



Averting Illicit Financial Flows in Nigeria's Extractive Industry

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1

COMPONENTS OF ILLICIT FINANCIAL FLOWS IN THE EXTRACTIVE INDUSTRY

This report answers the following questions on Illicit Financial Flows (IFFs) in the Nigeria extractive industry:

- What is responsible for Illicit Financial Flows in the Nigeria extractive industry?
- Who are those involved in Illicit Financial Flows in the Nigeria extractive industry?
- Where are the outflows of illicit financial proceeds in the Nigeria extractive industry?
- When does illicit financial flow happen in the industry?
- Why has the practice continued in the Nigeria extractive industry?
- How can we mitigate the risks of Illicit Financial Flows in the Nigeria extractive industry?

We used the typology approach to be able to provide answers to these questions. All the examples and case studies mentioned are already in the public domain.

In all, 12 case studies were used to identify, analyse, assess and measure the trends and patterns associated with Illicit Financial Flows in the extractive industry in Nigeria.

1.1. Understanding IFFs

The issue of Illicit Financial Flows (IFFs) is a global challenge.

The Washington-based Global Financial Integrity (GFI) defines IFFs as “all unrecorded financial outflows involving capital that is illegally earned, transferred or utilized, generally used by residents to accumulate foreign assets in contravention of applicable capital controls and regulatory frameworks, thus, even if the funds earned are legitimate, such as the profits of a legitimate business, their transfer abroad in violation of exchange control regulations or corporate tax laws would render the capital illicit”.

By interpretation, IFFs include the following:

- Capital that is legally earned but illegally transferred;
- Capital that is illegally earned but legally transferred;
- Capital that is illegally earned and illegally transferred.

Other scholars have also added to the knowledge on IFFs.

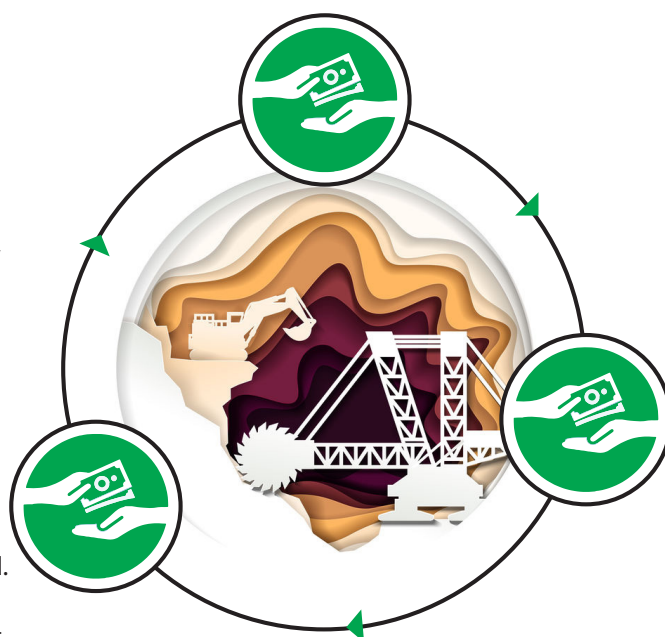
Kar and Cartwright Smith (2008) believe IFFs is “money that

is illegally earned, transferred or utilized if it breaks laws in its origin, movement, or use.

The Organization for Economic Cooperation and Development (OECD) offers a framework for IFFs as follows:

- Abusive transfer pricing between subsidiaries of the same group for the purpose of tax avoidance;
- Tax evasion;
- Manipulative Trade Pricing;
- Money laundering;
- Bribery and corruption.

This study therefore draws its direction from all these definitions.



1.2. Composition of the Nigeria Extractive Industry

In simple terms, the extractive industry consists of any operations that remove metals, minerals and other aggregates from the earth.

Examples of extractive process include oil and gas extraction, mining, dredging and quarrying.

In Nigeria, the extractive industry is usually grouped into two namely: the oil & gas sector and the solid minerals sector. The most dominant one, however, is oil and gas. It accounts for 9.6% of the country's GDP, while solid minerals contributes less than 1% according to figures released by the Central Bank of Nigeria (CBN) in the first quarter of 2018.

According to the CBN annual report of 2017, oil & gas accounted for 56.2% of total federally collected revenue. The National Bureau of Statistics (NBS) report on Foreign Trade stated that crude oil exports contributed 83.17% of total exports in Nigeria during the Third Quarter of 2017. The contribution by the solid minerals industry to both revenue and export is less than 1%.

1.2.1. Structure of the Oil and Gas sector

The oil and gas industry in Nigeria can be sub-divided into four. The upstream, midstream, downstream and services subsectors.

The upstream sector is the single most important aspect of the oil and gas industry. The sector is characterised by exploration and production of crude oil and gas.

As contained in the KPMG Nigeria oil and gas industry brief (2014), the major forms of corporate arrangements in the upstream sector are: Joint Ventures (JVs), Production Sharing Contracts (PSC), Service Contracts (SCs) and Marginal Field Concessions (MFCs).

Oil licenses are granted to companies by the Federal Government of Nigeria (FGN).

The downstream sector consists of distribution and marketing of refined petroleum products, transmission and conveyance of oil & gas to the refineries and gas stations and the refining of petroleum products.

The midstream covers the processing, storage, marketing and transportation of crude oil, gas-to-liquid and liquefied natural gas.

The services sector essentially offers technical and administrative support to all the other three sub-sectors.

1.2.2. Structure of the Solid Minerals Sector

Nigeria is endowed with 44 different minerals types scattered across 450 different locations around the country (Dateer Dayi Damulak, 2017).

Prior to the oil and gas booms of the '70s and '80s, solid minerals such as coal, tin and columbite contributed immensely to the economy of Nigeria. The story however changed for the worse with the oil and gas successes.

Some of the solid mineral resources found in Nigeria in commercial quantities include: Gold, Limestone, Gypsum, Kaoline, Granite, Marble Copper, Zinc, Iron-ore, Columbite, Tantalite, Coal, Glass-sand, Bitumen to mention just a few. However, the domestic mining industry is highly under-developed leading to Nigeria having to import minerals it can produce domestically. Rights to ownership of mineral resources are held by government which grants licenses to entities and individuals to explore mineral and sell mineral resources.

1.2.3. Statutory and Regulatory Framework for the Extractive Industry in Nigeria.

The extractive industry in Nigeria is regulated by the Federal Government and its agencies.

The key regulatory and statutory agencies are:

- Mines Inspectorate Department (MID)
- Ministry of Petroleum Resources
- Ministry of Mines and Steel Development

- Nigerian National Petroleum Corporation (NNPC)
- Department of Petroleum Resources (DPR)
- Nigerian Investment Promotion Commission (NIPC)
- Nigerian Maritime Administration and Safety Agency (NIMASA)
- Nigeria Customs Service (NSC)
- Nigerian Contents Development & Monitoring Board (NCDMB)
- Niger Delta Development Commission (NDDC)
- Nigerian Mining Corporation
- Nigerian Coal Corporation
- Nigerian Geological Survey Agency
- Nigerian Mining Cadastre Office.

