



Seplat Petroleum Development Company Plc

Related Party Transactions Policy and Guidelines

Adopted by the Board on 13 December 2012

Updated on 29 January 2016

1. INTRODUCTION AND PURPOSE

- 1.1 Although SEPLAT is incorporated in Nigeria and subject to Nigerian law, our listing in the London Stock Exchange makes the Company also subject to U.K. law.
- 1.2 Related Party Transactions are regulated by both Nigerian and U.K. laws. SEPLAT is required by law to disclose all Related Party Transactions and to conduct each such transaction in accordance with Arm's Length Principles. Respect of law is one of SEPLAT's key values, and the Company goes beyond compliance toward a value inspired culture. SEPLAT conducts business in a fair, honest and transparent manner, with accurate and complete business and financial records.
- 1.2 The purpose of this Related Party Transactions Policy ("Policy") is to establish the parameters within which SEPLAT deals with all Related Party Transactions, in compliance with the law.

2. APPLICABILITY

- 2.1 This Policy applies to every Employee and Director.

3. RESPONSIBILITY

- 3.1 The Board shall have overall responsibility for ensuring that this Policy: (i) is updated as required to remain in compliance with applicable laws in force, and (ii) is implemented and strictly enforced. The Board shall aim to reduce the Company's Related Party Transactions.
- 3.2 The Review Panel shall be responsible for the investigation and review of all Related Party Transactions. The Review Panel, FINCO, and the Board shall be responsible for the approval of Related Party Transactions in accordance with the threshold set out in Sections 7.2 – 7.4 of this Policy.
- 3.3 The CFO shall be responsible for the day-to-day implementation of this Policy, including the conduct of training and the interpretation of this Policy.
- 3.4 Supervisors shall be responsible for ensuring that their employees comply with this Policy in performing their duties.
- 3.5 The Head of any Function conducting an approved Related Party Transaction shall be responsible for ensuring that the transaction is conducted in accordance with this Policy, with proper documentation and record retention.
- 3.6 Each Employee and Director is responsible for reading this Policy carefully, understanding and complying fully with this Policy. In the event of the occurrence of any circumstance that is not expressly addressed in this Policy or in the event any Employee or Director is in doubt as to whether a transaction/activity would violate this Policy, clarification should be sought from the CFO.

4. DEFINITIONS

For purposes of this Policy, the following definitions of key terms shall apply:

- 4.1 "Arm's Length Principles" means that the terms of the Related Party Transaction must be similar or identical to the terms of an independent third party transaction carried out in the same or similar circumstances.
- 4.2 "Board" means the Board of Directors of Seplat Petroleum Development Company Plc.
- 4.3 "Director" means a member of the Board.
- 4.4 "FINCO" means the Finance Committee of the Board.



Seplat Petroleum Development Company Plc

- 4.5 “CFO” means the Chief Financial Officer of SEPLAT. However, where the Chief Financial Officer is a Related Party in a Related Party Transaction under review, then the CEO shall appoint another Key Personnel to act as CFO for purposes of applying this Policy to the transaction in question.
- 4.6 “Immediate Family Member” means the spouse/spousal equivalent, child, sibling, parent, partner, or in-law of a Related Party.
- 4.7 “Interested Persons” mean the Directors, CEO and Substantial Shareholders of SEPLAT, and their connected persons.
- 4.8 “Interested Person Transaction” means any transaction between SEPLAT, its subsidiary and/or affiliate (on the one hand) and an Interested Person (on the other hand), which directly or indirectly involves the:
- (a) provision of receipt of financial assistance;
 - (b) acquisition, disposal or leasing of assets;
 - (c) provision or receipt of services;
 - (d) issuance or subscription of securities;
 - (e) granting of or being granted options; or
 - (f) establishment of joint ventures or joint investments.
- 4.9 “Key Personnel” mean senior managers or officers who control, direct or administer the business of SEPLAT or its affiliate or subsidiary.
- 4.10 “NSE IPT Rules” mean the Nigerian Stock Exchange rules governing Interested Person Transactions, as issued on the 1st of November 2014 and amended from time to time.
- 4.11 “Related Party” means any person or entity who: (i) shares or is subject to a common control from the same source as SEPLAT, or (ii) who participate directly or indirectly in the management, control or profit of SEPLAT, or (iii) who exercises significant influence over the financial or and operating policies of SEPLAT at any time during a financial period. Under the International Accounting Standard, an entity is also a Related Party of SEPLAT if: (a) the entity is an associate or joint venture of SEPLAT or an associate or joint venture of a member of a group to which SEPLAT belongs, or (b) the entity and SEPLAT are joint ventures of the same third party, (c) the entity is a joint venture of a third party entity and SEPLAT is an associate of that third party entity, or vice versa. A Related Party can be an affiliate or a subsidiary of SEPLAT, Director, Substantial Shareholder, Key Personnel, or an Immediate Family Member.
- 4.12 “Related Party Transaction” means the direct or indirect transfer of goods, services, resources, or obligations between SEPLAT and a Related Party, whether or not a price is charged. For example, the transfer/sale/purchase/lease/license of goods, services, tangible or intangible assets, lending or borrowing money, standing as guarantor, or any transaction having financial implications.
- 4.13 “Review Panel” means the Related Party Transaction Review Panel, which will be the first level in reviewing and approving all Related Party Transactions. The Review Panel shall, at a minimum, consist of the following representatives (or their nominees):
- (a) CFO;
 - (b) General Counsel;
 - (c) Chief Operating Officer;
 - (d) General Manager, Business Integrity; and
 - (e) General Manager, Commercial & Tax (to give due consideration to transfer pricing and tax considerations)
- 4.14 “Substantial Shareholder” means any shareholder owning or controlling more than five percent (5%) of the total equity of SEPLAT.
- 4.15 “Transfer Pricing Methods” mean the process of comparing a Related Party Transaction with an identical or similar independent third party transaction in order to show compliance with Arm’s Length Principles.



