CHAPTER IV : MINISTRY OF PETROLEUM AND NATURAL GAS

4 Administered Pricing Mechanism for petroleum products

Highlights

The oil industry was operating under total regulation through Administered Pricing Mechanism (APM) till 31 March 1998, when refining activities were taken out of APM. The APM was based on cost plus returns which ensured full reimbursement of crude cost, operating expenses and 12 per cent post tax return on capital employed to refineries and marketing companies. The APM was controlled through a system of oil pool accounts maintained by Oil Coordination Committee. These accounts though supposed to be self-balancing had accumulated deficit of Rs 18271 crore as of June 1997. The deficit was liquidated through issue of 10.5 per cent bonds of Rs 12984 crore to oil companies on 29 March 1998.

The Ministry and OCC allowed overpayments/undue benefits of Rs 6321 crore to oil companies during 1993-98.

The functioning of APM entailed diligent scrutiny and determination of claims of oil companies by OCC and the Ministry. However, the institutional basis for an independent scrutiny of cost data by the Ministry was absent. As a result, the costing process is distorted to allow inadmissible returns to the oil companies over and above what was envisaged. The system of verification of claims lacked transparency.

Against a provision of 12 per cent post-tax return on capital employed, Ministry and OCC allowed pre-tax returns to oil companies, without making adjustments for actual tax payments by them. This resulted in grant of unintended benefit of Rs 2154.75 crore to the oil companies.

Assured cost plus returns on borrowings prompted the oil companies to invest large amounts at lower rate of interest and borrow at higher rates. At least Rs 1530 crore of investment since 1993-94 could have been used to liquidate excess borrowings and reduce interest burden of companies eventually reducing the liability on oil pool accounts

The standard throughput and standard production pattern, despite heavy capital investment, were not revised in accordance with the actual production pattern and actual throughput. This resulted in overpayment of Rs 95.10 crore on account of excess depreciation claims and Rs 1386.06 crore on account of incentive claims.

The oil companies incurred avoidable expenditure of Rs 72 crore on purchase of power from outside at higher rates while their captive power plants remained under-utilised.

Demurrage charges between 1993-94 and 1997-98 rose six times from Rs 103 crore to Rs 613 crore in case of crude and product imports, resulting in progressively higher retention price.

The OCC was reimbursing the entire expenditure on purchase of cylinders by allowing 100 per cent depreciation under retention price. Thus, the deposits against cylinders security should belong to the oil pool. The Ministry and the OCC gave undue benefits to oil companies by allowing them to retain LPG cylinder deposits. The interest cost foregone by the oil pool worked out to Rs 1514 crore.

Different oil companies were allowed varying margins for distribution. Compared to the lowest rate for margins for each activity allowed to the oil companies, the excess returns allowed to different oil companies on account of varying marketing margins worked out to Rs 1098.73 crore.

The Government, by withholding cess collected on crude production, denied the oil industry, the option of cheap and readily available fund for refining and exploration. The cess amount withheld by the government was Rs 30098 crore.

4.1. Introduction

4.1.1 India's petroleum sector consists pre-dominantly of government-owned enterprises such as ONGC[1] and OIL[2] in the upstream for exploration and production and IOC[3], BPC[4], HPC[5], IBP[6], MRL[7], CRL[8] and BRPL[9] in the downstream, engaged in refining and marketing/distribution. The entire oil industry was operating under a

[1] Oil and Natural Gas Commission/Corporation
[2] Oil India Limited
[3] Indian Oil Corporation Limited
[4] Bharat Petroleum Corporation Limited
[5] Hindustan Petroleum Corporation Limited
[6] Indo British Petroleum
[7] Madras Refineries Limited
[8] Cochin Refineries Limited
[9] Bongaigaon Refineries and Petro-Chemicals Limited

total regulation through APM[10] till 31 March 1998, when refining activities were taken out of APM.

4.1.2 Under the APM, oil refineries and marketing companies were compensated on the basis of retention concept and are allowed a return of 12 *per cent* post-tax at net worth and reimbursement of the operating cost. Under this concept, fixed level of profitability for the oil companies were ensured subject to their achieving laid down capacity. The prices of indigenous crude oil were also based on cost-plus formula wherein the oil producing companies were allowed operating cost and 15 *per cent* post-tax return on capital employed.

4.1.3 The APM was controlled through a complex system of Oil Pool Accounts maintained by the OCC[11], working under the MP&NG[12], to which the oil companies were to surrender the surcharges recovered from the customers after adjusting allowable claims. The accounts were maintained to provide uniform and stable prices within the country and were supposed to be self-balancing.

4.1.4 The efficiency of APM depended on the ability of the system to keep the Oil Industry Pool Account inflows and outflows in balance. However, from 1989-90, due to increase in the international prices of crude oil and petroleum products and falling domestic crude production, the pool account came under tremendous strain. It had an accumulated deficit of Rs 18271 crore as of June 1997. To meet the deficit, the government issued “ 10.5 *per cent* Oil Companies (Non-transferrable) Government of India Special Bonds 2005” on 27 February 1998 and 10 March 1998 towards payment of outstanding claims of the oil companies against Oil Pool Account as detailed below.

