CHAPTER XII: MINISTRY OF PETROLEUM AND NATURAL GAS

Bharat Petroleum Corporation Limited, Hindustan Petroleum Corporation Limited, Indian Oil Corporation Limited

12.1 Revenue Foregone

Inability to utilise pipeline as planned resulted in loss of opportunity to earn revenue of ₹ 5.17 crore besides avoidable expenditure of ₹ 15.99 crore.

Aviation Fuel Station (AFS) of all three Oil marketing companies viz. Indian Oil Corporation Limited (IOCL), Bharat Petroleum Corporation Limited (BPCL) and Hindustan Petroleum Corporation Limited (HPCL) at Chennai receive Aviation Turbine Fuel (ATF) from Chennai Petroleum Corporation Limited (Refinery), a subsidiary of IOCL. Indian Oil Corporation Limited (Company) commissioned (21 December 2008) dedicated ATF pipeline between the Refinery and AFS Chennai at a cost of ₹ 47.52 crore with a capacity of 0.18 million metric tonne per annum on single shift operation basis to avoid transport by tank trucks (TT).

The project was approved (November 2005) by the Chairman and Managing Director, after taking into consideration, *inter alia,* the proposal by the Executive Director (Finance), that the projected Internal Rate of Return (IRR) of *6.77 per cent,* which was below the benchmark IRR 11 of *per cent,* would be improved by sharing the pipeline and collecting charges from other Oil Marketing Companies (OMC) on commissioning. Further, OMCs had executed in March 2002 an agreement for sharing of logistics.

HPCL used the pipeline on two occasions (May-August 2009 and February 2010) for transporting 5,527 MT of ATF. The arrangement came to an end as the Company's demand of ₹ 612 per MT was not agreed to by HPCL because it was incurring ₹ 183 per MT for transportation through TTs.

Audit observed the following:

- During the period between December 2008 and September 2010, the other two OMCs had transported a total of 282,466 MT of ATF from the Refinery to AFS, Chennai through TT by incurring ₹ 25.16 crore (transportation cost of ₹ 5.17 crore and quality checking, handling and other expenses for transporting through TTs of ₹ 19.99 crore).
- IOCL did not make any efforts to market its pipeline to other OMCs.
- The matter of non- finalisation of transportation charges was not escalated to the higher levels even after having a master facility sharing agreement between the three OMCs.

This resulted in estimated extra expenditure of ₹ 15.99 crore by HPCL and BPCL towards quality checking, handling and other expenses, which could be avoided by

transportation through pipelines besides transportation charges ₹ 5.17 crore through truck transfers.

The Management of HPCL and BPCL did not reply while the Management of IOCL contended (September 2010) that they never envisaged that this facility would be extended to other OMCs as it was intended to create a strategic advantage. Further, assistance to OMCs would be subject to certainty of protecting their business interest, surplus capacity being available and mutually acceptable commercial terms.

The Company's present statement contradicted the justification provided in the IRR, where it was clearly stated that the pipeline IRR would be improved by carrying the fuel of other OMCs. Besides, sharing infrastructure, which was envisaged in the Product Sharing Agreement dated 31 March 2002 would be beneficial to the Government, the major stakeholder of all the OMCs.

As regards the strategic advantage claimed by IOCL, it did not sound logical or justifiable as IOCL only supplies ATF to HPCL and BPCL in any case from the Refinery at Chennai and denying more efficient transportation alone would not serve the stated purpose. Moreover, the benefits that would accrue to the society from reduced hazardous traffic in highly crowded city roads and the reduction in carbon footprints by not using motor transport were also to be considered.

Thus, expenditure of ₹ 15.99 crore incurred by the other two OMCs on quality control and transportation charges of ₹ 5.17 crore besides underutilisation of pipeline could have been avoided by use of pipeline for transportation of ATF from Refinery to AFS, Chennai. Further, IOCL lost revenue on pipeline usage which would have been between ₹ 5.17 crore and ₹ 17.29 crore♣ based on the rates to be decided by OMCs.

The matter was reported to Ministry in December 2010; reply was awaited (February 2011).

GAIL (India) Limited

12.2 Undue benefit extended to power producers

GAIL (India) Limited supplied natural gas at APM rates, in violation of the Ministry's directive, to ineligible consumers generating and supplying electricity to their customers at commercial rates through the grid of Tamil Nadu Electricity Board. This led to under recovery of ₹ 227.37 crore, undue benefit to such producers to that extent and extra burden of subsidy on the Government.

GAIL (India) Limited (Company) was supplying Natural Gas to its consumers under administered price mechanism (APM) at prices determined by the Government of India (GOI). To dismantle APM in a phased manner over the next three to five years, the Ministry of Petroleum and Natural Gas (Ministry) restricted use of APM gas only for fertiliser and for power generating companies supplying electricity to the grid for distribution to consumers through public utilities/licensed distribution companies (June 2005). Consequently, in June 2006, the Ministry revised the rates for APM gas supplied

♣ ***Estimated at ₹ 5.17 crore as per cost of truck transfers of 282465 MT by HPCL and BPCL at the rate of ₹ 183 per MT incurred by HPCL and ₹ 17.29 at the rate of ₹ 612 per MT demanded by IOCL.***

to certain category of consumers other than power and fertilizer sector consumers from ₹ 3200/MSCM[1] to ₹ 3840/MSCM and from ₹ 1920/MSCM to ₹ 2304/MSCM for North-east consumers.

The Company while implementing the GOI directives segregated its gas consumers in Cauvery Basin under four categories viz.

- Category A- State Electricity Boards and Government Companies generating power for supply to Grid for distribution to consumers;
- Category B- Private Companies generating power and selling to State Boards as Independent Power Producers (IPP);
- Category C- Consumers generating electricity for captive consumption without supplying to GRID; and
- Category D- Consumers generating electricity and supplying to various consumers using wheeling arrangement[2] with State Electricity Boards.

The Company charged its customers under Category A and B at the rate of ₹ 3200/- per MSCM and also Category D consumers at the rate of ₹ 3200/- per MSCM on provisional basis. The Company sought (July 2006) clarification from the Ministry whether Category D consumers were entitled for APM price. The Ministry's clarification was stated to be still awaited (August 2010).

Audit observed (July 2009) that even though there was no ambiguity in the Ministry's directives regarding applicability of APM gas price to consumers generating power for supply to the grid for distribution through public utilities/licensed distribution companies only (and not to the Category D consumers supplying power at commercially agreed rates), the Company, in violation of the Ministry's directives, extended the benefit of APM gas price rate to such Category D consumers. This resulted in under-realisation of ₹ 227.37 crore from seven consumers during the period from April 2006 to March 2010 in the Gas Pool Account. The undue benefit of ₹ 227.37 crore passed on to these consumers was bound to increase further till receipt of clarification from the Ministry.

The Management in its reply (May 2010/November 2010) stated that Natural Gas consumers under Category D were supplying power to stake holders/industrial consumers through the transmission network/grid of Tamil Nadu Electricity Board (TNEB) by giving about *15 per cent* of the electricity as wheeling charges to TNEB and that as the Ministry's directive did not mention about different rate to be charged to those consumers who were selling power to private parties through wheeling arrangement, GAIL had been charging APM gas price.

The reply of the Management is not tenable as the consumers falling under Category D were utilising the TNEB services for wheeling and the electricity generated from the gas utilised by consumers under Category D was being supplied to end users at commercial rates. Hence, being custodian of Gas Pool Account, it was the responsibility of Company to charge the correct rate instead of extending benefit to private parties on assumption basis under the shelter of referring the case to the Ministry for clarification and leaving

[1] ***Metric Standard Cubic Meter***
[2] ***The act of providing the service of transporting power over transmission lines***

the matter unresolved for an indefinite period. Further, such supplies at APM rates to non-eligible consumers enhanced the subsidy burden on the GOI.

Thus, supply of gas under the APM rates to non-eligible consumers in violation of the Ministry's order resulted in loss of revenue to the tune of ₹ 227.37 crore in the Gas Pool Account during April 2006 to March 2010.

The matter was reported to Ministry in September 2010; reply was awaited (February 2011).

Indian Oil Corporation Limited

12.3 Duty Drawback claims

Introduction

Section 75 of the Customs Act,1962 (Act) allows refund, known as drawback, of element of excise duty paid on indigenous inputs or customs duty paid on imported inputs included in the export of output. The Customs and Central Excise Duties Drawback Rules, 1995, (Rules) framed (May 1995) under the Act, define "export" to, inter alia, include "loading of provisions or store or equipment for use on board a vessel or aircraft proceeding to a foreign port". It prescribes certain procedures for claiming duty drawback on the exports. Rule 6 of the Rules, ibid, provides for fixation of brand rates (rate at which drawback is to be claimed), where 'all industry rates' (drawback rates notified for standard products) are not available for any category of goods exported. The exporter has to make an application, together with all supporting documents[1] for fixation of brand rate, to the relevant Customs and Central Excise Authorities, having jurisdiction over the manufacturer from where the goods are taken for export. Further, he has to register with the Customs authorities (Customs) at the Ports from where exports take place to enable claiming of drawback.