2

THE VULNERABILITY OF THE NIGERIA EXTRACTIVE INDUSTRY TO ILLICIT FINANCIAL FLOWS

2.1. The Reasons for Vulnerability

A report by the *High Level Panel (HLP)* of the African Union Commission/United Nations Economic Commission for Africa (AUC/ECA) in 2015 showed that Nigeria accounted for 30.5% of all the Illicit Financial outflows from Africa between 1970 and 2008.

According to the same report, the country lost about \$217.7billion to this scourge within the period.

Table 1: IFFs figures in Africa (1970-2008)

No.	Country	Cumulative IFFs US\$ Billions	Share in Africa's Total IFFs (%)
1	Nigeria	217.7	30.5
2	Egypt	105.2	14.7
3	South Africa	81.8	11.4
4	Morocco	33.9	4.7

Source: AUC/ECA (2015)

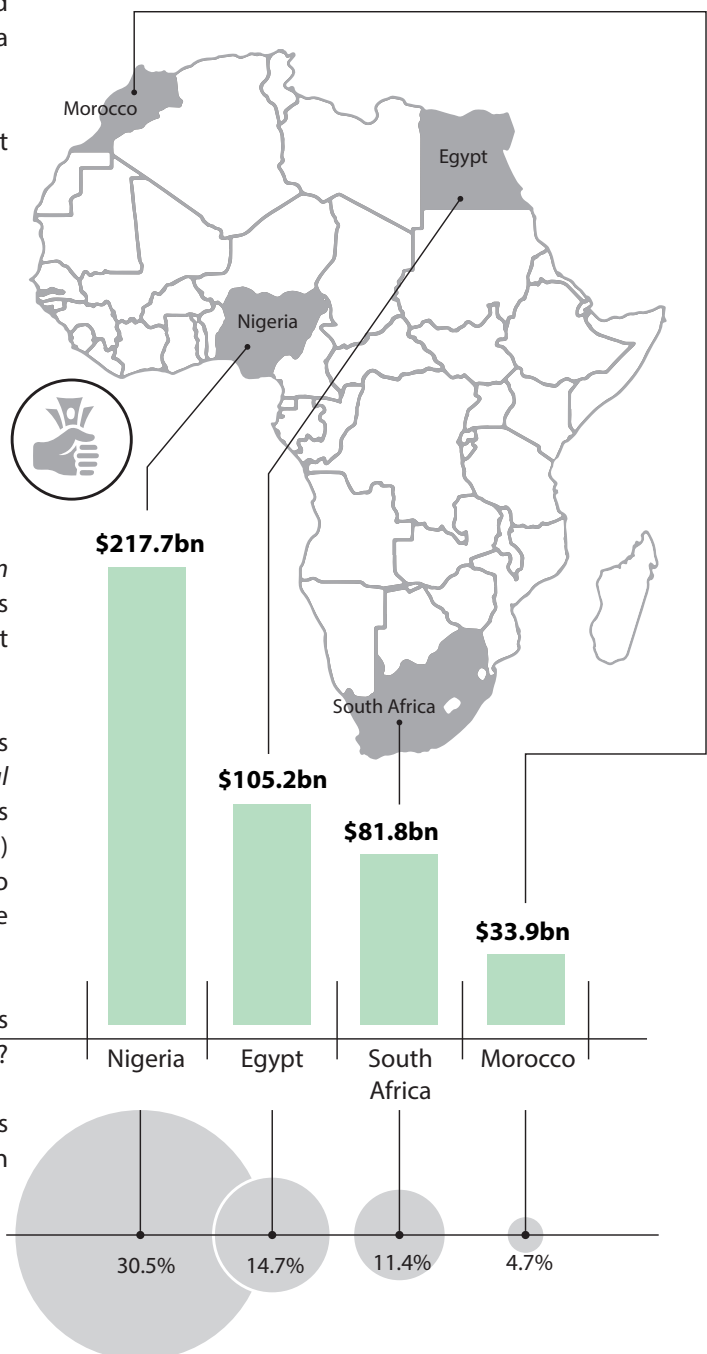
According to a report published by *ONE Campaign* in 2014, US\$1trillion is lost by developing countries yearly through, among other numerous web of corrupt activities, 'shady' natural resources deals.

A report published by the Anti-Corruption Resources Centre in 2011 (*Extractive sectors and Illicit Financial Flows: What role for revenue governance initiatives*) (Philippe le Billon) U4 issue (October 2011 No. 13) indicated that one of the most vulnerable sectors to *Illicit Financial Flows* in developing economies is the extractive industry.

The next logical question is: what makes Nigeria's extractive industry so vulnerable to *Illicit Financial Flows*?

The following reasons were listed by *Philippe le Billon* as the vulnerabilities of the extractive industry to IFFs in most developing countries in the report.

- Monolithic nature of the economy
- High political influence and control
- Dominance of government bureaucracy
- Significant level of corruption and bribery
- Technical and structural complexity
- Cash-based nature of the economy.



2.1.1. Monolithic Nature of the Economy

The Nigerian economy depends predominantly on its extractive industry. More than 70% of government revenues in Nigeria is from the oil and gas industry. With the dominant nature of the sector, every other activity and industry in Nigeria revolves around the petroleum industry. Since the sector is one that lays the golden egg, it is expected that it would be predominantly affected by the ills plaguing the country.

2.1.2. High Political Influence and Control

Since government at both Federal and State levels depend on the oil and gas industry in Nigeria, it is expected that the political class will hold tightly to it and will want to determine who gets what.

2.1.3. Dominance of Government Bureaucracy

The public service is noted for redtapeism. Sometimes, this encumbrances and administrative bottlenecks are created by civil servants and those in charge of regulatory bodies in order to manipulate the system.

2.1.4. Corruption Risk Level

Nigeria, like most resource-rich developing countries, faces significant challenges with corruption in the public sector. While the country has recorded some improvement since the return to democracy, and in spite of the current government's policy against corruption, Nigeria still ranks low on Transparency International's Corruption Perception Index. This poses practical challenges to all sectors of the economy, not least the extractive sector, especially given the peculiar governance challenges associated with rents from natural resource exploitation.

2.1.5. Technical and Structural Complexity

The Oil industry is technically and structurally complex and the legal and fiscal arrangement governing revenue flows are even typically more complex (Donwa, Mgbame & Julius, 2015).

This complexity makes it relatively easy for the operators and those in charge of administration to manipulate the process for their selfish and individual gains.

2.1.6. Cash-Based Nature of the Economy

Nigeria is a predominantly cash-based economy. Payments for goods and services are still majorly done in cash. An economy that is cash-based is prone to high incidences of economic and financial crimes especially corruption, bribery and money laundering. Cash transactions obliterate audit trail and aid illicit financial flows.

2.2. The Enablers of IFFs

Many studies have identified three enablers of *IFFs* within the extractive sector. These are: Bribery & Corruption, Illegal Resource Exploitation and Tax Evasion. These three factors, though not mutually exclusive, often occur concurrently. For example, a company might pay a bribe to illegally exploit a resource outside its concession area. Thereafter, the products are transported/smuggled outside the shores of the country without the payment of the required export duties.