(Rs in crore)

Sl. No	Company	Amount
1.	Indian Oil Corporation Limited	6478.00
2.	Oil & Natural Gas Corporation Limited	3122.00
3.	Mangalore refinery & Petro Chemicals Limited	1242.00
4.	Hindustan Petroleum Corporation Limited	994.00
5.	Bharat Petroleum Corporation Limited	760.00
6.	Madras Refineries Limited	164.00
7.	Oil India Limited	224.00
	Total	**12984.00**

4.1.5 The government sanctioned on 29 March 1998 the provisional payment to oil companies in lieu of their receivable claims from the

[10] Administered Pricing Mechanism
[11] Oil Coordination Committee
[12] Ministry of Petroleum and Natural Gas

OCC, with the condition that the claims would be subjected to audit by the Comptroller and Auditor General of India for their final acceptance.

4.2. Scope of audit

4.2.1 Audit Review of six oil companies[13] was carried out with a view to verifying the reasonableness and accuracy of cost of returns admitted in the margins and allowed to these oil companies; the extent of scrutiny of cost data by the OCC and Ministry; the extent and effectiveness of cost control measures taken by the oil companies; fixation/revision of standard product pattern, incentive claims; marketing efficiency and improvement in performance of oil companies. Of various cost elements, audit examined the following costs:

i. Cess on indigenous crude.

ii. Refining cost, interest on borrowing and return on net worth for refining.

iii. Installation, distribution and administrative costs, interest on borrowings and return on net worth for marketing.

4.2.2 The review was conducted for 1993-98. The costing structure of petroleum products is shown in **Annex A**.

4.3 Consumer and oil pool

All costs incurred in production, import, transportation, excise and custom duties on crude, operating expenditure of refineries and marketing companies, assured post tax return on capital employed to oil producing, refining and marketing oil companies, etc. were paid from oil pool. This aggregate cost was passed on to the consumer in full as oil pool was self-balancing. This system provided full protection to the oil companies in terms of assured profit. Since the administered prices are fixed on the premise that the oil pool account is self-sustaining, any overpayment leading to higher prices of controlled items is ultimately borne by the consumer.

4.4 Inadmissible payments common to crude production, refining and marketing

4.4.1 Cost data verification

One of the principal functions of OCC related to scrutiny and correct determination of claims from and surrenders to the oil pool accounts by the oil companies, carrying out a periodical revision of costs/margins of refinery, marketing and pipeline activities for consideration of the Ministry.

[13] IOCL, BPCL, HPCL, IBP, MRL, CRL, AND BRPL

A system of internal check in the Ministry and OCC for scrutiny of claims of oil companies was absent.

It is significant to note that for discharging such functions professionally and objectively, a well-knit team of professional Cost Accountants and Chartered Accountants within the OCC and the Ministry is an imperative for an independent verification of cost data that determines reimbursement to the oil companies. It is unacceptable that Ministry's attention escaped such professional needs. It was found that OCC functioned, implicitly, as an extended arm of the oil companies under the administrative control of the Ministry as the staff deployed in OCC were taken exclusively from oil companies. This had inherently undermined the objectivity. Even the Ministry did not consider it prudent to out-source expertise

Internal check in the Ministry was, thus, institutionally absent. OCC never contemplated to independently verify the cost data through the Bureau of Industrial Costs and Prices under the Ministry of Finance on a periodical basis to rule out the possibility of omissions and commissions.

4.4.2 Payment of element of corporation tax in excess of actual tax.

The retention price was to be fixed after allowing 12 *per cent* post tax return on net worth of the oil companies. The post-tax returns should be determined only on the basis of the actual corporation tax paid by the companies.

OCC calculated the retention price allowing 23.10 per cent pre tax return instead of 12 per cent post tax return without verifying actual payment. Verification of actual tax paid disclosed an overpayment ocf at least Rs 2154.75 crore

OCC, however, calculated the retention price after assuming the pre-tax return of 23.10 *per cent* on notional basis by averaging it on the basis of corporate tax rates for three years (1993-96) and never adjusted the payments made on the basis of actual corporation tax paid by the companies.

The corporate tax is payable on actual gross profit earned by company and is not related in any way to the net worth. It was, therefore, incumbent upon OCC to adjust the payments made on the normative basis on account of the actual corporate tax paid by the companies. Verification of actual corporation tax paid by the companies on their products under APM disclosed an overpayment of Rs 2154.75 crore to oil companies during 1993-98 as detailed below:

(Rs in crore)

Name of Unit	Amount
IOC	1189.12
HPCL	283.45
BPCL	227.48
IBP	92.12
CRL	144.33
MRL	218.25
Total	**2154.75**

The over payments to ONGC, OIL and BRPL on account of corporation tax may be worked out by the OCC. The OCC should verify the actual corporation tax paid by each company and component of APM products towards tax and adjust the excess payments. The OCC should institute a

system of verification of actual corporation tax paid by companies and adjustment of excess payment made on normative basis. Besides, unrealistic fixation of throughput as discussed in Paragraph 5.1 also led to overpayment on account of corporation tax.

4.4.3 Interest on loans

The oil companies simultaneously borrowed at higher rates while investing theirown funds at lower rates.

For the purpose of calculating return under net worth concept, gross capital employed was worked out after taking into account the net fixed assets and normative working capital. A return of 12 *per cent* post tax was adopted for actual net worth and balance portion of capital employed was compensated at the latest known average rate of interest. On the borrowed funds latest known average rate of interest of the individual company was adopted for computing the entitlement of the companies.