The Oil Marketing Companies (OMC) import crude to meet the domestic demand. While exporting the surplus products depending upon market conditions, OMCs also supply Aviation Turbine Fuel (ATF) to foreign bound aircrafts on regular basis out of bonded stock[2] which is deemed to be exports as per the Rules. Thus, OMCs are eligible to claim drawback for the customs duty suffered on the imported crude element included in the ATF/petroleum products exported, as well as such deemed exports.

Until the year ended 31 March 2002, the marketing and pricing of petroleum products were governed by Administered Pricing Mechanism (APM), under which, Government of India (GOI) controlled the prices of the products marketed by OMCs with assured marketing margins. During the APM Regime, the Indian Oil Corporation Limited (Company) acted as the canalising[3] agent to import crude/export petroleum products on behalf of all OMCs up to March 2001.

---

[1] ***Disclaimer certificate, production statement, process flowchart, worksheet for proposed brand rate, value addition statement, statement of imports and duty suffered thereon, proof of export etc.***

[2] ***Stock moved from refinery/terminal to Aviation Fuelling Stations without payment of excise duty.***

[3] ***A terminology used to indicate authorized service provider for execution and documentation of imports/exports.***

It did not, however, evolve systems and procedures to claim eligible drawback for the products including ATF exported during APM Regime. Consequently, the Company could not claim the drawback for its eligible exports. When the APM regime was dismantled the authority for the import/export vested with respective OMCs from April 2001 onwards.

Ministry stated (February 2011) that availing of duty drawback on ATF exported to foreign going vessels was never contemplated because of complexity of operations for distribution and impossibility of complying with legal requirements. Efforts were made by IOCL in consultation with PPAC[1] to simplify the procedures for claiming drawback.

The Customs and Central Excise Duties Drawback Rules which provide for claiming drawback on supplies to foreign going vessels came into effect as early as May 1995 and the time taken (more than eight years) to initiate procedures to claim the benefits under the Rules could have been reduced.

For the first time, the Company appointed (October 2003) M/s. Shangrila Pvt. Ltd., Mumbai (consultant) to assist it in getting the brand rate fixed and claiming the drawback for the ATF exported out of supplies taken from the refineries at Chennai and Haldia. The scope of the consultant was limited, on trial basis, to the claiming of drawback for the exports made from its Aviation Fuel Stations (AFS) located at Chennai and Bengaluru in Southern Region (SR) and Kolkata in Eastern Region (ER). The contract, valid for a period of one year, was extended from time to time to include exports made in SR up to March 2008 and provided for payment of service charges at 6.50 *per cent* of the amount actually received.

Consequently, the Company lodged its first claim in May 2005 in AFS, Chennai covering exports made from January 2004 and received drawback in January 2006. After gaining claim experience, scope of the consultant was extended (May 2007) for the ATF exported by AFS, Begumpet, Hyderabad which was taking supplies from refinery at Chennai. Similar efforts were not, however, made for other four out of five[2] AFS in SR which also exported ATF by taking supplies from refinery at Chennai.

The table below indicates the details of drawback amount claimed and received by the Company in the four Regions up to March 2008

(₹ in crore)

Region	Claim Lodged/ (Received)	Claims for exports covered during	Remarks
Southern Region	74.70/(70.94)	Jan 2004-Mar 2008	Claim of ₹ 7.24 crore for further exports in April-May 2008 is still in process.
Eastern Region	3.36/(0.02)	Jan 2004-Jan 2007	Switched over to the Advance Authorization Scheme (AAS) after January 2007.
Northern Region	0.69/(0.02)	Nov 2005- Nov 2006	Stopped claims on the basis of a legal opinion due to product comingling[3] issues.
Western Region	Not claimed for reasons not on record.		

[1] ***Petroleum Planning and Analysis cell***

[2] ***Trichy, Coimbatore, Calicut, Nedumbassery and Thiruvananthapuram.***

[3] ***Combining imported and indigenous crude in such a way deterring identification of imported component included in the exported output.***

Scope of Audit

In view of its success in claiming drawback for the ATF exported in SR, this thematic study aims at reviewing the systems and procedures evolved for ensuring drawback claims on all eligible ATF exports made out of bonded stock by all AFS locations irrespective of the source of supply. The scope for assessing consultant's performance is limited to the amount of claims made against the actual exports in the locations assigned, as no correspondence was made available between the Company and the consultant for assessing the qualitative aspects.

Audit objectives

The main audit objective is to examine whether

- There existed proper system for claiming duty drawback for all eligible ATF exports and
- Company had a system to prefer the drawback claims for other locations by virtue of the experience gained.

Audit criteria

The theme audit was based mainly on the following criteria:

- Provisions contained and prescribed in the Duty Drawback Rules, 1995;
- Terms and conditions of the work order issued to the consultant; and
- The claims data as furnished by the consultant and system extracted data on exports.

Audit Methodology

Audit followed the following methodologies -

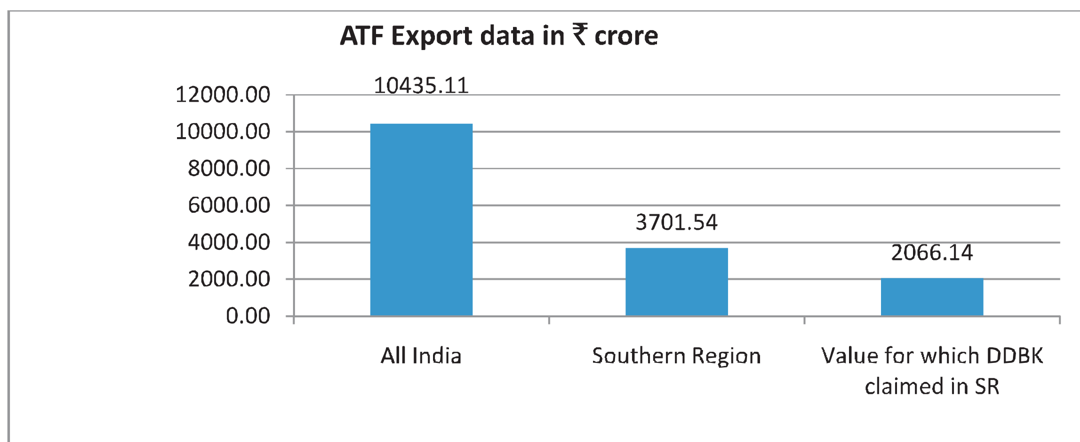
- Review of compliance of the provisions under the Duty Drawback Rules; 1995
- Comparison of the Consultant's performance with the scope of work;
- Review of reports on shipping bill-wise claims submitted by the Consultant; and
- Review of export data, circular instructions, Board Minutes and Agenda Notes.

Audit Findings

The audit observations are discussed in detail in the succeeding paragraphs:

12.3.1 Failure to claim eligible refunds

The chart given below summarises the value of ATF exported by the Company in the country and in SR between January 2004 and March 2008 and the value of ATF exports for which drawback was claimed in SR:



Source: Quantitative data - SAP reports; Value - Petroleum Planning and Analysis Cell, MOPNG, GOI.

It may be seen that though the Company exported ATF to the extent of ₹ 10435.11 crore in the country, it claimed drawback only for a partial value of ₹ 2066.14 crore against ₹ 3701.54 crore of ATF exported in SR. Out of ₹ 6733.57 crore exported in other regions, only ₹ 4.05 crore was claimed in ER and NR.

Ministry attributed (February 2011) it to the general constraints faced by oil industry all over India and such constraints including comingling and operational complexities, as the reasons for non/short-claiming of duty drawback. The reply further stated that, 72 *per cent* of the total exports were inadmissible due to legal complexities and only seven *per cent* could not be claimed.

As a coordinating and regulating agency, the Ministry could have taken the initiative and resolved the general constraints and addressed the legal complexities to facilitate timely claim of eligible drawback. Further, even after the appointment of consultant the drawback unclaimed worked out to 24.5 *per cent*[1] of the admissible claim.

The audit observations made on analysis of the SR data are discussed below in detail:

12.3.1.1 Incomplete claims

The export data on the ATF exported in SR between 2004-05 and 2007-08 revealed a total export of 1461 TMT[2] (value ₹ 3701.54 crore). Whereas the Duty Drawback of only ₹ 74.70 crore was claimed for a quantity of 759 TMT (value ₹ 2066.14 crore), leaving a balance of 702 TMT (value ₹ 1635.40 crore[3]) unclaimed. In two AFS locations, where the drawback claims were made, the drawback amount not so claimed worked out to ₹ 16.13[4] crore for a quantity of 165 TMT (Chennai 122 TMT and Bengaluru 43 TMT).