Table 2: Enablers of IFFs

	Corruption	Illegal Exploitation	Tax Evasion
Main financial flows	Facilitation payments (bribes) paid by companies, money embezzled from tax collection and budgetary allocation	Undeclared corporate revenues from illegal resource exploitation	Inflated costs deducted from taxable revenues, smuggling of resources
Main Beneficiaries	Corrupt government officials and companies gaining undue advantage	Domestic companies, local subsidiaries of foreign companies	Parent or holding companies, exporting companies

Source: Philippe de Billon (2011)

2.3. Frequency Level of IFFs

A study carried out by Philippe de Billon in 2011 shows that different extractive sectors are exposed to distinct risks of *Illicit Financial Flows*, reflecting the specific characteristics of the resources and modes of production involved.

Table 3: Frequency Level of IFFs

	Corruption	Illegal Exploitation	Tax Evasion
Oil	High	High	Medium
	Due to confidentiality and concentration of decision making and monitoring	Due to biased metering, siphoning and bunkering	Due to homogeneity of international prices according to oil quality
Gas	Medium	Low	High
	Due to limited market options	Gas theft is very difficult except at transit hubs between markets	Gas prices vary widely because of fragmented markets
Industrial Mining	High	Low	High
	Due to confidentiality and concentration of decision making and monitoring	Except in measurement and ore grading	Due to transfer mispricing
Artisanal Mining	Medium	High	High
	For grand corruption but high for petty corruption, due to diffuse resource flows except at official export channel	Due to accessibility of deposits and difficulties in monitoring	Due to smuggling

Source: Philippe Le Billon (2011)

Aside the factors highlighted by *Philippe Le Billon* in *Table 3* as aiding the frequency level of IFFs, other enablers include the jurisdiction and level of development of the affected countries.

2.4. IFFs Process and Cycle

Most cases of IFFs follow an outline that span across a long period of time if not swiftly identified and mitigated. The illegal mining of Nigeria's mineral resources in the last five years and revenue leakages in the solid mineral sector are vivid examples. Despite the fact that Nigeria is blessed with a lot of solid minerals, the industry contributes little to the country's earnings. In July 2018, an investigation was reportedly ordered by the House of Representatives and executed by an Ad-hoc Committee, over the alleged loss of over \$50 billion in gold tax revenue between 2013-2018 as a result of illegal mining and exportation of unprocessed gold from Nigeria. This feeds into the speculation that the vast majority of the country's gold resources are transacted underground without any record of financial accrual to the country and then smuggled to other countries.

One of the notorious cases of IFFs within the Nigeria extractive industry is that of the Malabu oil block. Malabu, a newly incorporated company without significant experience got an oil license in April, 1998. The then Petroleum Minister granted to Malabu Oil and Gas the exclusive rights to OPL 245, one of Nigeria's most valuable offshore oil blocks. Malabu had been set up just five days before the award.

OPL 245 sat idle for 13 years, until the Nigerian government facilitated a transfer of the rights from Malabu to Shell and Eni in 2011 via a two-step transaction. In the first step, Shell and Eni paid \$1.3 billion to the government. In the second step, the government agreed to transfer \$1.1 billion to Malabu owners. Malabu later transferred most of the funds it received to several shell companies with unclear beneficiaries, through various banks in London. The transaction has been under investigation in several jurisdictions.

Finally a typical IFFs cycle occurs with the use of money-box companies to accumulate income by evading tax. A "money-box" company is "a company which was non-resident for tax purposes and which was used to accumulate income, free of domestic tax, from the investment of surplus funds outside the domestic tax jurisdiction".¹ In reality, extractive industry companies involved in tax evasion practices would move billions of dollars from the host country through money-box companies in the home country to avoid taxation in the host country. These money-box companies would typically be the IOC's subsidiary registered in the IOC's home country. In some cases such arrangements / transactions are carried out in breach of regulatory disclosure guidelines in respect of their operations in the host country, thereby failing to pay tax in the country of extraction.

2.5. Trends and Patterns of IFFs

The scope and scale of IFFs out of Africa has continued to increase over the years, more especially within the extractive

¹ Association of Company Treasurers, available at https://www.treasurers.org/search/apachesolr_search/box

industry. According to *Mohammed Adow* (2014), at least \$1.8trillion illicitly flowed out of Africa between 1970 and 2009. This is far more than the external aid the continent received over the same period. He further stressed that Nigeria accounted for the highest amount of the illicit outflows.

IFF through Trade-Based Money Laundering (Trade Mispricing) during oil exports and imports is a noteworthy trend in Nigeria's extractive industry. UNCTAD/Ndikumana (2016) conducted a study highlighting how Nigeria lost capital through trade mispricing by its buyers. The study was divided into two sub-periods (1996-2003 and 2006-2014), because there was no UN Comtrade database for the years 2004 and 2006 for Nigeria.

The highlights of the study are discussed below.

2.5.1. IFFs through Oil Export Mis-invoicing

- Trade with five out of 17 major trading partners exhibit export under-invoicing, while the remaining 12 show export over-invoicing.
- United States (\$69.7 billion) followed by Germany (\$23.9) billion had the largest amount of under-invoicing.
- Trade with Italy and the Netherlands exhibit very high levels of export over-invoicing, with a total of \$25.1 billion and \$20.5 billion respectively.
- Excluding Italy and the Netherlands, total oil export under-invoicing with Nigeria's major trading partners amounted to \$51.9 billion over the 1996-2014 period.
- A substantial amount of oil exports to Switzerland was not recorded in Nigeria, or that the exported quantities or values were highly undervalued.

2.5.2 IFFs Oil Import Mis-invoicing

Though Nigeria is a leading producer and exporter of oil, it imports refined petroleum as a result of its poorly functional refineries.

Therefore, Nigeria also experiences *IFFs* through import mis-invoicing by its partners.

The findings revealed the following:

- There is systematic and substantial import under-invoicing in Nigeria. Cumulative oil import under-invoicing amounted to \$45.6 billion over the 1996–2014 period.
- Under-invoicing was higher during the 2006-2014 period. While the cumulative amount of unrecorded oil imports was \$3.4 billion in the earlier period, it was \$42.2 billion in the second period.
- Netherlands' trade with Nigeria exhibited very large oil import under-invoicing of \$24 billion over the period, mostly occurring during the 2006–2014 period (\$23.7 billion).

Table 4 summarizes the results for oil export and oil import mis-invoicing involving the leading partners. It is worthy to note that the result for Netherlands stand out. It appears that the bulk of oil exported by Nigeria to the Netherlands is not recorded on the export side. Also, most of oil exported by the Netherlands to Nigeria is not recorded at its stated destination either on the import side.