Seplat Petroleum Development Company Plc

5. POLICY STATEMENT

- 5.1 Every Related Party Transaction must be disclosed and approved in accordance with this Policy prior to commencement.
- 5.2 Any Related Party Transaction that pre-dates this Policy must be immediately reported for regularizing, in accordance with Section 6 below.
- 5.3 All Related Party Transactions must be conducted and priced in accordance with Arm's Length Principles.
- 5.4 Where a Related Party Transaction is approved under this Policy, the aggregate value of such transaction shall not be awarded to the Related Party. Rather, the Review Panel, FINCO or the Board (as appropriate) shall determine a percentage of the aggregate value of the transaction to be awarded to the Related Party and such other percentage to be awarded to an independent third party approved by the Review Panel, FINCO or Board (as appropriate).
- 5.5 SEPLAT shall disclose Related Party Transactions within its Annual Report and in a Transfer Pricing Declaration Form (attached to the FIRS Regulations). Disclosure of Related Party Transactions shall be in enough detail to enable a third party to understand the effect of each Related Party Transaction on SEPLAT's financial statement.

6. DISCLOSURE REQUIREMENTS

- 6.1 Each Director and Key Personnel shall immediately notify the CFO of any interest that he/she or an Immediate Family Member has in a potential or ongoing business with SEPLAT.
- 6.2 Every Employee involved in a Related Party Transaction shall immediately notify the CFO and ensure that a written approval is given before the transaction begins or continues.
- 6.3 Where a Related Party Transaction is initiated or proposed by SEPLAT, the Head of the relevant function shall immediately notify the CFO.
- 6.4 In the contracting process, the contracting Manager must obtain approval of the Related Party Transaction before taking any action in respect of the transaction.
- 6.5 The Review Panel shall have the power to initiate an investigation into any proposed or ongoing Related Party Transaction.
- 6.6 Every notice given in line with this Section 6 shall be in the appropriate *Form of Notice of Related Party Transaction*. Every notice shall be sent with all relevant documentation.
- 6.7 After receiving a *Notice of Related Party Transaction* and all required documentation, the CFO shall within forty-eight (48) hours, or at the earliest possible time, convene a meeting of the Review Panel to consider the Related Party Transaction.

