Preface

With the reforms in the economy which took place in the 1990's, Government decided to liberalise the framework governing the oil and gas Exploration and Production (E&P) sector, which has earlier been the sole preserve of the Government Sector. After award of small and medium sized discovered and producing oilfields as well as some exploratory blocks in the early 1990's, Government formulated the New Exploration Licensing Policy (NELP) in 1997 and notified this policy in 1999. This policy had the objective of not only attracting private capital to the E&P Sector but also introducing the technical expertise and efficiency of global players in this field.

In order to ensure balanced and effective partnerships with global E&P Companies, the Production Sharing Contracts (PSCs) between the Government and the private players were revised. These contracts were structured in such a fashion that the exploration risk *viz.* the cost incurred in searching for oil and natural gas, without certainty of discovery, was to be borne by the private contractors. The private contractors incur capital expenditure towards discoveries, irrespective of the fact whether oil or gas is discovered or not. It is only when hydrocarbons are discovered and assessed to be commercially viable, that the contractor has the first rights on the revenue streams accruing from sales of oil and gas till his costs are recovered. The balance revenue, termed as "Profit Petroleum", is shared between the Government and the contractors, with the contractors generally getting a higher share in the initial stages since he has to recover contract costs. The Government share of revenues becomes significant only when the production reaches substantial levels and the contractor has recovered his accumulated capital cost. Further, under NELP, Government companies and private players are treated at par.

The principle underlying the PSC model, under the NELP, as it currently stands, involves a scale for profit sharing between the Government of India and the contractor, based on a critical parameter – the Investment Multiple (IM). This is essentially an index of the accumulated net cash flow to the contractor relative to the accumulated expenditure on exploration and development activities. The objective underlying the PSC is that ideally the operator would attempt to maximize simultaneously both the government revenues and his own profit by minimizing contract costs for any level of production.

In order to ensure that the expenditure proposed to be incurred as well as actually incurred by the operator does not adversely affect the Government's revenue interests, the PSC contemplates the Management Committee (MC), chaired by a GoI representative, as responsible for approving field development plans as well as annual work programmes and budgets for development and production operations. However, operational control of E&P activities would vest with the Operating Committee, consisting of representatives of the contractors.

This audit was conducted in response to a request from the Ministry of Petroleum and Natural Gas for a special audit of PSCs in the context of large Government stake in the form of profit petroleum and concerns about the capital expenditure being incurred by some contractors in development of blocks awarded under NELP. We scrutinized records of the Ministry of Petroleum and Natural Gas and the Directorate General of Hydrocarbons (DGH) in respect of a sample of 20 PSCs covering the period from 2003-04 to 2007-08. In addition we also conducted supplementary scrutiny of records of operators of 4 blocks/ fields (KG-DWN-98/3, RJ-ON-90/1, Panna-Mukta and Mid & South Tapti), covering the two year period 2006-07 and 2007-08. Our audit was interrupted due to difficulties in obtaining access to the records of operators for supplementary scrutiny, which were later resolved with assistance and cooperation of Ministry of Petroleum and Natural Gas.

This report of the Comptroller & Auditor General of India for the year ended March 2011 containing the results of Performance Audit of Hydrocarbons Production Sharing Contracts has been prepared for submission to the President of India under Article 151 of the Constitution of India.