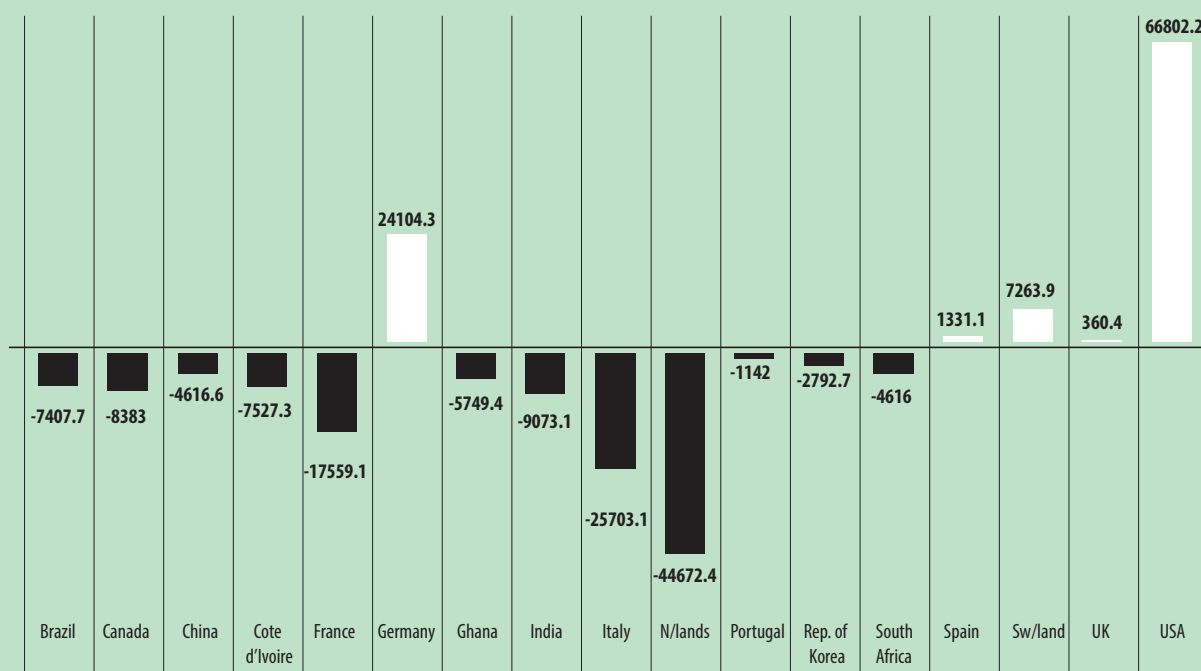
Table 4: IFFs Due to Oil Export and Import Mis-invoicing: 1996-2014

Partner	1996-2003 US\$	2006-2014 US\$	Total 1996-2014 US\$
Brazil	-899.8	-6507.9	-7407.7
Canada	-1356.2	-7026.8	-8383
China	-98.5	-4518.1	-4616.6
Cote d'Ivoire	-1105.9	-6421.4	-7527.3
France	-2770.0	-14789.1	-17559.1
Germany	3363.0	20741.3	24104.3
Ghana	-584.8	-5332.6	-5749.4
India	-10332.0	1258.9	-9073.1
Italy	-5293.1	-20409.9	-25703.1
Netherlands	-2879.0	-41 793.4	-44672.4
Portugal	361.8	-1503.9	-1142.0
Rep. of Korea	-197.2	-2595.5	-2792.7
South Africa	-654.3	-3961.7	-4616.0
Spain	459.3	871.8	1331.1
Switzerland	2987.6	4276.2	7263.9
United Kingdom	290.0	70.4	360.4
United States	51201.7	15600.6	66802.2
Total	32524.7	-71957.2	-39432.5
Excluding Netherlands	35403.7	-30163.7	5239.9

Source: UNCTAD/Ndikumana (2016)

The impact of IFFs especially in the extractive industry has been severe. PASGR (2018) reported that illicit financial flows have contributed to draining Nigeria's external reserves (which fell to about US\$20 billion in 2015/16), reduced tax collection, worsened poverty and inflation, and widened income gaps.

IFFs Due to Oil Export and Import Mis-invoicing: **Total 1996-2014 (\$)**



3

MEASUREMENT OF ILLICIT FINANCIAL FLOWS

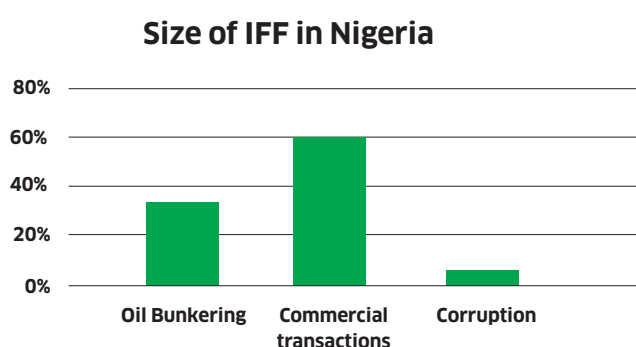
3.1. Global Practice

Reports from *TrustAfrica* (2017) showed that 92.9% of the total amount of *IFFs* in Nigeria came from the oil sector. Out of this, oil bunkering is said to account for about 35%.

The report also indicated that commercial transactions by multinationals that dominate this sector using tax evasion, money laundering and transfer pricing account for more than 60% of Nigeria's illicit financial flows.

Table 5: Volume of *IFFs*

Source: *Trust Africa* (2017) and Compiled by *DataPro*



According to *Global Financing Integrity (GFI)*, the methodology through which illicit financial flows can be measured are:

- External accounts whereby *Illicit Financial Flows* are captured by the *Change in External Debt (CED)* measure, and
- Mispricing of external transactions whereby *Illicit Financial Flows* are captured by the *Gross Excluding Reversals (GER)* measure.

Generally, *IFFs* are difficult to measure as a result of their illegality, type of activities that underlie them, and data challenges.

3.2. Measurement Methodologies

The following are some of the methodologies commonly used to calculate *IFFs* in an economy.

3.2.1. Balance of Payments (BoPs)

As defined in an article published by *thebalance.com*, the Balance of Payments is the record of all international trade and financial transactions made by a country's residents.

The Balance of Payments has three components. (1) The Current account, (2) The Financial account and (3) The capital account. The current account measures international trade, net income on investments, and direct payments. The financial account describes the change in international ownership of assets. The capital account includes any other financial transactions that do not affect the nation's economic output.

Global Financial Integrity also believes that the Balance of Payments data contributes to the analysis of net errors and omissions.

3.2.2. Mirror Trade Analysis (MTA)

Kahler et al. (2018) wrote that Mirror Trade Analysis seeks to identify *IFFs* that take place through the channel of trade mis-invoicing (under or over-reporting the value of imports or exports to generate unreported side payments). Motives can be trade-based money laundering (using mis-invoicing as a means to transfer money), evading tariffs and taxes, or evading currency controls. Mirror Trade Analysis is the basis for the widely cited trade mis-invoicing studies, such as those carried out regularly by GFI.

Other examples include the findings of *UNECA's* High Level Panel on *Illicit Financial Flows* from Africa and research by James Boyce and Leonce Ndikumana (2008).

According to Boyce and Ndikumana (2008), when goods are traded internationally, they generate at least two sets of records: one at the export end and another at the import end. This methodology assumes that the declared price and quantity of an export should match the declared price and quantity of the shipment when it reaches its destination (allowing for shipping and insurance costs). Most commonly, studies allow a 10 percent margin for insurance and freight, but some seek to take a more sophisticated approach, applying different margins for different types of goods and different pairs of countries at different times.