7. REVIEW PROCESS

- 7.1 All Related Party Transactions shall be reviewed and screened by the Review Panel in the first instance.
- 7.2 Related Party Transactions with an aggregate value up to US\$ 5,000,000 (Five Million United States Dollars) shall be reviewed and approved by the Review Panel. The Review Panel shall document all meetings and justification for its decision and make a report to FINCO at the next meeting of the Committee. FINCO shall submit the report of the Review Panel and its recommendations to the Board at the next Board meeting.
- 7.3 Related Party Transactions with an aggregate value exceeding US\$ 5,000,000 (Five Million United States Dollars) but up to US\$ 10,000,000 (Ten Million United States Dollars) shall be approved by FINCO. The Review Panel shall conduct a review in the first instance, and if the Review Panel approves the transaction, it shall refer the transaction to FINCO for approval, together with all documentation, a summary of its discussions, and recommendations on the transaction. FINCO shall review and make a decision on the Related Party Transaction. FINCO shall submit to the Board at the next Board meeting, a report of its decisions, together with a summary of its discussions, justification for its decisions. Where



Seplat Petroleum Development Company Plc

business exigencies require urgent consideration of a Related Party Transaction to be approved by FINCO, the Review Panel may request the Chairman of FINCO to convene a special meeting of FINCO to address the Related Party Transaction.

- 7.4 Related Party Transactions with an aggregate value exceeding US\$ 10,000,000 (Ten Million United States Dollars) shall be approved by the Board. The Review Panel shall conduct a review in the first instance, and if the Review Panel approves the transaction, it shall refer the transaction to FINCO for a review in the second instance. If FINCO approves the transaction, it shall refer the transaction to the Board at the next Board meeting, together with all documentation, a summary of its discussions, and recommendations on the transaction. The Board shall act as final authority on the approval of the transaction. Where business exigencies require urgent consideration of a Related Party Transaction to be approved by the Board, FINCO may request the Chairman of the Board to convene a special meeting of the Board to address the Related Party Transaction.
- 7.5 In determining whether to approve, deny, ratify, or amend a Related Party Transaction, the Review Panel, FINCO, or Board shall consider the following factors (as appropriate):
- (a) Description of the Related Party Transaction, particularly the terms, purpose and timing;
 - (b) Name of each Related Party and the nature of their relationship with SEPLAT;
 - (c) The extent of each Related Party's interest in the transaction;
 - (d) Whether the terms of the Related Party Transaction is the same or similar to the terms of an independent third party transaction conducted under the same or similar circumstances;
 - (e) Whether the transaction could potentially expose SEPLAT to violation of the Income Tax (Transfer Pricing) Regulations No. 1 of 2012, the IAS 24 (Related Party Disclosures) under the International Financial Reporting Standards, any statutory modifications or re-enactments thereof, and other applicable laws;
 - (f) If the transaction involves the sale of an asset, the full description of the asset, including date acquired and costs basis;
 - (g) Review of the Transfer Pricing Method used and alternative approaches to valuation of the transaction;
 - (h) Whether there was a bidding process and the results of such process, as well as the transparency of the process;
 - (i) The approximate value of the transaction and the approximate value of the Related Party's interest in the transaction;
 - (j) Information concerning potential counterparties in the transaction;
 - (k) Whether the transaction includes any potential risk to SEPLAT's reputation;
 - (l) Whether the transaction could potentially have an adverse impact on SEPLAT's share price and/or relationship with key institutional investors;
 - (m) Description of any provisions or limitations imposed as a result of entering into the transaction; and
 - (n) Any other relevant information regarding the transaction.
- 7.6 A Director or Key Personnel shall not participate in any discussion of a Related Party Transaction for which he/she or any of his/her Immediate Family Member is a Related Party, except when the Review Panel, FINCO, or Board invites such Director or Key Personnel to provide necessary information.

8. EXTENSIONS OF AND VARIATIONS TO APPROVED TRANSACTIONS

- 8.1 Any extension of or variation to an approved Related Party Transaction must be referred back to the Review Panel for consideration. Where the proposed extension or variation will increase the aggregate value of the transaction beyond the approval threshold of the Review Panel, the Review Panel shall, if appropriate, refer the transaction to FINCO or the Board for approval, as applicable.

9. DECISION

- 9.1 Attendance by all members of the Review Panel shall be required to constitute the quorum for any meeting, and decisions shall be by unanimous vote. Where members of the Review Panel fail to agree,



Seplat Petroleum Development Company Plc

the transaction shall be referred to FINCO for approval. The decision of FINCO and the Board shall be in line with their agreed voting procedures, otherwise will be by majority vote of unaffected members that are present during discussions.

