Chapter

2

Audit Framework

Chapter 2 Audit Framework

2.1 Scope of Audit

The performance audit of joint venture operations of the Company was taken up for the first time because since incorporation in 1965 to March 2004, the Company had acquired only eight Exploration and Producing (E&P) assets and its turnover was just ₹ 3,245 crore in 2003-04. However, during the period 2004-10, a total of 37 new E&P assets were acquired by the Company. Also, out of eight assets abandoned by the Company since incorporation, seven assets were abandoned during this period due to non discovery of hydrocarbons and after incurring an expenditure of ₹ 997.66 crore.

Audit reviewed the Company's transactions, on the basis of records available in India, relating to acquisition, exploration, development and production of oil and gas fields abroad through Joint Ventures (JVs) and through its subsidiary or JV Companies for the period from 2004-05 to 2009-10 and examined the adequacy of the systems for due diligence, formation of joint ventures and internal controls in respect of these overseas Exploration and Producing (E&P) assets.

2.2 Audit objectives

The Performance audit was conducted to assess:

- The adequacy of due diligence process for identification, appraisal and evaluation of investment opportunities in the E&P assets;
- The rationale behind formation of JVs and adequacy and reasonableness of terms and conditions of Joint Operating Agreement (JOA) and Exploration and Production Sharing Agreement (EPSA)/Production Sharing Contract (PSC) governing JV operations to safeguard financial interests of the Company; and
- The adequacy of internal control and internal audit arrangement to provide a reasonable assurance to the stakeholders on the investment.

2.3 Audit criteria and methodology

The following audit criteria were used;

- policies and guidelines of the Company and the Government of India for acquisition of E&P assets;
- legal provisions, rules and regulations of the host countries;
- terms and conditions of the contracts/agreements; and
- *international best practices as per the standard guidelines of Petroleum Resources Management System.*

Audit examined the records relating to acquisition of the blocks, processing and interpretation of seismic data and reserve estimation along with Agenda & Board Minutes, opinions of technical, legal and financial consultants, JOA, EPSA/PSC and records available at Corporate Office of the

Company. Subsequently, it was felt that the audit findings were required to be benchmarked with the standard practices followed by other E&P companies for acquisition of stakes in E&P blocks. Accordingly, two technical experts viz. Shri Y.B.Sinha, Ex-Director (Exploration), ONGC Ltd. and Shri P.K. Chandra, Former Vice Chairman and Advisor to ONGC Ltd were engaged who provided their expert opinion on the technical issues of this review. Their views have been appropriately incorporated in the performance audit report. After receipt of responses from the Ministry, a meeting was held on 24th November 2010 with the Ministry and Management and further clarifications and comments made by them during this interaction were also considered while finalizing this report.

A sample of 20 out of 45 E&P assets were taken up in Audit on Judgmental sample basis, classifying E&P assets into Producing, Developing, Exploration and Abandoned categories up to March 2010 as detailed below:

E&P Assets	No. of Assets	Total Investment as of March 2010 (₹ in crore)	No. of assets selected for audit	Total investment in assets selected for audit. (₹ in crore)	Percentage of investment in selected E&P assets to total investment
Producing, Developing/Discovered	14	49,195.79	7	44,196.06	89.84
Exploration	23	2,229.94	7	1,242.81	55.73
Abandoned	8	1,066.17	6	978.88	91.81
Total	**45**	**52,491.90**	**20**	**46,417.75**	**88.43**

Representative samples of the blocks were selected based on investment and risk factors involved. It was not possible to go for statistical sampling, as the risks involved between purchase of an exploration asset, a developing asset and a producing asset varied from very high to extremely low respectively.

In conclusion, the audit covered more than 50 per cent of the investment in producing, developing, exploration and abandoned E&P assets because producing and developing E&P assets led to maximum investment, while exploration assets which had a potential of an extremely high return on investment led to minimum expenditure and so did abandoned assets.

2.4 Acknowledgement

Audit is appreciative of the co-operation received from the Management of the Company with regard to providing information, records, clarifications, and for arranging discussions with the concerned officers from time to time.

2.5 Audit findings

Audit findings are discussed in three Chapters as detailed below:

- **Chapter 3** : flags due diligence processes relating to evaluation of Investment Opportunities
- **Chapter 4** : discusses issues while forming Joint Ventures
- **Chapter 5** : highlights inadequacies in the Internal Control System