Gaps and mismatches in trade statistics can occur for innocent reasons, such as errors in recording prices or amounts, goods transiting via bonded warehouses, price volatility, and differences among countries in categorizing products, and variable shipping and insurance costs. Volker Nitsch (2015) highlights how small changes to underlying assumptions can have large implications for the resulting estimates.

The calculations also tend to deliver a different pattern of findings for landlocked countries and for countries with seaports, which are more likely to reflect different patterns of trade reporting and transport costs than inherently different patterns of underlying criminal economies. Mirror Data Analysis can be used as a starting point for investigating customs fraud but cannot be directly interpreted as evidence of such fraud.

3.2.3. Extrapolation from International Offshore Wealth

According to Kahler et al. (2018), this method seeks to identify the stock of financial assets held offshore and estimate the proportion housed there to evade taxes. The Tax Justice Network, an international organisation based in the United Kingdom, for example, estimates that between \$21 trillion and \$32 trillion of private wealth is registered in offshore international financial centers. Gabriel Zucman (2013) uses data on aggregate worldwide reported assets and liabilities and cross-border deposits provided by the Bank of International Settlements to estimate that approximately 8 % of household financial wealth is held overseas. However, much offshore money represents sovereign wealth funds, pension funds, and other institutional investment, as well as individual investment that is tax compliant. Zucman (2013) assumes that 75–80 percent of offshore assets and income are unreported by owners. However, this assumption seems hard to support given that many of the offshore jurisdictions Zucman (2013) assesses are largely compliant with *Financial Action Task Force (FATF)* standards and are part of the Common Reporting Standard of exchange of financial information.

4 ILLICIT FINANCIAL FLOWS CASE STUDIES

4.1. Opportunities and Control Failure

The opportunities for *IFFs* through fraud and money laundering generally start as administrative control failures by those expected to exercise the statutory and regulatory framework in the industry.

The resultant effect is the high politicization of discretionary powers, inadequate corporate governance, regulatory capture, political interference, conflict of interest, corruption, bribery, tax evasion and other illegal and criminal activities by operators and regulators.

4.2. IFFs Indicators and Redflags

In analysing each of the case study presented in this report, we considered the inherent opportunities and control failures that led to the illicit financial flow.

Some of the red flags and indicators include the following:

1. Involvement of *shell companies*¹ in the award of licenses and contracts within the industry.
2. Involvement of blacklisted and sanctioned individuals and companies in the award of permits, licenses and contracts in the industry.
3. Abuse of office and conflict of interest by *Politically Exposed Persons (PEPs)*² in the award of permits, licenses and controls in contravention of existing public service code of conduct.
4. Failure to ascertain and verify the *Ultimate Beneficial Owners (UBOs)* in the award of permits, licenses and controls within the industry.
5. Cases of conflict of interest on the part of government officials and those with political power in awarding permits, licenses and contracts to themselves and their cronies.
6. Lack of enforcement of *Anti-Bribery and Corruption (ABC)* Policy that forbids government officials and those with political powers from accepting or soliciting for favours, gifts, bribes and other illegal gratuities/gratifications from operators within the extractive industry in Nigeria.
7. Encouragement of a monopolistic market, whereby competition is deliberately constrained in the award process in order to favour a particular individual or company.
8. Diversion of revenue and payment from government coffers to individuals pockets.
9. Non-enforcement of uniform standards for operation in the sector.
10. Rent-seeking within the industry whereby individuals and companies “hawk” licenses, permits and contracts at a margin.

4.3. Case Study Presentation

The case studies discussed here are all in the public domain. They were all selected based on their relevance to this study.

¹ A Shell company is an entity registered to conceal ownership and has no significant assets or operations. It is also called portfolio company.

² A political Exposed Person (PEP) is a senior public officer or civil servant including elected politician, traditional ruler and s/he close and business associate.

4.3.1. Case Study 1: Malabu Oil Block Scandal

Amount involved \$1.1b

Parties involved

Shell and Enil paid \$1.1b for the acquisition of OPL 245 oil block from Malabu Oil & Gas.

In 2011, Shell and Eni paid US\$1.1bn for one of West Africa's largest oil fields, OPL 245, situated off the coast of Nigeria. The payment was equivalent to 80% of Nigeria's proposed 2015 health budget, but the money did not benefit the country's citizens. Instead, it went to a company called Malabu Oil and Gas, which was secretly owned by the former oil minister who had granted his company rights to the oil field in 1998. At the time, Malabu was a newly minted firm set up five days before the award of the license, with no apparent operations or experience. Like many others, this deal for a massive state asset was conducted behind closed doors, without the knowledge of the public or investors. Shell and Eni denied paying anyone other than the Nigerian government but there is clear evidence that they knew their payment would be diverted into private pockets. By doing business with corrupt politicians, Shell and Eni exposed their shareholders to enormous risk.

Source: *Global Witness (Nov 17, 2015)*

Opportunities and control failures

- The company and/or its principals had no prior relevant work experience. For example, the company put itself forward as an exploration and production firm but had never undertaken upstream activities before.
- It was awarded the contract at the expense of other more experienced and operational firms.
- Conflict of interest in the award of oil license.
- Secrecy and lack of transparency in the conduct of oil & gas businesses.

4.3.2. Case Study 2: Sale of Crude to Briefcase Companies

In 2012, it was reported that NNPC sold crude to unqualified companies, commonly known as "briefcase companies". Quite a number of the crude traders did not demonstrate renowned expertise in the business of crude oil trading and had lifted crude oil only once between 2002-2011.

It was also observed that some of the companies who lifted crude oil could not be found as listed on the approved master list of customers. This suggests that Nigeria sold crude oil to certain traders without a formal contract. NNPC made use of traders as middlemen for the exportation of crude oil and importation of petroleum products, which led to the reduction of margins obtainable on sale of crude oil and increased costs on purchase of petroleum products.

Source: *The Ribadu-Led Petroleum Revenue Special Task Force Report (2012)*

Opportunities and Control Failure

- Large portions of the country's crude oil production were sold to unqualified companies who ended up selling it to more experienced commodities traders at a margin.

4.3.3 Case Study 3: Oil-for-Product Swaps

Nigeria lost over \$723 million (about N221.5 billion, at N306.3 to \$1) through the Offshore Processing Arrangement, OPA adopted by the Federal Government in 2015 to supply refined petroleum products in the country, the latest Nigeria Extractive Industries Transparency Initiative, NEITI 2015 Oil & Gas Industry Audit Report, has revealed.

The controversial arrangement was introduced by the Nigerian National Petroleum Corporation under the supervision of the then Minister of Petroleum Resources, Diezani Alison-Madueke, and was quite popular during the Goodluck Jonathan administration.

It was an arrangement that involved the allocation of Nigeria's crude oil to select indigenous and foreign oil traders under agreed swap contract terms, in exchange for refined products for local consumption.

Apart from the difficulty in getting commensurate value of petroleum products for the volume of crude oil allocated for refining, the arrangement was identified as one of the ways corrupt government officials funneled the country's

crude oil abroad for their selfish benefits.