- 9.2 Upon review of the details of a Related Party Transaction, the Review Panel, FINCO, or Board (as appropriate) may approve, deny, ratify or revise the terms of the Related Party Transaction. All Employees and Directors shall comply with the decision of the Review Panel, FINCO, or Board (as appropriate).
- 9.3 Any decision taken by the Review Panel or FINCO shall be reported to the Board at the next Board meeting.
- 9.4 FINCO shall have the power to override any decision of the Review Panel. The Board shall have the power to override any decision of FINCO, and any decision of the Board shall be final and binding on all Employees and Directors.
- 9.5 Any decision taken on a Related Party Transaction shall be properly recorded, together with a summary of discussions and all relevant documentation. A copy of the final decision on any Related Party Transaction shall be given to the CFO to notify the party seeking to approve the transaction and other relevant parties.

10. INTERESTED PERSON TRANSACTIONS

- 10.1 When considering any proposal for SEPLAT, its subsidiary or affiliate to deal with an Interested Person, the Company shall in good time notify and discuss such proposal with the Nigerian Stock Exchange (“NSE”) in order for the NSE to advise on whether such dealing will be classified as an Interested Party Transaction.
- 10.2 The Company shall immediately disclose, in its Accounts and to the NSE, any Interested Party Transaction of a value (or aggregate value for the same Interested Person within the same financial year) equal to or more than 5% of Seplat Group’s latest audited net tangible assets.
- 10.3 The Company shall obtain the approval of securities holders for any Interested Person Transaction of a value (or aggregate value for the same Interested Person within the same financial year) equal to or more than 5% of Seplat Group’s latest audited net tangible assets or 5% of SEPLAT’s issued share capital.
- 10.4 With respect to the sale or proposed sale of any unit of property projects of SEPLAT, its subsidiary or affiliates to an Interested Person,
 - (a) the Audit Committee and the Board shall first approve such sale or proposed sale, after satisfying itself that the terms of the sale or proposed sale are fair, reasonable and not prejudicial to the interests of SEPLAT and its minority shareholders. No Interested Person shall participate in any vote to approve the sale or proposed sale;
 - (b) the Company shall announce, with the details outlined in Section 2.2 of the NSE IPT Rules, the sale or proposed sale approved by the Audit Committee and the Board within two (2) weeks of such sale or proposed sale; and
 - (c) The Company shall, where required, obtain the approval of securities holders no later than six (6) weeks before the date of the sale or proposed sale.
- 10.5 The Company shall prepare and submit to the Securities and Exchange Commission (“SEC”) a circular containing the scheme of all Interested Party Transactions (“IPT Circular”), with the details outlined in Section 5.0 of the NSE IPT Rules. The Company shall subsequently issue the IPT Circular within 28 days after approval by SEC.



Seplat Petroleum Development Company Plc

10.6 The Audit Committee shall give an opinion on any Interested Party Transaction involving the issue, for cash, of any listed class of shares or securities, or the purchase or sale, for cash, of any real property for cash, for which an independent professional valuation report was obtained and such valuation was disclosed in the IPT Circular.

10.7 The Company may, via a circular to shareholders, obtain their general mandate for recurrent Interested Person Transactions of revenue or trading nature or that are necessary for SEPLAT's day-to-day operations (e.g., purchase and sale of supplies and materials). However, the general mandate shall not extend to Interested Person Transactions involving the purchase or sale of assets, undertakings or businesses. Each year, the Company shall obtain a renewal of the general mandate.

11. DOCUMENTATION AND RECORD RETENTION

11.1 The Head of the function conducting a Related Party Transaction shall be responsible for ensuring that the Related Party Transaction is reduced to contract, with the proper documentation of all key activities.

11.2 All documentation on a Related Party Transaction shall be retained for a minimum period of six (6) years from the date on which the tax return relevant to the last entry was filed.

12. CONFLICTS OF INTEREST VERSUS RELATED PARTY TRANSACTIONS

12.1 Employees and Directors should recognize the difference between conflicts of interest and Related Party Transactions; Conflicts of interest relate to the conflicting *private* interests of Employees and Directors, while Related Party Transactions relate to SEPLAT's exchange of resources with its Related Parties. Related Party Transactions are strictly regulated by law and violations attract severe penalties.

12.2 In line with good corporate governance, Employees and Directors should not report conflicts of interest as Related Party Transactions; Such reports must be disclosed in accordance with SEPLAT's Conflicts of Interest Policy for Employees and Directors.

12.3 If any Employee or Director is unsure whether to disclose a transaction or activity as a conflict of interest or a Related Party Transaction, he/she should contact the CFO for clarification.