Ministry stated (February 2011) that formulating the claim procedure took time because of the operational complexities and procedural requirements. The reply further stated that

[1] ***382707/1562122 = 24.50 percent***

[2] ***Thousand Metric Tonnes.***

[3] ***The value is lower than that claimed due to period difference.***

[4] ***Chennai AFS ₹11.91 crore and Bangalore AFS ₹4.22 crore reckoned at their respective brand rates.***

certain clarifications sought from CBEC[1] and RBI were awaited for taking necessary action as per legal provisions irrespective of the commercial benefits.

The fact remained that the Rules came in to existence from May 1995 but systems and procedures were not formulated up to 2003-04. Further, the drawback amount not so claimed included ₹ 1.37crore (Chennai ₹ 0.15 crore and Bengaluru ₹ 1.22 core) on 13.70 TMT (Chennai 1.57 TMT and Bengaluru 12.13 TMT) of ATF exported later during January 2006 to March 2008. As a facilitating agency, Ministry should have taken prompt action to obtain clarification from the authorities concerned and with the efflux of time the possibility of getting drawback is remote.

12.3.1.2 ATF exported from other locations

The AFS situated at Calicut, Trivandrum, Trichy and Coimbatore also received bonded stock of ATF from the refinery at Chennai and exported 7.20 TMT during the four year period ended 31 March 2008. Though eligible, the Company did not claim drawback for the reasons not on record. Since the scope of the consultant's work was specific to cover collection of documents from the exporting locations that were sourcing ATF from the refinery at Chennai, the Company should have taken preliminary steps to extend his scope in getting the brand rates approved, preparing the export documents etc. The failure had resulted in foregoing drawback claim of ₹ 65.55 lakh in the said locations.

Ministry stated (February 2011) that normally ATF for Calicut, Trichy and Coimbatore was sourced from the refineries situated at Kochi and Mangalore owned by other OMCs and that due to supply constraints, these AFS received product from refinery at Chennai, which could not be envisaged at the time of placing work order to the Consultant.

However, AFS at Trichy and Coimbatore started receiving the bonded stock of ATF continuously from the refinery at Chennai from November 2007 and March 2008 respectively and no arrangements were made for claiming drawback on exports.

12.3.1.3 ATF sourced from other refineries

As per the Rules, the exporter alone is eligible to claim drawback. With the opening up of economy, all the refineries in Public Sector are owned by the OMCs either individually or jointly. The Product Sharing Agreement, executed (March 2002) among OMCs for sourcing different petroleum products from refineries for marketing across the country, did not provide for sharing relevant documents and information to facilitate drawback claim in the event of export of products sourced from the refinery of another OMC.

Owing to non-availability of disclaimer certificate (a document required to get brand rate fixed) from the manufacturer, the Company could not claim drawback on a quantity of 343 TMT of ATF sourced from the refinery at Kochi owned by Bharat Petroleum Corporation Limited and exported between January 2004 and March 2008 from its AFS at Calicut (115 TMT), Nedumbassery (130 TMT) and Trivandrum (98 TMT). The drawback not so claimed worked out to ₹ 33.60 crore[2] (Calicut ₹ 11.32 crore, Nedumbassery ₹ 12.68 crore and Trivandrum ₹ 9.60 crore) adopting the brand rates of refinery at Chennai for the relevant period.

---

[1] ***Central Board of Excise and Custom***

[2] ***Reckoned at the relevant brand rates of Chennai Refinery in the absence of brand rate of Kochi Refinery***

Ministry stated (February 2011) that there was reluctance on the part of other OMC refineries to go for duty drawback rates and hence the drawback for supplies taken from them could not be claimed. The reply added that as the industry sub committee viewed (April 2000) that PSU oil companies would not be eligible for duty drawback on supply of ATF to foreign going aircrafts, the same ATF price had been fixed for domestic/foreign going aircrafts.

It is pertinent to note that the same committee recommended that the matter of duty drawback on ATF supplies to international airlines should be taken up by the MOPNG with the Ministry of Finance to enable claiming of duty drawback, which had not been implemented (February 2011). Irrespective of the price of ATF, the Rules provide for claiming of drawback by OMCs on supplies to international airlines which would have only increased their margin. Further, there was also no evidence of this matter having been taken up with other OMCs or proactive action by the Ministry for resolving the issue of claiming drawback on supplies sourced from refineries of other OMCs.

12.3.1.4 Revenue loss due to delays in decision making

AFS at Begumpet, Hyderabad started (February 2006) taking bonded supply from refinery at Chennai for its exports. The preliminary steps involved in drawback claim for the exports were, however, taken only in May 2006. In the previous three month period, a quantity of 5.166 TMT of ATF involving unclaimed drawback amount of ₹ 44.93 lakh[1] was exported by the said AFS. In view of their restricted working hours at Begumpet, Customs demanded (18 August 2006) payment of mandatory overtime charges (MOT) of ₹ 23895 per week for extended period of working hours required in execution of documents.

A decision for making such payment was taken belatedly in March 2007. On receipt (April 2007) of approval, AFS Begumpet released the first weekly payment on 5 May 2007 and commenced the export of ATF under the drawback shipping bill from the next day. During the intervening period between 18 August 2006 and 5 May 2007, the Begumpet AFS exported 15.814 TMT of ATF, of which, the quantity eligible for drawback worked out to 15.339 TMT after giving allowance for ineligible unscheduled flights[2]. Considering monthly average drawback of ₹ 15 lakh not claimed in the previous quarter, if a cost benefit analysis was done to decide on MOT within two weeks, the Company could have recovered a net drawback amount of ₹ 1.34[3] crore.

While accepting the delay in commencement of drawback claims in Begumpet, Ministry stated (February 2011) that the initial problems were resolved and claims commenced. The fact remained that there was a delay of nine months leading to loss of revenue.

12.3.2 Deficient Systems and procedures.

While appointing (October 2003) the consultant, the Company neither specified any time limit in their scope of work nor put in place any control mechanism to monitor the timely processing of claims. Moreover, the responsibility for preparation of primary documents (like drawback shipping bills, Aviation Delivery Receipt etc.,) required to organize the drawback claim was retained by the Company and the officials managing the AFS

---

[1] ***Reckoned at the relevant brand rate of Chennai refinery***

[2] ***Special Chartered flights***

[3] ***On 15339.25 MT reckoned at the then brand rates of Chennai Refinery after reducing the MOT charges.***

locations did not have expertise in taxation matters. The detailed instructions explaining documentation procedure to be followed for making drawback claims were issued only in August 2007. Audit observed that these led to a situation where:

- delays ranging between 14 and 20 months from the date of first export occurred in claiming the refunds in three[♣] locations sourcing their ATF from the refinery at Chennai;
- claims amounting to ₹ 2.66 crore (involving 29.461 TMT in 1418 cases) were disallowed by Customs in Chennai for reasons like inadequacy/discrepancy in the documentation;
- there was an under recovery of ₹ 1.15 crore (Chennai ₹ 60.64 lakh and Bangalore ₹ 54.24 lakh) due to filing the claims either for an aggregate quantity lower than that was allowed in brand rate orders or by adopting incorrect brand rates; and
- In the said three AFS locations, there were delays in getting the refunds beyond the prescribed period of one month varying up to 1210 days.
- No MIS was available on the claim process i.e. date of deemed export, date of claim, date of receipt in respect of each export location in the Company. Only the status report as reported by the consultant on the position of submission/receipt in respect of documents collected by him was available.

Ministry stated (February 2011) that there were discrepancies in the claims preferred as the activity was handled for the first time and that the claims were cleared after furnishing of documents.

The reply is not acceptable as the issues could have been avoided through proper training of personnel at the locations. Further, the rejected claims of ₹ 2.66 crore pertained supplies for non-scheduled flights or quantity in excess of that approved by Customs, the possibility of refund is remote.

Conclusion

- The Company did not claim the drawback for the exports made between May 1995 and March 2002 as there was no system of incentive during APM Regime;
- Audit appreciate the efforts taken by the Company to claim drawback when the other OMCs were not claiming the same; and
- The attempt made by the Company to claim drawback was partial in terms of exporting locations/sources of products.

12.4 Early payment of Running Account bills before due date - Loss of interest

Indian Oil Corporation Limited, by releasing 'On Account' payments earlier than the due date to the contractors of lumpsum turnkey contracts, incurred loss of ₹ 5.37 crore.

[♣] *AFS at Chennai, Bangalore and Hyderabad*

Indian Oil Corporation Limited (Company) is executing a Residue Upgradation Project (RUP) for production of Euro III/IV compliant Motor Sprit (MS) and High Speed Diesel (HSD) at Gujarat Refinery. The Board of Directors of the Company approved (January 2007) the project at an estimated cost of ₹ 5,693 crore with scheduled date of commissioning in January 2010. A number of Lumpsum Turnkey (LSTK) contracts were awarded under this project. The General Conditions of Contract (GCC) for the LSTK contracts included a provision for 'On Account' payment against Running Account bills. The GCC also included a provision for interest payable by the Company on delayed payment of Running Account bills and notional interest on early payment of Running Account bills to be adjusted against interest on delayed payment not exceeding the delayed payment interest. Under Clause 6.4.8.3[♠] of the GCC, the due date of payment for the purpose of interest on delayed payments and notional interest on early payments was reckoned as 56 days from the receipt of Running Account bills by the Engineer-in-Charge.

