview of NNPC;
- d) That NNPC has consistently provided detailed explanation on the Value Shortfalls to the relevant stakeholders at various engagements including FAAC meetings and the onerous responsibility of the federation to bear the cost;
- e) That the continuous deduction of the Value Shortfall is solely on Federal Government directives not to increase the PMS pump price to reflect the market fundamentals and all other macroeconomic variables pending the conclusion of the ongoing discussion with the organized labour and other stakeholders;
- f) NNPC Act, Chapter N123, laws of the Federal Republic of Nigeria 2004 Part 1, Section 7, Sub-section 4 (b) stipulates that **"such money as may be received by the Corporation in the course of its operations or in relation to the exercise by the Corporation of any of its functions under this Act, and from such fund there shall be defrayed all expenses incurred by the Corporation"**; and
- g) NNPC Act, Chapter N123, laws of the Federal Republic of Nigeria 2004 part V, Section 53 (7) states that **"NNPC Limited and any of its subsidiaries shall conduct their affairs on a commercial basis in a profitable and efficient manner without recourse to government funds and their memorandum and articles of association shall state these restrictions, and NNPC Limited shall operate as a Companies and Allied Matters Act entity, declare dividends to its shareholders and retain 20% of profits as retained earnings to grow its business"**.
- h) **Value Shortfall** - the deduction for Value Shortfall started on 8<sup>th</sup> January, 2021 to 29<sup>th</sup> October, 2021.

## Appendix 3

- i) The total amount deducted from the Federation Account in respect of Value Shortfall was **One Trillion, Twenty Seven Billion, Seven Hundred and Eighty Three Million, Thirty Six Thousand, Two Hundred and Twenty Five Naira, Twenty Five Kobo (₦ 1,027,783,036,225.25)** as shown in the table below:

NNPC Value Short Fall January - October, 2021		
S/N	Months	Deductions for Value Shortfall ( ₦ billions)
1	January	-
2	February	25,374,228,794.87
3	March	60,396,474,465.87
4	April	61,966,456,903.74
5	May	126,298,457,944.36
6	June	164,337,097,352.49
7	July	103,286,281,752.62
8	August	173,131,639,213.61
9	September	149,283,084,869.20
10	October	163,709,314,928.49
<b>Total =</b>		<b>1,027,783,036,225.25</b>

### 6.0 General Observations and Findings

6.1 Based on the submissions made by OAGF and NNPC, the following findings were made:

- Section 162 (2) of the 1999 Constitution of the Federal Republic of Nigeria (As Amended) provides for 13% Derivation on natural resources, is not subject to any other law, thus the provision of the Constitution on the application of the Derivation principle should take precedence.
- The Revised 2020-2022 Medium Term Fiscal Framework indicated the deduction of cost recovery from gross Federation Account inflow of Oil Revenue;
- The Revised 2020-2022 Medium Term Fiscal Framework shows that other deductions such as Priority Projects, 13% Derivation and Special Federation transfers are deductions to be made on Total Oil and Gas Revenue after Operational Cost Recovery, **however it did not categorically state that Government Priority Projects should be deducted before the payment of 13% derivation to Oil Producing States;**
- The Revised 2020-2022 Medium Term Fiscal Framework shows that Net VAT revenue is arrived at after cost of collection, transfer to North East Development Commission (NEDC) have been deducted. **In this case cost of collection is removed and credited to the relevant Agencies before transfers are made to NEDC.**
- NNPC Act, Chapter N123, laws of the Federal Republic of Nigeria 2004 Part 1, Section 7, Sub-Section 4 (b) allows NNPC to defray all expenses incurred in the conduct of its business before remitting operating surpluses.
- That funding for **Government Priority Projects** are not part of cost associated with production but rather are Federation investment and economic diversification expenditure;

## Appendix 3

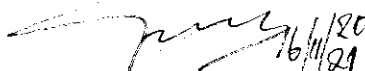
- g) NNPC Act, Chapter N123, laws of the Federal Republic of Nigeria 2004 part V, Section 53 (7) grants NNPC the right to conduct their affairs on a commercial basis in a profitable and efficient manner without recourse to government funds;
- h) There was no justification to the disparities observed in the distribution of Oil revenue and that of VAT revenue;
- i) That deductions made in respect of Under Recovery (PMS Subsidy) is not part of cost associated to production of Oil and Gas and is exposed to the vagaries of price of oil at the international market;
- j) That such deductions as under recoveries, cost of collection, funding for Priority Projects greatly reduce the amounts payable to the beneficiaries and thus negate the intent and spirit of the provisions in Section 162 (2).

### 7.0 Conclusion

7.1 After extensive deliberations and based on the above observations, the Ad-hoc Committee recommends as follows:

- a) That the computation and payment of 13% derivation for Oil and Gas resources should not be subjected to any other cost not associated with the operational cost of Oil and Gas revenue and thus any other cost not directly related to production, such as funding for Priority Projects, cost of under recovery (PMS Subsidy, etc) should be worked out after the computation of 13% derivation for oil producing States;
- b) That the Office of the Accountant-General of the Federation should redesign the template for computing 13% derivation on Oil and Gas in harmony with recommendation (a) above;
- c) That the Office of the Accountant-General of the Federation in conjunction with RMAFC should articulate any under payments made in respect of 13% derivation for Oil and Gas Revenue to beneficiaries from January 1999 to October 2021.

7.2 The Ad-hoc Committee thanks the PMSC for the opportunity to serve.



**H.E. Chris A. Akomas, Ph.D, FNIM**  
Chairman, Indices & Disbursement Committee,  
Revenue Mobilisation Allocation & Fiscal Commission  
16<sup>th</sup> November, 2021