13. EXCEPTIONS TO THIS POLICY

13.1 Any exception to this Policy must be approved in advance by the Board.

14. VIOLATION

14.1 SEPLAT shall enforce a zero-tolerance policy for any violation of this Policy, including and up to termination of employment or directorship.

14.2 Employees and Directors are required to comply with this Policy, to immediately disclose any ongoing and proposed Related Party Transaction, and to immediately report any violation of this Policy.

14.3 In the event SEPLAT becomes aware that a Related Party Transaction is being conducted in violation of this Policy, the matter shall be dealt with by the Board. The Board shall review the Related Party Transaction in line with Section 9.4 of this Policy, and shall decide whether to terminate, ratify, or revise the transaction. The Board shall also recommend sanctions as appropriate.

15. AMENDMENTS

15.1 This Policy may be amended from time to time by the Board.



Seplat Petroleum Development Company Plc

RELATED PARTY TRANSACTIONS GUIDELINES

These Guidelines serve as guidance for compliance with the law (particularly transfer pricing regulations) and SEPLAT's Related Party Transactions Policy. Management should use these Guidelines as a reference point for ensuring compliance.

1. INTRODUCTION AND PURPOSE

- 1.1 There are legal requirements that SEPLAT must comply with in relation to Related Party Transactions. Upholding its commitment to compliance with law, SEPLAT introduced a Related Party Transactions Policy ("Policy") setting the standard for dealing with all Related Party Transactions.
- 1.2 The purpose of these Guidelines is to: (a) explain how the Policy should be implemented in day-to-day operations; (b) explain how to apply the Arm's Length Principles to all Related Party Transactions, and (c) detail the requirements for disclosure, documentation and statutory filings of Related Party Transactions under the law.

2. AFFIRMATION OF THE RELATED PARTY TRANSACTIONS POLICY

- 2.1 These Guidelines should be read and applied together with the Policy. In the event of any conflict or ambiguity between these Guidelines and the Policy, the Policy will supersede to the extent of the conflict or ambiguity.
- 2.2 All defined terms in these Guidelines will be construed in accordance with the Policy, unless expressly defined within the body of these Guidelines.

3. ASSOCIATED POLICIES

- 3.1 These Guidelines should be read together with SEPLAT's: (i) Related Party Transactions Policy, (ii) Transfer Pricing Policy, and (iii) Conflicts of Interest Policy.

4. REGULATORY CITATIONS

- 4.1 In the context of Related Party Transactions, due consideration has been given to: (i) the Income Tax (Transfer Pricing) Regulations No. 1 of 2012 ("FIRS Regulations"), (ii) the IAS 24 (Related Party Disclosures) under the International Financial Reporting Standards ("IFRS"), and (iii) the Organization for Economic Cooperation and Development Transfer Pricing Guidelines ("OECD Guidelines").

5. GUIDING PRINCIPLES

- 5.1 Transfer pricing manipulation is a key concern behind regulations on Related Party Transactions. Transfer pricing manipulation is when Related Parties under-price or over-price the resources transferred between each other. Usually, the goal is to evade taxes and influence the financial position of the entity.
- 5.2 To guard against transfer pricing manipulation the law requires all entities to disclose and conduct every Related Party Transaction in accordance with Arm's Length Principles. This means that the price of the resource being transferred must be similar to the price of the same or similar resources transferred in the open market ("Arm's Length Price"). The law recognizes that a Related Party Transaction may have certain conditions that are available on the open market, and permits entities to make necessary adjustments for those conditions in order to accurately determine the Arm's Length Price.
- 5.3 Like any other entity, when SEPLAT is involved in Related Party Transactions, the law places a burden on SEPLAT to prove that it properly *disclosed* each transaction and *conducted* each transaction in accordance with Arm's Length Principles. SEPLAT will be deemed to have met this burden by providing sufficient documentation to show thorough analysis of comparable market conditions to determine the Arm's Length Price.

Seplat Petroleum Development Company Plc

5.4 The Transfer Pricing Methods are the globally accepted processes for determining the Arm's Length Price applicable to a Related Party Transaction. Each Transfer Pricing Methods conducts a comparative analysis between a Related Party Transaction and its identical or similar independent third party transaction.

6. HOW TO APPLY THE TRANSFER PRICING METHODS

6.1 The FIRS Regulations subscribe to the globally accepted Transfer Pricing Methods of: Comparable Uncontrolled Price, Resale Price, Cost Plus, Transactional Net Margin, and Transactional Profit Margin. The FIRS may from time to time prescribe additional methods to be used.