A test check of 217 of the 274 payments made to major vendors related to the period from January 2008 to March 2010 revealed that the Company had been making 'On Account' payments before the due date as prescribed in Clause 6.4.8.3 of the GCC *i.e.* before expiry of 56 days from the receipt of Running Account bills by the Engineer-in-Charge without availing of the full period available with the Company for making 'On Account' payments as per the conditions of the contract. Of the 217 cases test checked by Audit, early payment of Running Account bills for a total amount of ₹ 789.80 crore in 182 cases with loss of interest amounting to ₹ 5.93 crore and delayed payment for a total amount of ₹ 104.03 crore in 31 cases involving an interest cost of ₹ 0.56 crore were noticed. This resulted in a net interest loss of ₹ 5.37 crore to the Company on account of making payments earlier than the due date.

The Management stated (August 2010) that Clause No. 6.4.8.3 of GCC was not the clause for releasing the payment within stipulated time and the provision of clause 6.4.8.3 could not be construed to mean that any credit facility had been allowed to the Company. The Management added that payments against the Running Account bills were released as and when supplies were made and services were rendered and that these were not early payments but only timely payments to arrest any slippage in the project completion schedule.

The Ministry, while endorsing the views of Management, admitted (December 2010) that there was no time schedule in the present GCC for payment of running bills, whereas the time schedule of 56 days indicated in the clause 6.4.8.3 was for the purpose of calculating late payment interest and notional interest.

The justification given by the Company as well as Ministry for the early release of payment was not commercially prudent in view of the following:

The due date by which 'On Account' payments had to be released had not been defined or spelt out in the contract except in clause 6.4.8.3 of GCC. By including the clause

---

[♠] ***Clause 6.4.8.3: For the purpose of calculating late payment interest and notional interest the relevant due date shall be the date terminating with the expiry of 56 (fifty six) days after the date the contractor delivers his Running Account Bill to the Engineer-in-Charge for certification in accordance with the contractual provisions***

6.4.8.3 in the GCC forming part of tender documents, the Company had led the prospective bidders to believe that the payment would be rightfully due only after 56 days and, therefore, they ought to have priced their rates by building up the interest on the working capital for 56 days. Considering the fact that the Company had been resorting to heavy borrowings from the market by not availing this clause in full, the Company had not only lost the opportunity afforded by the GCC, but had also given an unintended benefit to the contractors. As the Company was making e-payments through RTGS[♣] system, it should have released payments on the working day preceding the due date, to avoid loss of interest.

Recommendation

The Company should review the clauses in the General Conditions of Contracts to lumpsum turnkey contracts relating to interest on delayed/early payment and modify them suitably so that the due date of payment of running bills is unambiguous and no unintended benefit flows to the contractor.

Numaligarh Refinery Limited

12.5 IT Audit on Enterprise Resource Planning – SAP

Numaligarh Refinery Limited implemented SAP R/3 in 2005. Delays in up-gradation to SAP ECC version 6 resulted in non utilization of hardware purchased at a cost of ₹ 1.49 crore for the purpose. Review of the system revealed lack of referential integrity regarding excise duty, lack of input controls resulting in excess provision for entry tax, incomplete master data, non charging of depreciation as per policy of the Company etc. Further, Goods receipt based invoice verification feature was not used compulsorily for payment of goods received. Thus, the SAP ERP needs further customization to enable generation of reliable data.

Introduction

Numaligarh Refinery Limited (Company) was incorporated in April 1993 as a Government Company under the Ministry of Petroleum and Natural Gas. The Company has its Corporate Office at Guwahati, Assam and Refinery at Golaghat, Assam. The Company commenced commercial production from October 2000. The products of the Company are mainly evacuated through Bharat Petroleum Corporation Limited. The Company has also engaged in retail marketing through 108 retail outlets.

IT Systems

Initially, the Company implemented Ramco Marshal Enterprise Resource Planning (ERP) system. Due to technical limitations of the RAMCO system and also to ease synergy of operations with group companies, the Company decided (August 2004) to switch over from RAMCO ERP to SAP R/3 (Enterprise edition 4.7). This ERP system was customized and implemented by SAP India Pvt. Ltd, Bangalore using Oracle 9i as

---

[♣] ***RTGS - Real Time Gross Settlement System is funds transfer system where transfer of money takes place from one bank to another on a 'real time' and on 'gross basis'. Settlement in real time means payment transaction is not subjected to any waiting period. 'Gross settlement' means the transaction is settled on one to one basis without bunching or netting with other transaction, once processed payments are final and irrevocable.***

Database Management System (DBMS) at a total cost of ₹ 8.33 crore. The system went live on 1 August 2005. It has been running on six servers viz., Production, Application, Development, Backup, Quality and Test in addition to other servers for Networking Services at the Refinery site, Golaghat, Assam. The Company also maintains one server at Kolkata office for off-site back up. The Company initially procured 230 operational users and 10 information user licenses from SAP. The Company has implemented Finance and Controlling (FICO), Material Management (MM), HR and Payroll, Sales & Distribution (SD), Project System (PS) and Plant Maintenance (PM) modules of SAP R/3 ERP and is in the process to upgrade to SAP ERP 6.0.

Scope of Audit

Audit reviewed the implementation of the ERP system and the areas covered in MM module and general ledger, accounts payables, accounts receivables and assets accounting in Finance & Controlling (FICO) module. Further, various Information System (IS) controls inbuilt in the system ensuring integrity of the data and security were also examined. For this purpose, data for the period 2005-06 to 2009-10 were evaluated during March 2010 to July 2010.

Audit Objectives

The objective of audit was to seek assurance whether the implementation of MM and FICO modules in the Company had been carried out in the most effective manner. To achieve the main objective audit focused on the following:

- Whether effective input controls and validation checks existed in the system to ensure reliability and integrity of the data;
- Whether customization of the system suited the requirements of the Company and its users;
- Whether the mapping of the business and managerial requirements of the Company were adequate and complete and
- Whether security controls adopted by the Management were adequate.

Audit Criteria

The following criteria were adopted:

- Accounting policy of the Company and orders/circulars/notification issued by Government of India and the concerned State Governments etc., from time to time.
- Business rules and procedures.
- Various control and security parameters as prescribed by the Company in its IS Policy.

Audit Methodology

The following methodology was used during audit:

- Study and scrutiny of relevant records/ documents relating to system development.

- Interaction/ discussion with the ERP Team as well as end-users through issue of audit requisitions/ queries.
- Analysis of data, extracted from SAP tables as well as from standard and in-house developed SAP reports, using Computer Assisted Audit Technique (CAAT).
- Before the commencement of audit, an entry conference was held at Golahat, Assam in April 2010, detailing the broad objectives of IT Audit. The findings of the audit during the review were discussed in the exit conference (October 2010) with the Management.

Audit Findings

12.5.1 Upgradation of ERP

The Company, to remain up to date, decided (October 2008) to upgrade the existing SAP ERP R/3 Enterprise Edition 4.7 to SAP E.C.C[1] version 6. Accordingly, apart from the existing 240 SAP user licenses, additional 114 SAP user licenses and 516 licences for ESS[2] were obtained (December 2008) at a cost of ₹ 99.54 lakh for upgradation. It was noticed that the department could utilise only 308 SAP licenses till October 2010 and thus additional 46 SAP user licenses and 516 ESS licences procured remained un-utilised. Further, hardware procured at a cost of ₹ 1.49 crore also remained idle as the upgradation process which was to be completed in October 2009 was yet to be completed (September 2010).

The Management accepted the facts and stated (October 2010) that the unused licences were kept for future requirement. Management further stated that the hardware purchased were being gradually utilised with the upgradation of SAP.

The Company should speed up the process of upgradation so as to utilize the user licenses and hardware procured.

12.5.2 Segregation of duties

Analysis of authorization/ responsibilities allotted to various users revealed that in one department of the Company, nine users were given rights to create as well as release Purchase Orders. This indicated deficiencies in segregation of duties and deficiency in control mechanism.

While accepting the observation, the Management stated (October 2010) that necessary corrective action would be taken.

12.5.3 Referential Integrity:

In a relational database system, data integrity is ensured by referential integrity due to which any changes in data will have a cascading effect on all the related records. It was observed that Excise duty has to be paid as per the terms and conditions defined in the Purchase Order. Thus the amount of excise duty as per Purchase Order (PO) should automatically flow to the payment bill. Scrutiny of data relating to excise duty as captured in the PO vis-à-vis that captured in the tax invoice revealed that out of 8487 POs for which excise duty was paid during the period covered under audit, in respect of 1347

---

[1] ***Enterprise Central Component***
[2] ***Employee Support Services***

POs the amount of excise duty as per PO condition was not matching with excise invoices. It was further noticed that excise payment exceeded by ₹ 4.75 crore in case of 897 POs while in case of 450 POs, the payment shown was lesser by ₹ 2.94 crore. This indicated that the system did not have sufficient validity checks to ensure correctness of payment of excise duty as per conditions laid down in the PO.