The Buhari administration in November 2015 jettisoned the OPA for being “uneconomical and wasteful”.

In its place, the government opted for the Direct Sale-Direct Purchase, (DSDP) arrangement “to enthrone transparency and eliminate the activities of middlemen in the crude oil exchange for product matrix”.

In addition, the report, which also covered other aspects of operations of the country’s oil and gas industry, said there was an outstanding liability of about \$498 million from under-delivery of imported products by companies contracted under the OPA.

Other losses recorded during the period, the report noted, totaled about \$90 million lost through a practice where the NNPC opted to use a revised/lower pricing option at the point of payment, instead of the higher price at the point of purchase.

Source: *Premium Times* (December 29, 2017)

Opportunities and Control Failures

- The use of middle men in the execution of petroleum deals.
- Lack of transparency in the pricing of petroleum products.

4.3.4. Case Study 4: Contracts to Indicted Companies

The list of companies released by the Nigerian National Petroleum Corporation for the 2017/2018 crude oil trade includes firms indicted and some facing criminal charges for fuel subsidy fraud.

The oil subsidy regime between 2009-2011 recorded one of the most monumental cases of fraud in Nigeria’s history with the government paying importers subsidy for 59million litres of fuel per day, while the country actually consumed about 35million litres. In 2011, Nigeria spent N2.5trillion on fuel subsidy a 900% increase from the N245billion in the year budget.

More than 30 companies were indicted after the investigations were launched, and several of them still facing criminal charges in Nigerian courts for making hugely inflated subsidy claims.

The NNPC released the names of 39 winners for the sale and purchased of Nigerian crude in 2017/2018.

At least six of the companies listed were indicted or still facing charges for fuel subsidy fraud. According to reports, many of the multinational oil companies and other high-level investors in the system, have a way of manipulating the system having contributed to the campaign and funding of some political parties and government officials.

Source: *Premium Times* (January 12, 2017).

Opportunities and Control Failures

- Lack of comprehensive due diligence on companies bidding for contracts.
- Failure to implement the law that requires ascertaining the ultimate beneficial owners of bidders before awarding contracts.
- Ongoing cases of over-invoicing.
- Conflict of interest involving politically exposed persons.

4.3.5. Case Study 6: Stolen Crude Oil

Available records of crude oil shipments from the NNPC, CBN and the Pre-shipment Agencies show a shortfall of 57,830,000 MT of Nigerian crude oil for the period 2011 to 2014.

This translates to illegal oil flows of more than \$12b to the USA during this period while more than \$3b was recorded to China and \$839,522,600 to Norway.

Records also showed a liquefied natural gas shortfall of 727,460 metric tons, estimated at over \$461million from shipments to 7 countries, traced to cargoes at each destination port of entry, that have been established as undeclared.

Source: *Vanguard Newspaper* (October 22, 2017)

Opportunities and Control Failure

- Lack of effective, proportionate and dissuasive sanctions against buyers of stolen Nigerian crude.

4.3.6. Case Study 7: Misrepresentation of Technical and Structural Details

A 2015 research by NRG found that some of Nigeria's oil-for-refined-product swap contracts contained unbalanced or inadequately defined terms that allowed the traders to profit at the government's expense. NRG estimated that losses from three technical provisions in a single "offshore processing" contract could have reached \$381 million in one year (or \$16.09 per barrel of oil sold). Some of the unbalanced provisions dealt with the measures used to convert volumes of crude into volumes of refined products. Another gave the company an excessive allowance for the value of oil lost during the refining process. The contracts were awarded at a time of strong competition for Nigeria's oil trading business, and other companies proved willing to sign contracts with much less profitable terms.

After a change in government, NNPC cancelled three of such contracts in mid-2015, stating that they were "skewed in favor of the companies such that the value of product delivered is significantly lower than the equivalent crude oil allocated".

Source: Natural Resource Governance Institute (April 2017).

Opportunities and control Failures

- Collusion between operators and regulatory agency to defraud government of its revenue.
- Manipulation of the technical and structural details for selfish gains.

4.3.7. Case Study 8: Oil Bunkering Activities

Nigeria loses an estimated \$1 billion yearly in the West African bunkering market valued at over \$3 billion as some oil companies operating in the country patronize cheaper petroleum products sourced from illegal bunkering activities to fuel marine vessels and Floating Production Storage Offloading Vessels (FPSOs).

Most leading international and indigenous oil & gas companies through their procurement process, have continued to patronize illegal refined products and products obtained from vandalized pipelines, thus aiding and abetting crude oil theft and robbing the country from genuine bunkering operators. It was gathered that the loss of revenue by the country from illegal bunkering is worsened by the fact that foreign vessels that come to Nigeria choose to refuel offshore Cotonou and Ghana for security reasons. It was gathered that as the market shrinks for local licensed bunkering trading companies, they still have to battle with illegal bunkering operators who have now penetrated the mainstream consumer base by offering low prices.

Source: ThisDay Newspaper (September 5, 2017).

Opportunities and Control Failure

- Enforcement failure by regulators within the sector.
- Lack of self-regulatory standard among operators.
- Aiding and abetting criminal activities by operators.

4.3.8. Case Study 9: The Fuel Subsidy Scam

Following the removal of subsidy on PMS on the 1st day of January, 2012 by the Federal Government of Nigeria and the attendant spontaneous social and political upheavals that greeted the policy, the House of Representatives in an Emergency Session on the 8th of January, 2012 set up an Ad-hoc Committee to verify and determine the actual subsidy requirements and monitor the implementation of the subsidy regime in Nigeria.

The Committee Report showed that N261.1 billion was expended in petroleum subsidy in 2006, N278.8 billion in 2007 and N346.7 billion in 2008. Five companies, including the Nigerian National Petroleum Corporation (NNPC), were involved in managing the subsidy in 2006; it rose to 10 companies in 2007; and 19 in 2008. Within a year, 121 companies were added to the subsidy management list, making a total of 140 companies in 2011.

The Committee's investigation further revealed that certain marketers collected subsidy of over N230.184 Billion on PMS volume of 3,262,960,225 litres that were not supplied, from the records made available during the course of the investigation.

The Accountant-General that served during the period 2009 was also found to have made payments of equal installments of N999 Million 128 times within 24 hours on the 12th and 13th of January 2009, totaling N127.872 Billion. The confirmed payments from the CBN records were made to beneficiaries yet to be disclosed by the OAGF or identified by the Committee. It was discovered that only 36 Marketers were participants under the PSF Scheme during this period. Even if there were 128 marketers, it was inconceivable that all would have imported the same quantity of products to warrant equal payments.

Source: *The House of Representatives Ad-Hoc Committee Report on fuel subsidy probe. (April, 2012)*

Opportunities and control failures

- Lack of proper supervision by statutory bodies.
- Lack of verification of products supplied.
- Structured payment of equal installments.

4.3.9. Case Study 10: Illegal Export of Gold

The Economic and Financial Crimes Commission (EFCC) has seized gold worth about \$3, 131, 412.39 (N1, 127, 308, 460.39) being allegedly exported to Dubai, United Arab Emirates, illegally.