6.2 **Calculations under the Comparable Uncontrolled Price ("CUP") Method.** CUP compares the price charged for property, goods or services transferred under a Related Party Transaction with the price charged for same or similar property, goods or services transferred under a comparable independent third party transaction, under comparable circumstances. The price resulting from the comparison should be adjusted by any functional difference that could materially affect the price on an open market.

EXAMPLE:

(a) COMPANY A provides consultancy services to its affiliate, COMPANY B. What is the Arm's Length Price that COMPANY B should pay to COMPANY A for consultancy services?

Assuming COMPANY A also provides a similar scope of consultancy services to COMPANY X (an independent third party) for NGN1,000,000. Then, the Arm's Length Price to be paid by COMPANY B to COMPANY A should also be NGN1,000,000.

(b) To demonstrate when and how adjustments by any functional difference that could materially affect the price on an open market should be made, assume COMPANY A does not include any warranty in its consultancy services to its affiliate COMPANY B, but COMPANY A includes a six (6) month warranty package in its consultancy services to COMPANY X that is valued at NGN100,000. Under this scenario the Arm's Length Price should be adjusted in consideration of the different warranty conditions, by subtracting the value of the warranty from the value of the services, as follows:



- Cost of services to COMPANY X: NGN1,000,000
- Less: value of warranty to COMPANY X: NGN100,000
- Arm's Length Price to be paid by COMPANY B: NGN900,000

6.3 **Calculations under the Resale Price Method ("RPM").** RPM compares the price at which property/product is purchased from a Related Party with the price at which that property/product is resold ("Resale Price") to an independent third party. The Arm's Length Price is calculated by subtracting an appropriate gross margin on the Resale Price and other adjustments for costs associated with purchase of the property/product (e.g., custom duties) from the Resale Price. RPM is known to be useful for transfers between a distributor and its Related Party, where the distributor has not added substantial value to the property/product.

EXAMPLE:



Seplat Petroleum Development Company Plc

COMPANY A is an oil and gas E&P company. COMPANY A sells oil to COMPANY B (its affiliate) for distribution to the market. COMPANY A also sells oil to COMPANY X, an independent third party. What is the Arm's Length Price that COMPANY B should pay to COMPANY A for the oil?

Assume a market analysis shows that the gross profit margin of COMPANY X from the resale of oil to its customers is 10%, and COMPANY X spends money on marketing while COMPANY B does not. The Arm's Length Price will be computed as follows:

▪ COMPANY B's sale of oil to unrelated parties	\$5,000
▪ Less: Arm's length resale price margin based on COMPANY B's transactions (10% x 5,000)	\$500
▪ Less: Adjustment for marketing costs	\$100
▪ Arm's Length Price to be paid by COMPANY B:	\$4,400

6.4 **Calculations under the Cost Plus Method ("CPM").** CPM compares the mark-up on the direct and indirect costs incurred in a Related Party Transaction with the mark-up of the direct and indirect costs incurred in a comparable independent third party transaction.

EXAMPLE:

COMPANY A, an oil and gas E&P company engages COMPANY B, its affiliate, to provide a rig and drilling services. What is the Arm's Length Price that COMPANY A should pay to COMPANY B for the rig and drilling services?

An analysis of the financial statements of drilling contractors similar to COMPANY B shows an average earning of 20% on costs. Assuming COMPANY B's costs amount to \$100,000, the Arm's Length Price to be paid by COMPANY A should be \$120,000 (that is, NGN100,000 + [20% of NGN100,000]).

6.5 **Calculations under the Transactional Net Margin Method ("TNMM").** TNMM compares the net profit margin relative to an appropriate base (including costs, sales or assets) received from a Related Party Transaction with the net profit margin relative to an appropriate base received from a comparable independent third party transaction.

EXAMPLE:

COMPANY A is a manufacturer of office furniture, and sells all its furniture to COMPANY B, its affiliate. What is the Arm's Length Price that COMPANY B should pay to COMPANY A for office furniture?

Note: In this case, CUP cannot be used to determine the Arm's Length Price because there are no reliable adjustments to account for differences between COMPANY A's office furniture and similar office furniture in the market. It may therefore be more reliable to examine the net margins of comparable companies.