The Management stated (October 2010) that the problems in standard SAP programme in this regard were being corrected. Management further stated that subsequent revision, if any, of excise duty was captured in a separate table and not got updated in the relevant purchase order.

The Management's contention itself was an indication that there was lack of data integrity between the two records. Further, non-revision of the PO condition would lead to under/over provision of non-deductible taxes, like entry tax, etc. in the system.

12.5.4 Input Control and validation checks

The following deficiencies were noticed in this regard:

12.5.4.1 Vendor Master

Analysis of the Vendor Master revealed the following:

- In Vendor Master, 32 vendors had been allotted two vendor code each indicating lack of validation controls. It was also observed that purchase orders were issued to those vendors under different vendor IDs which may result in generation of incorrect creditors' balance.

  While accepting the existence of duplicate vendors in the system, the Management stated (October 2010) that except three duplicate vendors, others are required as per business requirement of different categories of payment. However, it was noticed that 17 duplicate vendors of the same category still existed indicating absence of input controls in this regard.

- The vendor master must be maintained with complete information including address of the vendors. However, due to absence of input controls, complete information about the vendors like street, postal code, contact numbers were not captured. Further, the system was not customized to capture email ids of vendors.

While accepting the observations, the Management stated (October 2010) that corrective action would be taken.

12.5.4.2 Material Master

The Material Master contained 73,517 material codes as on 31 March 2010. It was noticed that 4391 materials were allotted 12,923 material codes indicating allotment of multiple codes for the same material description. It was also observed that different quantity of stock was lying in stores for these materials under different codes. Existence of same stock under different IDs may not help proper inventory control.

The Management stated (October 2010) that difference in such materials could be traced from the long text of the material. However test check revealed that the long text was also the same in respect of 11 such duplicate material codes. The Management also stated

that a new codification system which would eliminate duplicate codes would be implemented soon.

12.5.4.3 Customer Master

Customer Master should have complete and accurate information for all the customers. Review of customer master revealed that:

- Crucial information like postal codes (in 20 customers), telephone numbers, and e-mail IDs were not captured.
- Postal codes for 97 customers contained incorrect codes.

The Management stated (October 2010) that PIN code of 'Numaligarh' was captured considering the billing location of those customers. This could not be accepted since the Customer Master should have the correct details of the customers for future references.

12.5.4.4 Credit to Customers

As per the business requirement, the Company extended credit to its various customers after taking prior approval and such credit limits are fed in the system for individual customers. However, data analysis showed that though the credit limit to four customers was set as 'zero', credit between ₹ 2.57 lakh and ₹ 72.37 lakh was allowed to those customers. This indicated absence of validation controls to ensure control over credit management.

The Management stated (October 2010) that credit was allowed to these direct customers as per the terms of the supplies. It is however reiterated that such credits approved should be duly entered and monitored through the system.

12.5.4.5 Creation of Purchase Requisition

Review of purchase requisitions revealed following inadequacies:

- Out of 6257 purchase requisitions, 128 purchase requisitions valuing ₹ 22.67 crore were created after placement of purchase orders.

The Management stated (October 2010) that no purchase requisitions would be entertained subsequent to release of the final PO. However further analysis of data showed that Management's contention is not acceptable as system accepted release of purchase requisitions even after the release of 47 POs.

- It was noticed in audit that 5122 purchase requisitions valuing ₹ 184.64 crore were kept pending without placement of purchase orders for more than 3 months (June 2010). Out of these, in respect of 4516 purchase requisitions, the required delivery date had expired. Further, in 613 cases, POs were placed based on fresh requisitions when the earlier requisitions for the same item were still pending. This may lead to unwarranted procurement.

The Management stated (October 2010) that open and unwanted purchase requisitions would be deleted from the system.

12.5.4.6 Purchase Order Conditions

During the period from 2005 to 2010, the Company placed 25014 purchase orders. Analysis of data relating to PO condition revealed the following discrepancies which indicated absence of input controls:

- Excise duty in respect of 1342 items involving 51 purchase orders was captured twice in the PO condition. Consequently, entry tax liability is being generated in the system incorrectly.
- In case of 36 Purchase Orders, the entry tax element was shown twice in the PO condition. As a result, there was excess provision of entry tax amounting to ₹ 10.38 lakh.
- In case of 122 Purchase Orders, insurance element was shown twice in the PO condition resulting in excess provision of insurance.

The Management accepted the facts and stated (October 2010) that action would be taken to contain these deficiencies.

12.5.4.7 General Ledger Account

Scrutiny of Chart of Accounts data revealed the following discrepancies:

- "Cost of Project Surplus Materials" being a single ledger account was assigned two different General Ledger Account codes which indicated lack of control in assigning General Ledger codes.
- Narration, indicating summary is an integral part of recording of accounting transactions. It would be difficult to understand the transactions in absence of narrations. However it was noticed that in most of the transactions, narration was not fed against.

The Management accepted the facts and stated (October 2010) that due care would be taken in future to avoid such recurrence. Further, it was assured that input of 'narration' would be made mandatory.

12.5.4.8 Capital work-in-progress

On account of payment of capital advances without reference to their WBS[♣] elements and consequent failure in clearing of capital advances due to partial capitalization of projects resulted in difference in the value of asset under construction between SAP standard report and GL account of capital work-in-progress to the tune of ₹ 75 crore. The difference was further reduced to ₹ 1.11 crore manually by the Management after being pointed out. This indicated lack of adequate input control over payment and adjustment of capital advance.

While accepting the fact, the Management assured (October 2010) necessary corrective action.

12.5.5 System Customization

Following deficiencies were observed during scrutiny of customisation of SAP ERP system in line with the business rules of the Company:

12.5.5.1 Unit of measurement

Out of 73517 material codes defined in the master, for 63282 materials, the Unit of measurement (UoM) was defined as "Numbers (NOS)" which meant the quantity of the

[♣] WBS = Work Breakdown Structure. For any project defined there should be at least one WBS element to identify the particular project.

materials could be represented only in whole numbers. It was, however, observed that in seven cases, the stock of the material was indicated in fractional quantities. This indicated deficient customization in this regard.

While accepting the observation, the Management stated (October 2010) that corrective action would be taken.

12.5.5.2 Entry Tax

As per Assam Entry Tax Act 2008, Entry Tax is payable on original invoice value including Insurance, Excise Duty, Freight and all other charges incidentally levied on the purchase of goods. It was observed that entry tax had been calculated in the system without considering higher education cess on excise duty, freight, etc. which was in contravention of the Assam Entry Tax rules and regulations.

While accepting the observations, the Management stated that required correction had been made in the system.

However, since the revised excise duty is not captured in the PO condition as pointed out in para 2.3 supra, incorrect provisioning of Entry Tax still persist in the system.

12.5.5.3 Materials in Transit

Material in Transit (MIT) indicates those materials which have been dispatched by the vendor but yet to be received by the Company. Test check of data generated through customized Report on MIT revealed that it included materials valuing ₹ 16.02 lakh against 62 closed purchase orders which were placed during the period 2005 to 2008. Thus, the possibility of goods remaining in transit against closed order and that too, over a period of two to three years was remote. Thus due to improper customization, purchase orders were allowed to be closed in the system without taking into account of the MIT.

The Management stated (October 2010) that corrective action would be taken after necessary review.

12.5.5.4 Valuation of Stock

Scrutiny of records of stock items in the system revealed the following discrepancies:

- Countervailing Duty (CVD) is required to be paid as a part of Customs Duty in connection with import of materials. In most of the cases, this CVD can be claimed as modvat credit. As per Accounting Standard, this should not form part of the purchase cost of materials. It was, however, observed in the system that in case of import of Methyl Tertiary Butyl Ether (MTBE), CVD had been included within the purchase cost of materials and was accordingly considered for valuing closing stock. Thus, the system configuration was not in conformity with the Accounting Standard, which necessitated passing of manual entries, thereby, leaving scope for errors and omissions.

While accepting the facts, the Management stated (October 2010) that it occurred due to use of wrong transaction code which had since been corrected.

- As per Company's Accounting Policy, stores and spares are to be valued at weighted average cost. However, scrutiny of stores as on 31March 2010 revealed that 84 materials, returned to stores on being found excess on physical verification in refinery, were valued at nil despite having quantities available in the stock.

This indicated that the system has not ensured complete customisation of data which is indicative of deficiency in mapping of business processes and rules.

The Management stated (October 2010) that corrective action would be taken.

- Scrutiny of stock as on 31March 2010 revealed that same materials (52 numbers) with different valuation with different quantity were lying in stock. The valuation of these materials at different rates is against prudent accounting principles. This may lead to improper inventory control.

The Management stated (October 2010) that same materials had been valued under different rates depending upon the purpose of procurement such as normal store, project or consumption. The Management contention could not be accepted as the same is not a good practice for inventory control in the system.