The precious metal was said to have been seized at the Nnamdi Azikiwe International Airport by a team of EFCC detectives.

The chief suspect had allegedly scaled through the scanning points without being detected, which pointed to connivance with some of the officials at different scanning points.

The gold was reportedly handed over to Abba by a syndicate of illegal miners operating in Zamfara State.

Source: *The Nation (October 14, 2018)*

Opportunities and Control Failures

- The gold being transported were sourced from illegal miners from Zamfara state.
- Suspicion of connivance with some officials at different scanning points in the airport.

4.3.10. Case Study 11: Under-Reporting of Production Volume

The Nigeria Extractive Industries Transparency Initiative (NEITI) audit report showed inconsistencies in Nigeria crude oil production and lifting data provided by Nigerian National Petroleum Corporation (NNPC), Department of Petroleum Resources (DPR) and Oil and Gas companies operating in the country. This has confirmed claims by stakeholders and Transparency watchdogs that the Government does not know the actual volume of crude oil produced in the country, giving room for criminal collusion in the industry.

NEITI in its 2015 Audit Report in the oil and gas industry disclosed that different crude oil production and lifting records were maintained by the Crude Oil Marketing Division (COMD) of the NNPC, the DPR and oil companies. The report stated that while the DPR records put total crude oil production in 2015 at 780.831 million barrels, the NNPC's recorded put the output at 780.368 million barrels, a difference of 462,269 barrels.

In addition, the report noted that records by oil companies put the total production at 771,198 million barrels, a difference of 9.633 million barrels and 9.17 million barrels compared to the DPR and NNPC's records respectively.

The report further accused oil companies of doctoring their actual production data, by presenting two different data for the purpose of taxes.

The report noted that all these inconsistencies were an indication of inefficiency system and represents a huge loss of revenue to the country.

Source: *NEITI Audit Report for 2015.*

Opportunities and Control Failure

- Lack of adequate oversight controls by the statutory and regulatory agencies.
- Absence of uniform and standard financial reporting format by operators for tax purposes.
- Technical and financial misstatements.

5 MITIGATING THE RISK OF ILLICIT FINANCIAL FLOWS

5.1. Mitigating the Risk

The principles of fraud risk management indicate that to mitigate the risk of criminal activities, we have to remove the opportunities for it to exist.

Following from the discussion of the different ways through which illicit financial flows occur in the extractive sector and the factors that make the extractive industry especially vulnerable to these practices, the following measures are being recommended to policy makers and stakeholders to tackle illicit financial flows in the extractive sector. While some of the measures are specific to the sector, others are measures generally recommended for addressing the occurrence of illicit flow of funds in the economy. Some of the recommendations are drawn from existing key studies on illicit flows in Africa and in the extractive industry. Other recommendations are based on review of the operations and process in Nigeria's extractive industry.



5.1.1. The Transparency Antidote

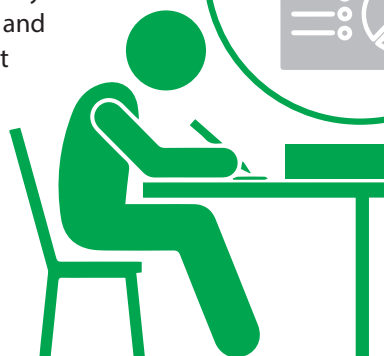
Illicit activities necessarily in secret hence the first prescription is to increase scrutiny and expand the constituency of accountability holders. The Extractive Industries Transparency Initiative (EITI) as the primary global instrument for promoting and institutionalizing openness in the extractive sector has covered significant ground in subjecting countries' natural resource revenues to greater scrutiny. However, current implementation of revenue transparency should be extended to cover comprehensive reporting of other activities across the value chain including contract transparency, beneficial ownership, minerals trading, and volume tracking. Beneficial ownership information especially will help to curb transfer pricing by increasing the likelihood of identifying ownership relationships that are typically used to facilitate transfer pricing and mispricing. Increased information about operators' cost of operations will also enable more accurate estimation of operating profits and hence helps to prevent or at least reduce incidences of profit underreporting for the purpose of tax under-assessment and payment. This can be achieved through modeling the cost structure of the industry in a way that disincentivizes manipulation of operating results for the purpose of tax avoidance.

Geological information should be provided in such a way that they can be aggregated for the purpose of analyzing, forecasting and monitoring. Adequate and up-to-date geological information about mineral occurrence and volume of endowment will help to prevent or reduce undervaluation and illegal exploitation especially in the solid minerals sector. Companies should be mandated to provide and update geoscientific information about their lease area and government should carry out periodic verification.



5.1.2. Accountability Instruments

This measure is related to the transparency prescription and an integral component of the underlying principle of the EITI idea. Revenue, ownership, tax etc. information exist primarily for the purpose of accountability. There should be a deliberate policy to promote effective demand-side accountability platforms – media, civil

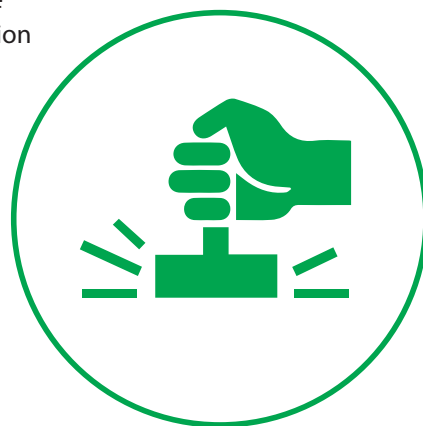


society and professional associations – across jurisdictions. This policy should include programmes to build analysis capacity of civil society organisations, media and parliamentarians to understand tax issues. They should be adequately equipped to share information across jurisdictions to enhance the effectiveness of monitoring beyond the scope of traditional established governance structures.

5.1.3. Certification of and Validation

Countries should be encouraged to platforms and channels which discourage trading in illegally exploited minerals through product certification. Certification instruments provide a forum for voluntarily participating countries to trade in mineral resources that have been duly certified as not originating from illegal sources, or which has been properly priced at the point of origin.

A similar incentive system can be implemented at the contracting stage to reduce the potential for illicit flows occurring down the road in the course of operations by companies. For this purpose it is recommended that countries should restrict minerals exploration and exploitation contracts to companies registered in high-disclosure jurisdictions. This would create a disincentive for companies to use jurisdictions with minimal disclosure laws to avoid tax.



5.1.4. Enforcement

Effective enforcement of existing global governance regulations increases the likelihood of prevention of illicit financial flows. In the absence of a robust beneficial ownership reporting legal framework, enforcement of existing Anti-Money Laundering and Combating Terrorism Financing (AML/CTF) regulations in Nigeria will enable government and its institutions to track sources and beneficiaries of proceeds of transactions emanating from the exploitation and trading in minerals, where there is suspicion of illegal benefits from mineral resources.

Similarly, but on a more global scale, the current stolen asset recovery initiative between the World Bank and the United Nations Office of Drug and Crimes should be extended to cover the retrieval of tax avoidance benefits linked to corruption carried out by corporations.