Test check of records revealed that oil companies had borrowed money from outside agencies within the country in Indian Rupees during 1993-98 as shown below:

(Rs in crore)

Company	1993-94	1994-95	1995-96	1996-97	1997-98
HPCL	918.51	599.53	444.36	1411.21	1254.93
BPCL	405.84	407.80	519.07	1357.53	1460.90
IOC	1021.02	1074.01	2257.32	4122.31	2958.78
IBP	287.11	253.59	314.72	444.76	492.42
Total	**2632.48**	**2334.93**	**3535.47**	**7335.81**	**6167.03**

Side by side the oil companies were also found investing their own money with other agencies as detailed below:

(Rs in crore)

Company	1993-94	1994-95	1995-96	1996-97	1997-98
HPCL	270.80	271.35	282.47	283.82	1640.98
BPCL	150.01	242.29	165.80	244.80	1080.44
IOC	3857.63	3856.89	3689.31	3384.06	9279.16
IBP	91.19	149.15	161.72	197.92	239.72
Total	**4369.63**	**4519.68**	**4299.30**	**4110.60**	**12240.30**

From **Annex -B**, it is seen that investment made by HPCL, BPCL, IOC and IBP was always above Rs 270 crore, Rs 150 crore, Rs 3300 crore, Rs 90 crore respectively during 1993-94 to 1997-98 while the internal borrowings of the companies for the same period were always above Rs 440 crore, Rs 400 crore, Rs 1020 crore and Rs 280 crore respectively. It is also seen from the **Annex** that for most of the years interest paid was around ten *per cent* of the borrowings, indicating that the borrowings were for substantial time periods. The investments made by the companies could have been utilised to liquidate borrowings to the extent of their investments. Since the interest rates fetched on investments are always lower than the interest rates paid on the commercial borrowings, this step would have reduced the interest outgo for the companies. Lack of such efforts showed absence of cost control measures by the oil

companies. Exact amount of payments to oil companies from oil pool on account of borrowings could not be ascertained for want of complete details.

4.4.4 Working capital

Though oil companies collected in advance large amount on accounts of depreciation charges and excess corporation tax, OCC failed to reckon these while remitting working capital of Rs 1351.39 crore.

The OCC allowed interest on the amount of working capital requirements for cost of crude, storage of raw materials and petroleum products for period ranging between 30 days and 45 days.

Under the system of cost plus assured returns, OCC/Ministry was reckoning each and every component of cost for reimbursement. The latter, therefore, should have included advance recovery of depreciation, tax component of return etc. while calculating working capital requirements for oil companies.

Further, the marketing divisions of oil companies were delivering petroleum products to retailers/dealers against advance payment. These advance payments were, however, not taken into consideration while calculating requirement of working capital.

Had these accruals been included in the determination of working capital requirement by the OCC/Ministry, the normative working capital requirements allowed for oil companies could have been reduced and would also have reduced outgo from oil pool on account of interest for working capital.

4.5. Refining

4.5.1 Fixation of standard throughput

The fixation of standard throughput[14] for each refinery by the Ministry on the recommendation of OCC was important as at that level of throughput and production the refinery gets full compensation for the cost incurred by it and the return on its investment. These standard throughputs were normally fixed for a period of three years, and were to be revised when new facilities, additions and modifications in individual cases were likely to affect the existing standard significantly.

The Ministry had admitted that normal achievable capacity was to be taken into account for fixing standard throughput. However, test-check of records pertaining to cost updation revealed that the standard throughput revised in 1993-94 and 1996-97 was not according to the capacity utilisation of preceding years for all refineries as detailed in **Annex C**.

It would be seen (from the Annex) that during 1993-94 to 1995-96, ten refineries[15] achieved throughput in excess of standard throughput for all three years (1993-94 to 1995-96). The actual throughput was as high as

[14] Quantum of crude refined annually
[15] BPCL, Mumbail; MRL Narimanam; HPCL, Vizag; IOC, Haldia; IOC, Koyali; IOC, Mathura; IOC, Baruni; IOC, Guwahati; IOC, Digboi; BRPL, Bongaigaon.

124 *per cent* of standard throughput for 1995-96 for IOC, Haldia. Besides, for these three years, there were also capital additions for refineries in respect of four companies as shown in table below. These capital additions would also have contributed to increased throughput capacities of the refineries. However, OCC did not furnish the detailed basis for lower revision of throughput than actually achieved even when capital additions for up gradation were being made

Besides, the capital additions in the refineries were made and additional returns were allowed during 1993-98 without verification of actual date of commissioning in many cases. The capital additions for 1993-98 in refineries are detailed below.

(Rs in crore)

Year	Total capital additions	Additions in plant & machinery
Hindustan Petroleum Corporation. Ltd.		
1993-94	26.67	25.06
1994-95	59.39	54.13
1995-96	40.12	36.77
1996-97	39.42	35.79
1997-98	68.88	60.95
Bharat Petroleum Corporations Limited		
1993-94	94.29	75.96
1994-95	74.52	56.27
1995-96	147.30	119.18
1996-97	75.34	35.72
1997-98	57.93	38.39
Indian Oil Corporation Limited		
1993-94	518.10	502.09
1994-95	Not furnished	
1995-96	2097.06	1990.17
1996-97	272.06	251.41
1997-98	784.16	698.51
Cochin Refinery Limited		
1993-94	72.44	48.28
1994-95	336.54	322.15
1995-96	27.55	15.27
1996-97	117.38	104.45
1997-98	88.90	66.62

Non-revision of standard throughput of the refineries according to the above provisions had resulted in excess benefits in the shape of extra recovery of *per unit* operation and capital related charges on the production beyond the standard throughput. (as discussed in paragraphs 4.2, 4.3 and 5.2).