A market analysis identifies COMPANY X (an independent third party and a manufacturer of office furniture) as a suitable company for comparison with COMPANY A. COMPANY X realizes a net mark-up (i.e. operating margin) of 10%. The Arm's Length Price will be computed as follows:

▪ COMPANY A's cost of goods sold:	\$5,000
▪ COMPANY A's operating expenses:	<u>\$1,500</u>
▪ Total costs for COMPANY A:	\$6,500
▪ Add: COMPANY X's net mark-up (10% x 6,500):	\$650
▪ Arm's Length Price to be paid by COMPANY B:	\$7,150



Seplat Petroleum Development Company Plc

- 6.6 **Calculations under the Transactional Profit Split Method (“TPSM”).** TPSM compares the division of profit and loss realized from a Related Party Transaction with the division of profit and loss realized from a comparable independent third party transaction.

EXAMPLE:

COMPANY A manufactures gas plants and buys patented gas plant designs from its affiliate, COMPANY B. COMPANY A sells its production line to another affiliate, COMPANY C. What is the Arm’s Length Price that COMPANY A should pay to COMPANY B as royalty for the patented gas plant designs?

An analyses of companies comparable to COMPANY A, COMPANY B, and COMPANY C show that comparable companies realize 5%, 10%, and 20% profit margin on their operating assets, respectively. Assuming the operating assets of the affiliated companies are as follows: COMPANY A: \$200, COMPANY B: \$300, COMPANY C: \$500. The Arm’s Length Price will be computed as follows:

- Optimum profit of COMPANY A: \$10 (5% of \$200)
- Optimum profit of COMPANY B: \$30 (10% of \$300)
- Optimum profit of COMPANY C: \$100 (20% of \$500)
- Aggregate Profit of Affiliated Group:
Group: \$140 (\$10 + \$30 + \$100)
- Arm’s Length Price to be paid by COMPANY A: \$30 (\$140 - \$10 - \$100)

Note: The optimum profits attributed to the activities of COMPANY A and COMPANY C should be deducted from the Aggregate Profit of the affiliated group in order to isolate the value of intangibles held by COMPANY B (the patent owner).

7. CHOOSING THE MOST APPROPRIATE TRANSFER PRICING METHOD

- 7.1 The law allows SEPLAT to choose any Transfer Pricing Method to analyze a Related Party Transaction. However, SEPLAT must be able to provide sufficient documentation to show that the method applied was most appropriate to the circumstances of the Related Party Transaction. The FIRS may audit such documentation.
- 7.2 However, the traditional methods (CUP, RPM, and CPM) are regarded by the OECD Guidelines as more reliable than the transactional profit methods (TNMM and TPSM). The CUP Method is noted by the OECD Guidelines as the most direct and reliable way to determine the Arm’s Length Price. The OECD Guidelines particularly recommend the following methods for the following transactions:
- (a) Tangible property: CUP
 - (b) Services (particularly intra-group services): CUP or CPM
 - (c) Intangible property or sale of goods incorporating intangible property: CUP or RPM
 - (d) Marketing operations: RPM
- 7.2 The FIRS will consider the following factors when determining whether an entity has applied the most appropriate Transfer Pricing Method to each Related Party Transaction:
- (a) the respective strengths and weaknesses of the Transfer Pricing Method in the circumstances of the case;
 - (b) the nature of the Related Party Transaction under review, particularly the functions performed, assets employed and risks assumed by each party to the transaction;
 - (c) the availability of reliable information needed to apply the Transfer Pricing Method; and



Seplat Petroleum Development Company Plc

- (d) the degree of comparability between the Related Party Transaction and the same or similar independent third party transaction, and the extent to which reliable and accurate adjustments can be made to account for/eliminate any differences.

8. REQUIREMENTS FOR DISCLOSURE, STATUTORY FILING, AND DOCUMENTATION

Disclosure Requirements:

