

CBN's directive on destination payment for all Form M, Letter of credit and other forms of payment

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KPMG Nigeria

The Central Bank of Nigeria (CBN) issued a Circular Ref. No. **TED/FEM/FPC/GEN/ 01/005 of 24 August 2020** to the effect that authorised dealers are no longer permitted to open Form M in favour of procurement companies. CBN further stated that, going forward, Form M for letters of credit, Bills for collection and any other form of payment can only be opened for ultimate suppliers of goods or services. The aim of the new directive is to curb incidences of price manipulation, transfer pricing, over-invoicing, cost duplication and double handling charges.

We have highlighted below some of the key benefits of procurement agency arrangements which should inform the need for stakeholder engagement and design of a mechanism to prevent its abuse:

Benefits of using procurement agents

- a. Coordination** – Most local companies purchase several inputs, including raw materials, equipment and spare parts, from different ultimate suppliers spread across multiple jurisdictions. The procurement companies add value to the local companies by assisting them to coordinate and procure these items and thereby relieve them of the challenges of dealing with multiple vendors, logistics and handling, storage and distribution of such materials across geographies. Nigerian companies would likely incur significantly higher costs if they were to handle such matters on standalone basis.
- b. Discounts** – Leveraging their economies of scale, procurement companies are in a pole position to negotiate and obtain volume discounts that each operating company may not be able to do as a sole buyer.
- c. Financing** – Procurement companies also bridge the gap by financing purchases from the ultimate suppliers, especially in periods of foreign exchange crunch in Nigeria. It is also often the case that better financing terms can be obtained by such companies leveraging the group balance sheet to obtain credit from much cheaper sources than might ordinarily be available to a pure play Nigerian company.

- d. Contracting** – Most ultimate suppliers, such as original equipment manufacturers, typically do not sell directly to individual buyers. Rather, they prefer to contract with accredited agents or entities in jurisdictions with highly efficient and effective judicial systems.

Commentaries

There is value in related parties of multinational companies leveraging their global procurement infrastructure and arrangements to fulfil their import requirements. An outright ban on such arrangements will potentially increase procurement cost for local companies which could increase the cost of goods to final consumers in Nigeria. For instance, the absence of procurement companies that guarantee uninterrupted supply of inputs to manufacturing companies in the country may lead to disruption of the production process. Also, the discounts normally granted on bulk purchases under global ordering arrangement may no longer be available to local companies ordering on their own account.

Admittedly, procurement agency arrangements may be open to abuse by the inherent nature of their situation outside of Nigerian fiscal regulatory environment and the associated opacity of their operations and value add. However, we believe that this should be a basis for introducing better visibility and transparency into such arrangements on a case-by case basis (since the models vary significantly across industries, sectors and players). The various types of procurement agencies can be differentiated, and explanations proffered to justify the margins retained by such agencies vis-à-vis value added

to the Nigerian recipient of the goods and services.

We would encourage further engagement between the CBN and the stakeholders to agree on modifications that could be made to the Form M protocols that would address the legitimate fiscal regulators' concerns, whilst harnessing positive benefits of utilising such procurement agencies to source the much-needed inputs for manufacturing in Nigeria, or for achieving cost efficiencies. For instance, the Income Tax (Transfer

Pricing) Regulations, 2018 requires the beneficiaries of procurement company services to provide the ultimate supplier's receipts and invoices for items purchased through them. This is to enable the Federal Inland Revenue Service to verify the reasonableness of the transfer price to Nigerian companies.

It is hoped that stakeholder engagement with the CBN will result in a win-win arrangement both for the country and the affected businesses.

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