4.5.2 Un-intended benefits towards extra recovery of depreciation charges.

While fixing the retention price per unit for the refineries, the depreciation charges were taken into account as an element of cost. The chargeable amount of depreciation on the fixed assets was divided by the standard throughput of crude for working out per tonne rate of depreciation for payment through cost. Thus, the total amount of depreciation charges were recovered fully on achievement of the standard throughput and if the actual throughput was more, the oil companies were recovering extra amount towards depreciation charges.

OCC allowed extra payment of Rs 95.10 crore towards depreciation charges.

Test check of records/data relating to oil companies revealed that actual throughput of crude was much more than the standard throughput. This had resulted into grant of un-intended benefits/extra recovery of Rs 95.10 crore towards depreciation charges during 1993-98 on the production beyond the standard throughput as shown below:

(Rs in crore)

S.No.	Unit	Amount
1.	IOC Mathura	3.84
	IOC Haldia	8.98
	IOC Koyali	18.75
	IOC Barauni	0.55
	IOC Guwahati	1.64
	IOC Digboi	0.54
2.	HPCL Visakh	-0.68
	HPCL Bombay	8.95
3.	BPCL	23.06
4.	MRL Chennai	10.30
5.	CRL Cochin	18.00
6.	BRPL Bongaigaon	1.17
	Total	**95.10**

4.5.3 Under-utilisation of captive power plant.

The refineries had installed their own captive power plant to generate electricity to get uninterrupted supply of power and also to effect economy in refining. The installed capacity, actual generation, requirement and quantum of power purchased from outside during 1993-98 in three refineries of BPCL and HPCL, for which data was available, was as detailed in **Annex-D**.

Under-utilization of captive power plants in three refineries resulted in an extra avoidable expenditure of Rs 72 crore.

It would be seen that the capacity utilisation of the refineries was less than the installed capacity, which necessitated purchase of power from outside sources during 1993-98. The cost of production of power in the captive plant was much lower than the cost of power purchased from outside sources, yet the refineries did not ensure captive generation to the optimum capacity. The oil companies thus incurred an avoidable

extra expenditure of Rs 72.00 crore on the purchases reckoning 90 *per cent* capacity utilization, the maximum achieved by one of the refineries. Since the entire expenditure formed part of operational cost, which was taken into account for determining the margin, the oil companies did not put efforts to optimise the capacity.

4.5.4 Non-revision of standard product pattern: Payment of incentive claims

Each refinery had a standard product pattern of various distillates[16], fixed by OCC based on type of crude, design of refinery, chemicals and catalysts used, secondary processing facilities, etc. This standard product pattern was used for the purpose of computing the retention price for the product of each refinery. The fixation of standard product pattern for each refinery was important as it was on achieving this product pattern refineries got full compensation for the costs incurred and the return on its investment.

The Government started a scheme for grant of incentive from November 1977 under which the refineries were allowed to retain the benefit of improvement in the pattern of productions of various distillates. The value realised from improved production of various costlier distillates was compared with the standard product pattern of the refineries and the refineries claimed the difference as incentive.

The improvement in product pattern could be on account of usage of good quality crude, adoption /installation of new machinery, equipment, chemicals and catalysts, adoption of new technology, expansion of capacity, managerial efficiencies, etc. While the benefit, accrued as a result of managerial efficiency was allowed to be retained by the refineries, the benefit accrued by other means was allowed to be retained till such time the investment made for the purpose were recognised for compensation towards return, depreciation, etc.

Non-revision of product pattern by OCC on the basis of actual capability of refinery, new operating practices, type of crude processed etc. led to extra benefit of Rs 1386.06 crore

Test-check of records revealed that Rs 1386.06 crore was paid to the refineries during 1993-98 as detailed in **Annex-E** as incentive claims of the refineries. The OCC had not revised the product pattern on the basis of actual production of various distillates during the previous year. The OCC also did not take into account the capital additions resulting in increased capacities of refineries in terms of product pattern while investments made were promptly recognized for return and depreciation. Further the improvement in product pattern comes substantially from improvement in operating practices, which are subsequently adopted by all the refineries. While one time award for efficient operating practices was justified, however, it also required a further revision and adoption of new standards for product pattern. In its absence the product patterns already achieved were allowed incentives year after year. There was no evidence that OCC had distinguished between the improved operating practices and managerial efficiency for allowing incentive claims.

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[16] Motor Spirit, High Speed, Diesel, Aviation Turbine Fuel, Naphtha, Light Diesel Oil, Superior Kerosene Oil, Fuel, Oil, Bitumen Liquefied Petroleum Gas etc.

Incentive claims of BPCL were examined in detail. It was seen that in the claims preferred, type of crude used by the refinery, a very important factor influencing the product pattern was not mentioned. When imports are made, the foremost consideration is yield value of crude. However, in calculation of payment of incentive, yield value was not considered, rendering these calculations redundant.

In the scheme of incentives claims, retention prices were allowed for quantity of excess production of products over and above the standard production prescribed and same were deducted for products where production was less than standard production prescribed. Since the overall output remains same, if one product's production is increased, it means production for some other product will go down. Thus, if a product for which retention price is higher than average retention price, is produced more than the standard production and another product for which retention price less than the average retention price, is produced less than the standard production, then net incentive claims will be positive.

It was seen that the actual production of LPG, MS, HSD was consistently higher than standard production prescribed for these products during 1993-98. All these products were having higher than average retention prices for crude products; therefore excess production resulted in positive net incentive claims. However there was no upward revision in standard production for these commodities. Only standard HSD production was revised from 2.197 million tonne to 2.46 million tonne in 1996-97, while minimum annual production of diesel was 2.537 million tonne in preceding three years. Thus, standard production fixed had lot of cushion.