5.1.5. Collaborative Approaches

The schemes adopted by companies to earn and transfer funds from one country are complex, apart from the fact that perpetrated through illegal and/or clandestine or disguised means. In relation to the extractive industry, the practice presents additional complexity given the complexity and opacity of the sector. For reasons of this complexity and also for the reason that it is inherently a multi-jurisdictional practice, IFFs require collaborative, joined-up strategy to increase the chances of detection, prevention and enforcement. At the national level, collaboration should happen across sectors involving minerals agencies, tax authorities, law enforcement, exchange commissions, etc. Information sharing among agencies increases the likelihood of detection. International cooperation and collaboration between national institutions primarily through information sharing would, in the least, provide clues of illicit or questionable activity by corporations.



In terms of policy and legislation, government should consider anticorruption, illegal exploitation and tax agenda in a policy objective. It should therefore foster policy dialogue among officials in these institutions.

5.1.6. Taxation Instruments

Within the literature, some of the specific provisions recommended for enactment and adopted by this study include that government should enact measures to prevent excessive leveraging (debt to equity ratio) who increases high

interest deduction and reduces taxable profit. Corporations are generally reported to use this scheme to avoid tax by transferring funds to subsidiaries and related corporations in the form of interest payments to same companies for loans extended to them by those companies. Similarly, government should limit excessive deductions of interests on loans by companies, which reduces the amount of tax payable. As an administrative measure, tax authorities are also advised to treat excessive interest deductions between parties on a case by case basis, using the “arms-length” principle.



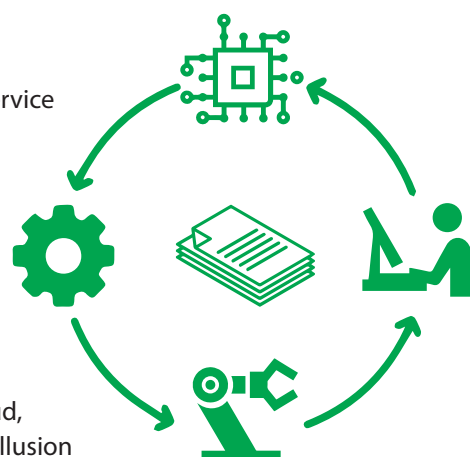
Government is also advised to ring-fence each extractive projects by companies in order to prevent companies from transferring losses or deductible expenses from one project to the other to reduce the amount of tax payable on a very profitable asset.

5.1.7. Adoption of Technology and Automation

It has been demonstrated that fraud and illegal activities associated with service delivery in any organisation can be combated through the introduction of electronic and computerized system.

The automation of the process and procedures associated with issuance of permit, licensing, bidding, contracting, monitoring, supervision and enforcement with the regulatory framework of the extractive industry in Nigeria will reduce the incidences of *IFFs*.

Any system that relies heavily on manual processing is usually prone to fraud, money laundering, bribery and corruption. Automation will limit human collusion and remove most of the opportunities that makes *IFFs* to exist.



5.1.8. Effective, Proportionate and Dissuasive Sanction Regime

Perhaps the greatest incentive to *IFFs* within the extractive industry in Nigeria is the absence of an effective, proportionate and dissuasive sanction regime.

There have been cases where those accused of criminal and illegal activities within the extractive industry in Nigeria continue to operate without serious sanctions to the individuals or their businesses. Effective sanctions must ensure that proceeds of *IFFs* are traced, frozen and eventually confiscated and forfeited to government. All cases of fraudulent activity in the sector must be sanctioned through criminal, civil or administrative procedures.





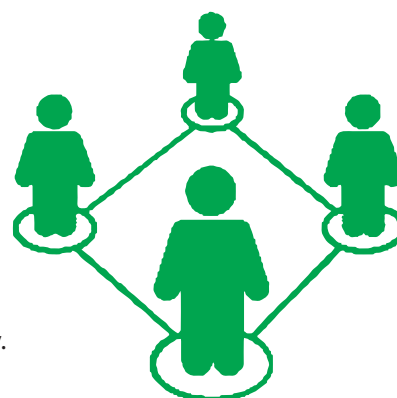
CONCLUSION

6.1. Key Action Recommendations

The preceding section suggests the various strategies for mitigating Illicit Financial Flows in Nigeria's extractive sector. These recommended approaches provide a broad framework for developing specific actions plans and programmes for immediate implementation by government and its institutions to curb IFFs in the extractive industry. This study now proceeds to recommend specific programmes for immediate adoption, particularly by governance institutions in the extractive sector.

6.1.2. Establish a Civil Society Network on Illicit Financial Flows

The civil society advocacy has been recognized globally as a way to combat corruption and illicit financial flows. Therefore, it is no doubt that involvements of civil society organisations in Nigeria will help reduced the vulnerabilities that create IFFs opportunities within the extractive industry. A network of civil society organisations with particular focus on anti-corruption and financial crimes should be established. Periodic workshops on 'IFFs in Extractive Industry in Nigeria' should be organized to build capacity of civil society within this network. In addition, collaboration with civil society will help create general public awareness and this can proffer robust strategies to fight IFFs in the industry.



5.1.3. Develop an Anti-Bribery and Corruption (ABC) Policy Framework

In Chapter 4, the lack of enforcement of Anti-Bribery and Corruption (ABC) Policy is identified as one of the challenges facing extractive industry in Nigeria. To this end, this study invites extractive industry governance institutions to come up with ABC policy frameworks that can be implemented to eradicate IFFs within the industry. This will involve design and implementation of strategies to combat corruption and IFFs originated from the operation of extractive industry. These agencies can set-up Anti-Bribery and Corruption Desk (ABCD) within Oil & Gas and Solid Minerals sectors across Nigeria to help track incidence of IFFs in industry going forward. Templates can be developed to report incidence of IFFs and the Anti-Bribery and Corruption Desk officers can be appointed to submit periodic incidence report to the existing Inter-Agency Task Team (IATT) and the NFIU. The reporting regime of IFFs within the extractive industry will exposed the illicit enrichment of politically exposed persons that are abusing public offices at the expense of national development.



5.1.4. Solvability Factor Model of IFFs in the Extractive Industry

The solvability factor model is a scientific approach to combat IFFs in the extractive industry. This model will probe all challenges faced in the industry in the quest to provide scientific solution. This project will be divided into three (3) stages: the first stage will probe the extractive industry threats and illicit opportunities. The second stage will develop mechanisms to combat the risks associated with threats and illicit opportunities impeding transparency of the extractive industry in Nigeria. The final stage, which is the third face, will test the mechanisms to combat IFFs in the industry and deploy solution to mitigate threats.



5.1.5. Eco System Data Management Solution

It is no doubt that the extractive industry in Nigeria lacks a robust data management framework to help fight associated risks and threats of the IFFs. Many of the affected sectors do not have required data to help follow the illicit financial flows. This limits the efforts to minimize illicit opportunities in the industry. In some instances, agencies within the sectors are not adequately sharing data with each other to reduce the illicit opportunities and inherent risks of IFFs in the industry. In the view of this, this study calls for an improvement in the management system within the industry. The future thoughts for data sharing requires the industry to deploy eco-system data management framework capable of linking data bases of one agency to another within the industry in order to achieve maximum solution for intelligence sharing.