12.5.5.5 Depreciation

As per accounting policy of the Company, depreciation is to be charged on addition/deletion of assets on pro-rata monthly basis including the month of addition/deletion. As such, the depreciation on assets should be charged from the month in which it was capitalized. The Company, however, maintained three dates, "Capitalization Date", "Ordinary Depreciation Start Date" and "First Acquisition Date" in its asset related data. Test check of assets' records vis-à-vis its depreciation charged revealed the following inconsistencies:

- Though the capitalization date matched with First acquisition date in case of 2203 assets, it was not matching with Ordinary depreciation Start date.
- There was no consistency in the system regarding the starting date of depreciation. A Test check of assets (valuing more than ₹ 5000) capitalized after April 2007 showed that 454 assets valuing ₹ 8.44 crore, the depreciation was not charged from the month of capitalization, being the policy of the Company. Out of these cases, in respect of four assets valuing ₹ 8.36 lakh, the depreciation was charged with reference to Ordinary Start date and in respect of 79 assets valuing ₹ 6.35 crore, it was charged with reference to 'First Acquisition Date'. In another four assets valuing ₹ 27.01 lakh, the depreciation followed the 'Ordinary Start date' and 'First acquisition date'(both were same), while for 367 assets valuing ₹ 1.73 crore neither of the three dates had been followed for charging the depreciation Above inconsistency indicated that method of charging depreciation as per accounting policy was not customized properly.

While accepting the observation, Management stated (October 2010) that required action would be taken to rectify the above-mentioned errors.

12.5.5.6 Materials not accounted in Stock

Scrutiny of records revealed that purchase orders valuing ₹ 36.05 crore were placed for directly charged items, i.e., items to be directly booked to the cost centre and no stock account was maintained for this type of items. As such, actual consumption, availability of stock or otherwise of these items was not controlled through the system. In the absence of which, control over huge quantity of inventory along with consumption of direct materials could not be enforced through the system.

The Management stated (October 2010) that control of consumption of the directly charged materials is maintained manually. The Management's contention indicated that it could not take benefit of the computerized system for proper inventory control in respect of directly charged materials.

12.5.5.7 Budgeting Activities

It was observed that activities like – placement of budget proposal from various user departments to finance department, allocation of budgetary funds to various user department, approval of budgets so allocated – all were performed manually using MS-EXCEL. After approval by the higher authority, the same was fed into the system. This indicated that the generation of budget was not configured in the system.

The Management stated (October 2010) that considering the business requirement budgeting process was kept outside the SAP. The reply indicated that the resources of the system were not fully utilised.

12.5.6 Business Process Mapping

Review of mapping of business rules into the system revealed the following deficiencies:

12.5.6.1 Payment to vendors without Good Receipt

As per business process requirement, payments to the vendor for purchase of goods will be either an advance payment against delivery of documents through bank or after receipt and inspection of materials. The system has the provision for "Goods Receipt-based Invoice Verification" which, if activated, verifies the quantity and value mentioned in the invoices with the figures of good receipt (GR) for processing payments.

During review of GR and invoice verification, it was noticed that for 150 line items relating to 69 Purchase Orders, payment of ₹ 4.27 crore was released against goods receipt value of ₹ 3.32 crore and payment of ₹ 0.91 crore relating to 61 POs was released though no GR existed in the system. This indicated absence of proper customization for compulsory use of the Invoice Verification feature. The system was therefore exposed to various risks like excess payments to vendors and payments without any supply.

The Management stated (October 2010) that action would be taken after analyzing the imbalances. They further stated that over a period of time all POs would be created based on the GR based invoices.

12.5.6.2 Liquidated Damages

The calculation of liquidated damages was not mapped into SAP system, though liquidated damages of ₹ 12.28 crore were deducted from vendors manually since implementation of SAP.

The Management agreed (October 2010) to explore the option in the upgraded version of SAP.

12.5.7 Goods Receipt/Invoice Receipt (GR/IR) Account

GR/IR is an intermediary account used for payments against goods received. It was observed that as on 31 March 2010, ₹ 53.83 crore unadjusted balances in GR/IR account was pending for clearance. Out of ₹ 53.83 crore, ₹ 36.29 crore was lying unadjusted for more than one year. This indicated lack of proper monitoring by the Company.

While accepting the observation, the Management stated (October 2010) that action is being taken to rectify the imbalance.

Conclusion

The delay in the upgradation process would result in delayed utilization of the new aspects of the version including Employee Support Services. The system did not have adequate input controls and validation checks which resulted in improper maintenance of master data and generation of incorrect provisions in the accounts requiring the manual intervention on several occasions. The SAP R/3 system was also not customized properly and the business rules were mapped inadequately which resulted in incorrect valuation of stores, errors in charging depreciation, risk of excess payment to vendors, etc.

Recommendations

The Company should:

- ***Ensure early completion of upgradation process and utilize the ESS licences procured for the intended purpose***
- ***Strengthen monitoring and authorization controls of transaction and access to the system.***
- ***Ensure that input controls and validation checks are inbuilt in the system so as to ensure completeness and correctness of the data.***
- ***Review the 'Master Data' periodically for ensuring veracity of the data and authorization thereof.***
- ***Utilise the system for better material management.***
- ***Customize all the available functionalities of the ERP system to the meet the business requirements.***

Oil and Natural Gas Corporation Limited

12.6 Unproductive investment besides expenditure on interim facilities due to improper planning

Improper planning in setting up of plant for extraction of ethane, propane and butane from liquefied natural gas resulted in unproductive investment of ₹ 573 crore since December 2008 besides expenditure of ₹ 100.47 crore on interim facilities.

In February 2003, the Ministry of Petroleum and Natural Gas (MOPNG) assigned Oil and Natural Gas Corporation Limited (Company) the right to extract C_2 (ethane), C_3 (propane) and C_4 (butane) from the Liquified Natural Gas (LNG) imported by Petronet LNG Limited♣ (PLL) at Dahej. Based on the Detailed Feasibility Report (DFR) prepared by Engineers India Limited (EIL), the Board of Directors of the Company (Board)

♣ *Petronet LNG Limited (PLL) was set up as a JV by the Government of India. The JV was promoted by GAIL, IOCL, BPCL and ONGC. The marketing rights were given to GAIL, BPCL and IOCL.*

approved (May 2004) a proposal[1] for setting up a plant (C_2C_3 plant[2]) of 10 million metric ton per annum (MMTPA) capacity at an estimated cost of ₹ 1,493.49 crore for extraction of ethane, propane and butane. The completion schedule was 30 months from the date of Board's approval. The Company invited (August 2005) bids for five MMTPA[3] capacity plant and awarded (November 2005) the contract to M/s Toyo Engineering at a cost of ₹ 573.29 crore with scheduled completion by May 2008. Though plant was mechanically completed by December 2008, it could not be commissioned till December 2010 as there was no arrangement to off-take the products.

The Audit observed that:

- DFR for setting up C_2C_3 plant had envisaged supply of the products (C_2, C_3 and C_4) to a petrochemical plant of IPCL[4] /Reliance Industries Limited (RIL) located at Dahej at a distance of two kilometers (kms.) from the proposed plant through a pipeline till the Company (ONGC) could set up its own petrochemical plant at Dahej. However, the Company had not taken up the matter with RIL till May 2007. Laying of a pipeline of two kms. required eight months' time and, hence, could have been completed within 30 months time allowed for setting up C_2C_3 plant. The Company, however, awarded a contract for laying of the pipeline only in July 2009. Though, the pipeline had been completed (July 2010) at a cost of ₹ 8.45 crore, no agreement could be reached with RIL till date (December 2010).
- As RIL had expressed interest in offtaking only C_2 (ethane) for interim period, the Company awarded (December 2009) a contract to M/s Toyo Engineering for creating truck loading facility costing ₹ 95.62 crore for supplying C_3 and C_4 to oil marketing companies (OMCs), but no agreement had been entered into with OMCs till date (December 2010). An expenditure of ₹ 71.83 crore had been incurred on this work till December 2010. The truck loading facility had not been completed. As a result, C_2C_3 plant could not be commissioned till date (December 2010).
- The products of the C_2C_3 plant were envisaged to be finally used as feed stock in a new petrochemical complex to be set up by the Company at Dahej. However, notification of award (NOA) for setting up a Petrochemical Complex at Dahej (DPC) at an estimated cost of ₹ 13,690 crore was issued in December 2008 with scheduled completion by December 2012.
- Due to the time gap between commissioning of C_2C_3 plant and the DPC, the Company was compelled to request (December 2009) M/s Toyo Engineering to extend the process performance guarantee beyond the original contractual period at a cost of ₹ 28.85 crore. Till December 2010, an expenditure of ₹ 20.19 crore has been incurred on this account. Consequently, the C_2C_3 plant completed in December 2008 at a cost of ₹ 573.29 crore proved to be unproductive besides

---

[1] ***In December 2003, the Board had originally approved the proposal for setting up of 1X5 MMTPA capacity plant at projected cost of ₹ 609.12 crore.***

[2] ***While C_2 and C_3 comprise major products, production of C_4 is marginal.***

[3] ***Due to restricted allocation of only 5 MMTPA of LNG to the Company by the Ministry.***

[4] ***IPCL was disinvested in 2001 and 21 per cent shares was taken over by Reliance Industries Limited (RIL).***

incurring expenditure of ₹ 100.47 crore[1] in creating interim facilities for offtake of the products and extended performance guarantee.