In case of LPG, the standard production was reduced from 2.20 lakh tonne to 2.17 lakh tonne in 1996-97, in spite of a minimum annual production of 2.56 lakh tonne in preceding three years. Since LPG had one of the highest retention prices, it resulted in substantial over payment of incentive claims. It was also seen that fuel and losses allowed to refinery for refining of crude which was supposed to be reduced, was revised upwards in 1996-97 from 3.08 lakh tonne to 4.19 lakh tonne in spite of actual fuel and losses being less than three lakh tonne in preceding three years. Correspondingly decrease in the standard production of other products resulted in excess incentive claims. Revision of standard product pattern to actual minimum production for these three components would have wiped out total incentive claims for BPCL.

There was no evidence that OCC had distinguished between the improved operating practices and managerial efficiencies in allowing incentive claims. Besides, the OCC also ignored past production levels for fixing standard product pattern, type of crude used and allowed excessive fuel & losses. These shortcomings emphasised the inadequacies in the administration of incentive claims.

4.5.5 Demurrage charges

The Ministry had designated IOC as the sole canalising agency for import of crude oil and petroleum products for the entire requirement of the oil companies engaged in refining and marketing. The import was being made on the basis of the demand of the various oil companies.

The delivered cost of crude oil comprised pooled *fob* cost, freight, ocean losses, wharfage, landing charges, demurrages, customs duty, etc. Actual payment of demurrage charges during 1993-98 were as given below:

(Rs in crore)

Year	Demurrage on crude oil	Demurrage on imports of petroleum products	Total
1993-94	34.77	68.58	103.35
1994-95	25.95	100.41	126.36
1995-96	64.66	313.55	378.21
1996-97	67.36	449.86	517.22
1997-98	86.70	526.46	613.16

Demurrage charges paid by oil companies increased from Rs 103 crore to Rs 613 crore during 1993-94 to 1997-98 that showed lax cost control measures.

From the above it would be evident that demurrage charges increased from Rs 103.35 crore in 1993-94 to Rs 613.16 crore in 1997-98. The OCC and the Ministry failed to contain the demurrage charges despite the provisions in OCRC[17] to make attempt to remove the constraints on port and other handling facilities to reduce the demurrages. The demurrages could have been minimized by planning ships availability at port and also by adoption of a medium and long-term strategy through appropriate investments in infrastructure in cohort with port authorities. This lack of effort was inherent in the arrangements based on system of cost plus returns.

4.5.6 Headquarter expenses of IOC

Headquarter expenses of IOC increased by 226 percent in five years. The expenses allocated to refineries were higher than actual and contained inadmissible items.

Examination of the amount apportioned to refining function in IOC disclosed rapid increase in the amount claimed as headquarters expenses relating to refining function, which went up from a mere Rs 19.52 crore in 1993-94 to Rs 63.55 crore in1997-98, an increase of 226 *per cent* as given below:

(Rs. in crore)

Unit	1993-94	1994-95	1995-96	1996-97	1997-98
Guwahati	0.66	0.83	1.02	1.74	2.26
Barauni	2.85	3.69	3.96	6.73	8.78
Gujarat	7.46	9.14	11.38	19.38	25.26
Haldia	2.42	2.67	3.30	5.61	7.31
Mathura	6.13	8.05	8.98	15.30	19.94
Total	**19.52**	**24.38**	**28.64**	**48.76**	**63.55**

[17] Oil Cost Review Committee

It was seen from the IOC records that there was no apportioning of headquarter expenses for lubricants, which were out of ambit of APM since November 1993. It was also seen that for 1996-97 and 1997-98 the headquarter expenses debited to refineries were in excess of actual expenditure by Rs. 1.05 crore and Rs 2.41 crore respectively. Besides, expenditure of Rs 5.25 crore incurred on advertisements during 1994-98 was incorrectly debited to refineries since sale promotion expenses were being paid separately through retention prices.

OCC did not scrutinize the correctness and reasonableness of amounts claimed as headquarter expenses before reckoning it as operating expenses. This unquestioned but assured reimbursement did not put any obligation on the IOC to contain the expenses on this account.

4.6. Marketing

4.6.1 Security deposits for gas cylinders:

Oil companies are charging Rs 900 per gas cylinder and Rs 100 per regulator towards security deposits for gas connections. The year-wise security deposit collected/recovered, accumulated deposits, amount spent by oil companies on purchase of cylinders and incremental investment by oil companies on purchase of cylinders were as given below:

	Years	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**
IOC	Deposit received	84.98	106.05	198.13	250.96	389.62
	Cumulative Deposit	747.00	853.05	1051.18	1302.14	1691.76
	Expenditure on purchase	164.94	241.25	280.50	375.11	480.20
	Incremental investment	--	19.08	9.81	23.65	26.27
HPCL	Deposit received	40.47	59.71	81.49	106.05	193.05
	Cumulative Deposit	371.16	431.47	512.97	618.03	811.08
	Expenditure on purchase	64.73	119.50	104.11	175.53	258.05
	Incremental investment	--	13.69	(-) 3.85	17.86	20.63
BPCL	Deposit received	52.00	78.80	97.10	120.50	247.30
	Cumulative Deposit	334.80	413.60	510.70	631.20	878.50
	Expenditure on purchase	33.95	121.39	67.51	96.10	211.46
	Incremental investment	--	21.86	(-) 13.47	7.15	28.84
Total cumulative deposits						**3381.34**

The rate of depreciation prescribed under Schedule XIV of Companies Act (amended in 1988) in respect of gas cylinders is 16.21 *per cent* (straight line method). However, the companies were continuing to charge 100 *per cent* depreciation in their books in the year of purchase and claiming full depreciation through retention price.