- 8.1 Before commencing, all Related Party Transactions must be disclosed and approved by the Review Panel, the FINCO or the Board (as appropriate) in accordance with the Policy.
- 8.2 It is important that all ongoing Related Party Transactions are disclosed because our financial and business records may be audited at any time by the FIRS to ensure compliance with the FIRS Regulations. Review of any ongoing Related Party Transaction should include opportunities to regularize defects or omissions in the transaction or processes.
- 8.3 SEPLAT should disclose Related Party Transactions within its Annual Report and in a Transfer Pricing Declaration Form (attached to the FIRS Regulations). The standard for sufficient disclosure of a Related Party Transaction is in enough detail to enable a third party to understand the effect of each Related Party Transaction on SEPLAT's financial statement ("Sufficient Disclosure").
- 8.4 SEPLAT's Annual Report should also include a statement of the Board on Related Party Transactions, particularly the nature of each transaction, the nature of each related party relationship, and other information that the Board (exercising its best judgment) believes is necessary for Sufficient Disclosure.
- 8.5 Disclosures should be made separately for each Related Party. However, Related Party Transactions of a similar nature can be disclosed in aggregate, except where separate disclosure is necessary for Sufficient Disclosure.
- 8.6 Disclosure of Compensation to Key Personnel. In addition to disclosures required by the FIRS Regulations, the IFRS requires companies to disclose the total compensation given to Key Personnel in the form of:
- Short-term employee benefits;
 - Post-employment benefits;
 - Other long-term benefits;
 - Termination benefits; and
 - Share-based payment.
- 8.7 Limited Disclosure of Transactions with Government as Related Party. The IFRS requires limited disclosure of a Related Party Transaction with a government body that has control, joint control or significant influence over SEPLAT (for example, joint venture partners), and limited disclosure of a Related Party Transaction with another entity that is also subject to control, joint control or significant influence by joint venture partner. In relation to the foregoing transactions, SEPLAT is required to disclose:
- Joint venture partner's name and the nature of joint venture partner's relationship with SEPLAT;
 - the name of the related entity that is subject to joint venture partner's control, joint control or significant influence; and
 - the nature and amount of each individually significant transaction, in enough detail necessary for Sufficient Disclosure.
- 8.8 Disclosures Exempted under the FIRS Regulations. SEPLAT may be exempted from the documentation and disclosure requirements of the FIRS Regulations if:
- the Related Party Transaction is priced in accordance with Nigerian statutory provisions; or



Seplat Petroleum Development Company Plc

- b. the price involved in the Related Party Transaction has been approved by other Government regulatory agencies established under Nigerian law (such as: National Office for Technology Acquisition and Promotion; Department of Petroleum Resources; Nigerian National Petroleum Corporation, etc). However, in this instance the FIRS must be satisfied that the approved price is in line with Arm's Length Principles.

Statutory Filing:

- 8.9 Every year, SEPLAT should complete and file, together with its tax return, a Transfer Pricing Declaration Form, disclosing all Related Party Transactions for that year and affirming whether or not transfer pricing documentation exists.

Documentation:

- 8.10 The activities of each approved or ratified Related Party Transaction should be properly documented in English. Examples of documentation that the FIRS may audit in relation to Related Party Transactions include: ledgers, cashbooks, journals, cheque books, bank statements, deposit slips, paid cheques, invoices, stock list, and other books of account and data. If audited by the FIRS, SEPLAT must present all requested and relevant transfer pricing documentation within twenty-one (21) days of receiving a request.
- 8.11 Documentation on Related Party Transactions should include a sound transfer pricing analysis to show efforts made to determine the Arm's Length Price for each transaction.
- 8.12 All documentation on Related Party Transactions must be in place before the due date for filing SEPLAT's income tax return for the year the documented transactions occurred. The documentation should be sufficient enough for the FIRS to verify that each Related Party Transaction is consistent with Arm's Length Principles.
- 8.13 Recommendation of Independent Audit. It is best practice for SEPLAT to engage an independent, competent and qualified auditor to periodically audit SEPLAT's business and financial records to ensure compliance with Related Party disclosure requirements under applicable law.

9. ADVANCE PRICING OF AGREEMENT AS AN ALTERNATIVE TO UTILIZING TRANSFER PRICING METHODS

- 9.1 SEPLAT may request the FIRS to enter into an Advance Pricing Agreement that sets the criteria for SEPLAT's compliance with Arm's Length Principles for specified Related Party Transactions over a fixed period of time ("APA").

10. PENALTY FOR VIOLATION

- 10.1 If the FIRS determines that a company or person has violated the FIRS Regulations, the FIRS will make necessary adjustments to the tax liability of the company or person, for each accounting year.
- 10.2 Failure to disclose and conduct Related Party Transactions in line with Arm's Length Principles may also result in loss of investor confidence in the company, damage to the company's reputation, and criminal prosecution of some Key Personnel for fraudulent misrepresentation of the company's financial statements.

11. AMENDMENTS

- 11.1 These Guidelines may be amended by the Board of Directors from time to time.