The Management in reply (September 2010) stated that:

- The response from RIL was at significant variation from the scenario considered in the DFR due to change in the Management and rapid deterioration in global business environment. Since RIL was ready to take only 50 *per cent* quantity of C_2 for short term, for C_3 and C_4 the Company approached the OMCs who agreed to uplift the entire quantity of C_4 and matching quantity of C_3 for supply as LPG after blending[2].
- Keeping in view the changing business environment and to mitigate the negative impact of idling of the plant, truck loading facility was proposed to evacuate the products. It was decided to go ahead with the truck loading facilities even before firm commitment from OMCs as the Company was confident of concluding marketing tie up for C_3 and C_4 products as there was a huge supply demand gap for the products in India.

The Ministry endorsed (January 2011) the views of the Management.

Reply of the Management/Ministry was not acceptable in view of the following:

- As per the DFR of December 2003 and February 2004, IPCL, Dahej was identified as a user for the C_2C_3 products till the setting up of a petrochemical complex. The Company, however, did not discuss the matter with IPCL/RIL till May 2007. Hence, the statement that the response from RIL was at significant variation from the scenario considered in the DFR was not tenable. Moreover, the negotiations with the OMCs had not been firmed up (December 2010).
- The contract for creation of facilities for evacuation of C_2, C_3, C_4 products *viz.* the pipeline and truck loading facilities were awarded only during July 2009 and December 2009 respectively. However, the Company had not signed an agreement with RIL for lifting of the product[3] till December 2010. Further, the truck loading facilities which were not envisaged in the original scope of work awarded in December 2005 would be rendered redundant on commissioning of the DPC.

Thus, improper planning resulted in unproductive investment of ₹ 573 crore since December 2008 besides expenditure of ₹ 100.47 crore till December 2010 on interim facilities.

---

[1] ***Pipeline completed in July 2008: ₹8.45 crore plus actual expenditure till December 2010 towards truck loading facility: ₹71.83 crore against contract of ₹95.62 crore and performance guarantee: ₹20.19 crore against commitment of ₹28.85 crore.***

[2] ***In which case the Company would be required to put up blending facilities involving additional expenditure and time lag of eight months.***

[3] ***For C_3 and C_4 negotiations are on with the OMCs. Moreover, the OMC have agreed to lift only C_4 and limited portion of C_3 to the extent that could be blended with C_4 as OMCs did not have the marketing rights for C_3.***

Recommendation

The Company should fine tune its planning process to ensure synchronization between related projects in order to optimize operational synergies and obviate avoidable expenditure and should also institute a system of value assurance review at different stages of large projects so that the changes in assumptions are adequately addressed.

12.7 Injudicious payment of golden jubilee incentive

The Company made an outright payment of ₹ 50,000 to each of its employees amounting to ₹ 173.70 crore as part of its golden jubilee celebrations. This payment was, however, not consistent with the Department of Public Enterprises' guidelines on ex-gratia, honorarium, reward *etc.* and performance related payments.

As part of its Golden Jubilee celebrations, the Board of Directors of Oil and Natural Gas Corporation Limited (Company) approved (July/August 2006) the grant of a gold medallion of 15 grams and a golden jubilee incentive built in the pay throughout the service period of the employee to yield a net present value of ₹ 50,000 per employee to all employees on rolls of the Company on 14 August 2005. However, subsequently, the Company revised (September 2006) its earlier decision and decided to pay the Golden Jubilee incentive of ₹ 50,000 as lump-sum (besides the gold medallion of 15 grams) to regular employees, including full time Directors, on the rolls of the Company as on 14 August 2005 and paid a total amount of ₹ 173.70 crore.

In reply to the audit observation that the payment of golden jubilee incentive, not being a payment under an approved incentive scheme, was in contravention of the Department of Public Enterprises (DPE)'s guidelines of 20 November 1997, the Management stated (June 2008) that the one time payment of ₹ 50,000 was a special dispensation given to all employees on the occasion of golden jubilee celebration to boost their morale and to ensure their commitment to the organization and also as a retention tool. The Management justified this payment on the ground that (i) DPE guidelines (25 June 1999) provided for Profit Sharing incentive up to 5 *per cent* of distributable profit based on the performance of work force in case the compensation to the employees was not appropriate; (ii) the payment (and the gold medallion) was approved by the Board and (iii) it did not squarely fall within the definition of incentives so as to bring it under the umbrella of DPE guidelines.

Audit observed that the one time payment was not performance related and not covered by the June 1999 guidelines above. Also the payment was not admissible under the November 1997 guidelines as the same clarified on incentives in the form of ex-gratia, honorarium, reward etc.

It was further observed that:

- During the period from September 2006 to September 2010, 653 employees had resigned or were removed from service after receiving the golden jubilee incentive. Of these, 339 employees had resigned/removed within one year of receiving the incentive.

- The Company made a payment of ₹ 11.50 lakh to 23 employees who had resigned or had been removed from service before the due date for drawal of salary for September 2006.
- In a clarification addressed to audit, the DPE confirmed (February 2011) that ₹ 50,000 paid as Golden Jubilee incentive and/or gold medallion of 15 grams was not part of approved performance related payment and not covered by its guidelines of June 1999 or the guidelines issued by it under 2007 pay revision of the public sector undertakings.

The Ministry stated (November 2010) that in future such an incentive would be linked to the condition that an employee serves for a minimum specified period after receipt of the incentive.

Recommendation

The Ministry of Petroleum and Natural Gas in conjunction with the Department of Public Enterprises should issue appropriate guidelines on payment of reward, in cash or in kind, to the employees of PSUs on commemorative events.

12.8 Unfruitful expenditure in exploration block beyond re-grant period

Failure of the Company in establishing any lead in the nomination block KK-DW-12 and 17 despite retaining the block for 11 years and acquisition of fresh seismic data in the block without ensuring extension of the petroleum exploration license beyond five years of re-grant period followed by surrender of the block resulted in unfruitful expenditure of ₹ 12.13 crore.

Oil and Natural Gas Corporation Limited (Company) acquired (April 1997) petroleum exploration license (PEL) for deepwater nomination block KK-DW-12 and 17 in Kerala Konkan Offshore. The Company obtained re-grant of PEL for four years cycle effective from 01 April 2003 to 31 March 2007 and extension for fifth year uptil 31 March 2008.

During the re-grant period of five years, though the Company completed the work commitments, it could neither fulfill its commitment of drilling a well in the fifth year nor establish any lead/discovery in the block since its acquisition. The Company requested (March 2008) the Ministry of Petroleum and Natural Gas (MOPNG) for extension of PEL for the block for sixth and seventh year on the ground that the regional prospectivity analysis carried out by its consultant in November 2007 indicated possibility of gas generation in Konkan basin. As no lead/discovery had been established by the Company in this block, the MOPNG did not agree to the request of the Company and directed (March 2008) it to surrender the block immediately.

The Company, however, again requested (May 2008) the MOPNG for seeking retention of the block for sixth and seventh year alongwith dispensation for drilling moratorium to fulfill drilling commitments, on the ground that available data and studies indicated improved prospectivity in the block and that drilling of the well in the fifth year could not be carried out due to non-availability of deep water rigs. It also indicated its plan to acquire 1,400 line kilometers (LKM) of long offset 2D seismic data for understanding the leads and for assessing the block. During November 2008 and January 2009, the

Company incurred an expenditure of ₹ 12.13 crore on acquisitions, processing and interpretation (API) of 1,200 LKM of 2D long offset seismic data.

In January 2009, the MOPNG replied to the Company that the latter was holding the block for more than 11 years and as such it did not find any justification for the Company seeking special dispensation. The Ministry reaffirmed (January 2009) its decision of March 2008 and directed the Company to surrender the block immediately. In February 2009, the Directorate General of Hydrocarbons (DGH) intimated that the block stood surrendered.

Audit observed that:

- As per policy of the Government of India (GOI) for nomination blocks, a nomination block has to be surrendered by the licencee in case no lead/discovery is established in it by the licencee by the end of fifth year of the re-grant period. The decision communicated by the Ministry in March 2008 was in consonance with the said policy of GOI. As the Company failed to establish any lead/discovery in the block despite retaining it for 11 years, it was not reasonable to expect re-grant of extension for sixth and seventh year.
- Though the Company's consultant had carried out the study in November 2007 indicating possibility of gas generation in the block, the Company did not approach the GOI well in advance for further extension of PEL and requested the GOI for the extension at the end of March 2008 when the validity of the PEL for the fifth year was expiring and the GOI had already decided to ask the Company for surrendering the block. In case, the Company had a strong case for further extension of PEL in deviation of the GOI's policy, the case should have been pursued with the GOI well in advance.
- Pending decision of the MOPNG, the Company incurred an expenditure of ₹ 12.13 crore on 1,200 LKM of 2D long offset seismic data during November, 2008 and January 2009 was not in order. Thus, failure to ensure the extension of the PEL before acquisition of fresh 2D long offset data rendered the expenditure unfruitful.