The consumer deposits for LPG cylinders amounting to Rs 3381.34 crore was not credited to the oil pool in spite of full reimbursement of expenditure on their purchase.

The OCC was also reimbursing the entire expenditure incurred on purchase of cylinders by allowing 100 *per cent* depreciation under retention price. Thus, the deposits received by the oil companies belonged to oil pool and should have gone towards reducing the deficit of oil pool. The entire amount of consumer deposits for LPG[18] cylinders of Rs.3381.34 crore was lying with the oil companies and being utilised by these companies as their internal resources.

Since the purchase of cylinders was totally financed by the oil pool, the deposits against cylinders should also have accrued to the oil pool. The oil companies could have been allowed to retain a small portion of deposits collected without interest to take care of refunds, which were insignificant. The OCC was not charging interest on security deposits received and retained by the oil companies. The interest on balances (including deposits and interest) would work out to Rs1514.41crore for the period 1993-98 even at the rate of 10 *per cent per annum* as detailed below:

(Rs in crore)

Period	Amount including interest of previous year	Additions during the year	Total deposits	Interest earned @ 10 per cent
Up to 92-93	1276.11	-[19]	1276.11	127.61
1993-94	1403.72	177.45	1581.17	158.12
1994-95	1739.29	244.56	1983.85	198.38
1995-96	2182.23	376.72	2558.95	255.90
1996-97	2814.85	477.51	3292.36	329.24
1997-98	3621.60	829.97	4551.57	445.16
Total				**1514.41**

4.6.2 Wide variations in per unit marketing margins allowed for various activities.

OCC took into account expenses common to all products on elements/activities like installation, distribution and administration cost, return on net fixed assets, working capital, RPO[20], air field stations, LPG filling return, etc. for computation of marketing margins

Variation in marketing margins allowed against various activities from 1993-94 onward were as given below:

[18] Liquefied Petroleum Gas
[19] Data prior to 1992-93 was not furnished
[20] Retail Pump Outlets

(Rs per kl)

	Installation common cost	Difference from lowest rate	Distribution common cost	Difference from lowest rate	Administrative common cost	Difference from lowest rate	Return on net fixed assets	Difference from lowest rate	Return on working capital	Difference from lowest rate	Retail pumps outlets cost/ return	Difference from lowest rate	AFS[21] cost/ return	Difference from lowest rate
IOC	20.99	-	24.52	-	28.93	4.30	35.30	-	42.29	11.63	30.92	3.05	223.50	7.07
BPCL	21.71	0.72	37.21	12.69	30.16	5.53	61.47	26.17	30.66	-	36.87	9.00	216.43	-
HPCL	22.66	1.67	37.55	13.03	24.63	-	60.79	25.49	31.66	1.00	27.87	-	488.06	271.63
IBP	36.73	15.74	37.05	12.53	51.26	26.63	60.57	25.27	31.23	0.57	40.11	12.24	-	-

Year-wise and company-wise quantity sold under APM during 1993-98 were as detailed below:

(in lakh tonne)

	1993-94	1994-95	1995-96	1996-97	1997-98	Total
IOC	364.55	357.64	400.13	413.57	425.84	1961.73
BPCL	121.53	134.58	153.73	160.36	168.20	738.40
HPCL	123.65	129.95	130.19	157.54	159.93	701.26
IBP	38.35	43.62	47.03	50.68	55.23	234.91

It is pertinent to point out that marketing involved mainly transportation, storage and distribution and did not involve any processing. Thus, in marketing there was no scope for significant variations either in operating costs or in returns on capital employed.

From the above, it would be apparent that there were wide variation in per unit of marketing margins allowed against each activity to oil companies suggesting lack of efforts for containing/reducing the cost and as the OCC was reimbursing all the expenditure incurred by the oil companies, the oil companies were trying to justify their cost rather than exercising cost control measures.

OCC allowed extra benefit of Rs 1098.73 crore to oil companies on account of varying marketing margins.

Taking the minimum per unit cost of one company against each activity and applying the same to other companies, the extra marketing margins allowed during 1993-98 to the companies would work out Rs 1098.73 crore as detailed in **Annex-F**.

Higher LPG filling return allowed

The OCC allowed per tonne return on LPG filling at varying rates of Rs 493.29, Rs 678.37 and Rs 660.73 to IOC, BPCL and HPCL respectively. The rates of BPCL and HPCL were higher resulting in extra reimbursement of Rs 155.23 crore during 1993-98 as detailed below:

LPG filling return

Company	Difference in rates (Rs per tonne)	Quantity sold (million tonne)	Excess (Rs in crore)
BPCL	185.08	4.440	82.18
HPCL	167.44	4.363	73.05
Total			**155.23**

[21] Air field stations

Reasons for variations in LPG filling returns were not furnished by OCC.

4.6.3 Allotment of dealerships

Recent public auction of RPO and LDO/SKO dealership on the direction of Supreme Court had clearly shown that the market value of these dealerships was very high. The amount realised through auction of these dealerships was as given below:

Sl. No.	Name of Oil Company	Location of RPO/SKO dealership	Amount realised (Rs in crore)
1.	BPCL	LDO/SKO dealership at Sultanpur (UP)	5.36 (Details of auction amount outlet wise not made available)
2.	-do-	LDO/SKO dealership at Faizabad (UP)	
3.	-do-	Retail Pump Outlet at Raibareilly (UP)	
4.	-do-	Retail Pump Outlet at Sultanpur (UP)	
5.	-do-	RPO at Raibareilly (UP)	
6.	-do-	RPO at Raibareilly	
7.	-do-	RPO at Delhi	
8.	-do-	RPO at Manimajra, Chandigarh	
9.	-do-	RPO at Darlaghat, Solan (HP)	
10.	-do-	RPO at Hyderabad	
11.	IOC	RPO at Pitampura, Delhi	3.11
12.	IOC	RPO at Sector 46, Chandigarh	1.75
13.	IOC(AOD)	RPO at Dimapur, Nagaland	0.16
		Total	10.38

In view of the high market value of that dealership commanded through the recent auction, this mode of allotment could be considered as an economic option. Through this, the oil companies could also derive substantial income out of the investments in retail infrastructure. Besides, this will reduce the burden on the oil pool.

4.7 Crude production

4.7.1 Levy of cess

The Government of India levied cess at the rate of Rs 900 per tonne in February 1989 on crude oil produced to create a fund for development of

oil sector under the Oil Industry (Development) Act, 1974. The amount of cess so collected was to be made available to the OIDB.[22]

The government did not pass on Rs 30098 crore collected through ces on crude oil to OIDB.

Mention was made in paragraph 3.3.3 of the Report of the Comptroller and Auditor General of India, Union Government, No. 19 (Commercial) of 1995 regarding the retention of the collection of cess in the Consolidated Fund of India. Audit further noticed that out of Rs 31000 crore collected towards cess up to March 1998, Government of India passed on only Rs 902 crore to the OIDB and retained the balance of Rs 30098 crore in government account.

The levy of cess was being charged from the consumers in terms of increased costs. However, oil companies were not provided with funds generated through cess collection of Rs 30098 crore. This resulted in commercial borrowings, thus, increasing operating costs, which in turn were again passed on to consumers through higher prices of petroleum products.

The OIDB charged interest for financial assistance/loan at the following rates:

Project	Percentage rate of interest charged
Exploration projects · higher risk areas · lower risk areas	5 10
Commercial discovery	14
Working capital loan in exceptional circumstances	18.5

Despite such lower rate of interest of 5 *per cent* to 14 *per cent,* it was seen from Annual Accounts that the oil companies were getting loan from banks/financial institutions at higher rates instead of getting it from OIDB.

[22] Oil Industry Development Board

GLOSSARY

Capital employed	Net fixed assets plus normative working capital.
Demurrage	Compensation for undue delay or detention of a vessel.
Incentive	Award for better performance in terms of production pattern.
Margins	Per unit returns allowed to companies inclusive of operating expenditure, return on capital employed, etc.
Net-worth	Share capital plus free reserves.
Normative working capital	Working capital requirement allowed to refineries as 45 days crude requirement in case of HPCL Bombay, MRL and Haldia refinery and 35 days crude requirements for other refineries with crude cost taken as Rs 1700 per tonne.
Retention Price	Retention price is computed by taking into account the delivered cost of crude refinery operating cost and a reasonable return on capital employed and other capital related charges.
Sales Plan Entitlements	Quantity of sales fixed by the OCC for marketing companies.
Standard throughput	Quantity of crude to be refined during the year as fixed by OCC/Ministry.
Standard Product Pattern	The proportion of products derived from refining of crude, fixed by OCC refinery wise on the basis of refinery design, type of crude processed etc.
Wharfage	Charges paid for using port.

Annex- B

(Refers to paragraph 4.4.3)

Investment made by the units and interest earned there on during 1993-98

(Rs in crore)

Year	HPCL		BPCL		IOC		IBP	
	Amount of investment	Interest earned	Amount of investment	Interest earned	Amount of investment	Interest earned	Amount of investment	Interest earned
1993-94	270.80	13.47	150.01	0.97	3857.63	348.72	91.19	14.73
1994-95	271.35	13.47	242.29	4.10	3856.89	371.76	149.15	19.31
1995-96	282.47	13.45	165.80	5.26	3689.31	315.95	161.72	19.02
1996-97	283.82	13.46	244.80	5.27	3384.06	314.40	197.92	15.30
1997-98	1640.98	33.17	1080.44	11.83	9279.16	233.07	239.72	17.18
Total	**2749.00**	**87.02**	**1883.34**	**27.43**	**24067.05**	**1583.90**	**839.70**	**85.54**

Amount of loan[*] taken by the units and interest paid thereon during 1993-98

(Rs in crore)

Year	HPCL		BPCL		IOC		IBP	
	Amount of loan	Interest paid	Amount of loan	Interest paid	Amount of loan	Interest paid	Amount of loan	Interest paid
1993-94	918.51	74.72	405.83	46.72	6499.90	398.35	287.11	32.92
1994-95	602.19	76.75	407.80	43.72	5366.71	475.24	253.59	32.83
1995-96	446.20	46.21	524.38	39.38	8227.36	560.15	314.72	38.78
1996-97	1418.09	97.52	1360.81	80.06	13178.76	1075.77	444.76	50.84
1997-98	1256.92	84.98	1464.37	112.23	14210.14	1126.15	492.42	65.39
Total	**4641.91**	**380.18**	**4163.19**	**322.11**	**47482.87**	**3635.66**	**1792.60**	**220.76**

Amount of interest paid on loans and interest earned on investments during 1993-98

(Rs in crore)

Name of units	Interest paid on loans	Interest earned on investments
HPCL	380.18	87.02
BPCL	322.11	27.43
IOCL	3635.66	1583.90
IBP	220.76	85.54
Total	**4558.71**	**1783.89**

[*] Loans includes internal and external loans as far the corresponding interest paid wasnot available separately.