The Management stated (September 2010) that:

- MOPNG had sought for (June 2008) clarification from the Company regarding commitment of a well in the block for considering the proposal for extension which indicated that the block was not being asked to be surrendered. In the hope of getting positive response, the Company carried out seismic survey. However, after a gap of eight months of its request for retaining the block, MOPNG informed (January, 2009) about its decision to surrender the block.
- In previous instances, DGH had granted sixth and seventh year's extension on the basis of G&G evaluation in nomination blocks *viz.* Gamij Extension III and Ahmedabad East Extension 1 in Cambay basin, KK offshore block in Kerala Konkan basin and WO-9 block in Western Offshore).
- All the data acquired formed the data repository of the Company to be used in subsequent rounds and, hence, the expenditure could not be construed as unfruitful. The Ministry endorsed the views of the Management in January 2011.

Reply of the Management/Ministry was not acceptable in view of the following:

- As response of the Ministry for reconsidering the decision was awaited, the Company should not have acquired 2D long offset seismic data. Further, the Company also did not apprise the Ministry of the fact that pending approval it was going ahead with the acquisition of the 2D long offset data.
- In case of the block WO-9, application for sixth and seventh year's extension was made on 21 November 2007 and approval was received on 28 February 2008. Fresh 3D survey was carried out only after receipt of approval *i.e.* in February 2009. As regards the blocks KK offshore, Gamij Extension III and Ahmedabad East Extension-1, Audit observed that no fresh/additional data was acquired during the sixth and seventh year of re-grant period. Hence, these blocks could not be compared with KK-DWN-12 and 17. Moreover, since the MOPNG in the first instance had already asked the Company to relinquish the blocks KK-DWN-12 &17 and also in view of the fact that there was no lead in these blocks, chances of acceptance of the request of the Company for extension were remote.
- If the Company had awaited the final decision of MOPNG before acquiring the fresh data, unfruitful expenditure of ₹ 12.13 crore could have been avoided.
- As per direction (February 2009) of DGH, the Company was required to surrender all the Geological and Geophysical (G&G) data collected in the block to the DGH for offering the relinquished block in the next NELP round of bidding. The seismic data acquired for the surrendered block did not serve the intended objective.

Recommendations

- ***The Company should ensure extension of PEL by DGH/MOPNG before acquiring additional/fresh data in any block especially when there had been no leads by the end of fifth year of re-grant period in which case Company was liable to surrender the block as per policy of the Government of India.***
- ***The Ministry should also expedite processing of requests for extension of PEL so as to allow the operator to firm up the work programme/action plan.***

Petronet India Limited

12.9 Unfruitful expenditure due to delay in taking decision

The change in policy of the Government and failure to take prompt action resulted in unfruitful expenditure of ₹ 16.05 crore.

In order to cater to the growing demand for petroleum products across the country and for developing an efficient pipeline network, the Government of India (GOI) felt the need to expedite the implementation of the pipeline projects. The GOI approved (April 1996) formation of a holding Company with equity participation from public sector oil companies (50 *per cent*) and from private companies, financial institutions and public by pooling the technical, financial and human resources available in the oil industry and minimising the limitations of individual oil companies. It was envisaged that the holding

Company would be in the nature of a financial Company and would form subsidiary companies for implementation of identified and prioritised pipeline projects. Accordingly, Petronet India Limited (PIL) was incorporated (May 1997) as a Joint Venture Holding Company by public sector Oil Marketing Companies (OMCs)[1] and financial institutions for development of petroleum product pipelines in the country on a 'Common Carrier Principle' for use of OMCs.

During the period from May 1998 to December 2000, PIL co-promoted five[2] Joint Venture (JV) companies for implementation of five pipeline projects. The oil companies in public and private sector as well as financial institutions participated in the promotion of these projects in different proportions depending upon their interest in the pipeline routes.

In November 2002, the Ministry of Petroleum and Natural Gas (MOPNG) issued revised policy guidelines which gave a free hand to individual oil companies to put up their own pipelines, which was a reversal of its earlier policy for setting up pipeline projects on 'common carrier principle'. This threatened the survival of PIL as even during the implementation of pipeline projects of PIL, oil companies backed out of the JV projects and started constructing their own pipelines independently.

One of the JV companies *viz.* PCTML was taken over by IOCL. The operations of another JV Company *viz.* PVKL commissioned in May 2000 had been suspended since May 2006 as the IOCL's product pipeline, to which this JV Company's pipeline was the feeder, was converted into crude service. Another two JV companies *viz.* PCCKL and PMHBL commissioned their projects in September 2002 and August 2003 respectively and the oil companies which transported their products in these two pipelines and had majority share in the respective JV companies showed interest in taking over the pipelines by themselves.

The project undertaken by the fifth JV Company *viz.* PCIL was dropped after spending an amount of ₹ 10.78 crore on survey and other preliminary expenses during the period from 2001-02 to 2004-05, of which ₹ 5.13 crore was spent between 2003-04 and 2004-05 after the GOI changed (November 2002) its policy for setting up pipeline projects. Majority of the shareholders expressed (January 2003) disinterest in continuing the project. The pipeline was to be implemented through 'Build, Operate and Transfer' process in which firm commitment of 'take or pay' was required to be given by the users of the pipelines. Since none of the OMCs agreed for the 'take or pay' clause, the project activities were discontinued, thus, rendering the expenditure of ₹ 10.78 crore unfruitful.

Since operations as well as the purpose for which PIL was formed came to a complete standstill consequent to the revised guidelines issued by the MOPNG, the shareholders of PIL unanimously opined (March 2004) that continuation of PIL was not viable and winding up process should be initiated. Accordingly, PIL intimated (August 2004) the MOPNG of its decision to wind up. However, no concrete decision had been taken by the

---

[1] ***Indian Oil Corporation Limited (IOCL), Hindustan Petroleum Corporation Limited (HPCL) and Bharat Petroleum Corporation Limited (BPCL)***

[2] ***Petronet VK Limited (PVKL – for Vadinar Kandla Pipeline), Petronet CK Limited (PCCKL - for Cochin-Coimbatore-Karur Pipeline), Petronet MHB Limited (PMHBL - for Mangalore-Hassan-Bangalore Pipeline), Petronet CTM Limited (PCTML – for Chennai-Trichy-Madurai Pipeline) and Petronet CI Limited (PCIL – for Central India Pipeline).***

Government till date (December 2010) on future of PIL. PIL continues without any useful activity and incurring avoidable overheads in the form of salaries to staff and other administrative expenses like rent *etc.*[*] After allowing a reasonable period of two years for taking a decision either to strengthen or to close the PIL from the time of PIL's representation (August 2004) to the GOI, an expenditure of ₹ 5.27 crore incurred by PIL from August 2006 to March 2010 on salaries and other administrative overheads was avoidable and unfruitful.

Thus, while the change in the pipeline policy of the GOI resulted in unfruitful expenditure of ₹ 10.78 crore on a project which had to be abandoned as a fallout of the policy change, failure to take timely action regarding the future of PIL resulted in an unfruitful establishment expenditure of ₹ 5.27 crore from August 2006 to March 2010.

The Management stated (August 2010) that due to new guidelines for laying petroleum product pipelines issued by MOPNG the promoters of PIL themselves began implementing their respective pipeline plans without routing it through PIL. The promoters had shown unwillingness in the PCIL project and on account of conflict of interest among promoters the project was abandoned.

As regards audit comment on the expenditure of ₹ 5.13 crore spent in financial years 2003-04 and 2004-05 after the GOI changed its policy in November 2002, the Management stated that since the work was on an ongoing basis, contracts had been awarded and liabilities committed right from financial year 2000-01 onwards. They further stated that closure or winding up of PIL was not possible without the MOPNG's (Administrative Ministry) approval.

The Ministry, while endorsing the views of Management, stated (December 2010) that PIL being a holding Company could be wound up only after the Subsidiary/JV companies co-promoted by PIL are wound up and added that the continued incurring of administrative expenses was unavoidable as PIL has to comply with the various statutory requirements till such time it was wound up which was a time taking process and could be done only with the approval of the GOI.

Reply of the Management/Ministry was not acceptable as Board of PIL had unanimously decided in March 2004 to wind up PIL and the same was intimated to the MOPNG in August 2004. However even after a lapse of six years no action has been taken in this regard.

Recommendation

The Ministry should take conclusive action regarding the future of PIL without further delay.

---

[*] ***In the range of about ₹ 1.25 crore to ₹ 1.50 crore per annum.***