Annex- C

(Refers to paragraph 4.5.1)

Standard/actual throughput and capacity utilisation of refineries

(in thousand tonne)

Refinery	Throughput for 1993-94			Throughput for 1994-95			Throughput for 1995-96			Throughput for 1996-97			Throughput for 1997-98		
	Standard	Actual	Percentage	Standard	Actual	Percentage	Standard	Actual	Percentage	Standard	Actual	Percentage	Standard	Actual	Percentage
HPCL, Mumbai	5500	5880	108.73	5500	5236	95.20	5500	5970	108.55	5835	6540	116.05	5835	6380	113.22
BPCL, Mumbai	6750	7203	108.71	6750	7505	111.19	6750	7480	110.52	6900	7840	110.72	6900	8000	115.94
CRL, Cochin	4700	4857	103.34	5150	5136	99.73	6583	7420	113.05	6760	7290	108.00	6750	7730	114.52
MRL, Chennai	5900	5717	98.90	5900	6920	117.29	5900	560	94.92	6120	6620	108.17	6120	6970	113.89
MRL, Narimanam	125	130	104.00	306	380	105.56	370	370	100.00	490	350	71.43	490	560	114.29
HPCL, Vizag	4300	4448	103.44	4300	5014	116.80	4300	5040	117.21	4515	4850	107.42	4515	2470	54.71
IOC, Haldia	2750	3106	112.95	2750	3258	118.47	2750	3420	124.36	3060	3450	112.75		4710	
IOC, Koyali	9100	8434	103.67	9100	9888	108.66	9100	10170	111.76	9430	10350	109.76	9430	10690	113.38
IOC, Mathura	7500	8518	113.57	7500	8377	111.89	7500	8330	111.07	7500	8110	108.13	7500	8570	114.27
IOC, Barauni	2100	2222	105.81	2100	2220	105.71	2100	2320	110.48	1900	1900	100.00	1900	2180	114.74
IOC, Guwahati	800	911	113.88	800	884	110.50	800	840	106.00	800	860	106.25	800	800	107.50
IOC, Digboi	500	554	110.80	500	536	107.20	500	560	112.00	500	480	96.00	500	500	100.00
BRPL, Bongaigaon	1100	1167	106.09	1100	1179	107.18	1201	1220	101.58	1500	1540	102.67	1500	1720	114.67
MRPL, Mangalore										2400	2792	116.33	3600	3955	100.86
Total	**51125**	**54247**	**106.11**	**51810**	**56533**	**108.12**	**53334**	**58720**	**110.10**	**57500**	**62762**	**109.15**	**55640**	**65295**	**117.35**

Annex- D

(Refers to paragraph 4.5.3)

Loss due to short fall in generation of electricity by Captive Power Plant

Unit	Year	Installed capacity	Optimum production*	Actual production	Short fall in production	Purchased from outside	Cost per unit (Rupees)	Rate at which purchased from outside Rs/kwh	Difference in cost (Rupees)	Extra amount paid (Rs in crore)
(in million kwh)										
BPCL, Bombay	1993-94	318.40	286.56	162.66	123.90	19.14	00.98	3.78	2.80	5.36
	1994-95	318.40	286.56	166.14	120.42	18.30	00.99	4.66	3.67	6.72
	1995-96	318.40	286.56	188.76	97.80	10.89	1.11	6.90	5.79	6.31
	1996-97	318.40	286.56	210.94	75.62	7.63	1.04	7.88	6.84	5.22
	1997-98	318.40	286.56	214.26	72.30	8.63	00.99	8.29	7.30	6.30
HPCL, Visakh	1993-94	114.88	103.39	78.30	25.09	10.25	00.68	2.84	2.16	2.21
	1994-95	114.88	103.39	79.63	23.76	15.94	00.70	2.52	1.82	2.90
	1995-96	114.88	103.39	80.79	22.60	16.64	00.94	2.76	1.82	3.03
	1996-97	114.88	103.39	98.82	4.57	6.72	00.95	4.49	3.54	1.62
	1997-98	114.88	103.39	63.70	39.69	2.94	00.99	3.34	2.35	0.69
HPCL, Bombay	1993-94	172.32	155.09	76.26	78.83	132.89	00.81	2.29	1.48	11.67
	1994-95	229.76	206.78	107.60	99.18	79.95	00.71	2.71	2.00	15.99
	1995-96	229.76	206.78	201.99	4.79	28.38	00.56	4.01	3.45	1.65
	1996-97	229.76	206.78	203.26	3.52	36.89	00.88	4.12	3.24	1.14
	1997-98	229.76	206.78	204.18	2.60	36.14	1.32	4.63	3.31	0.86
									Total	**71.67**

* Optimum production is taken as 90% of the installed capacity since HPCL refinery in Bombay achieved 90 per cent production in 1997-98.

Annex- E

(Refers to paragraph 4.5.4)

Statement showing the incentive claims of the Units during 1993-98

(Rs in crore)

S.No.	Year	BPCL	HPCL	IOC	Total
	1993-94	36.39	41.70	250.18	328.27
	1994-95	44.09	32.35	132.12	208.56
	1995-96	41.91	62.70	140.62	245.23
	1996-97	44.58	37.78	311.96	394.32
	1997-98	61.72	21.71	126.25	209.68
Total		**228.69**	**196.24**	**961.13**	**1386.06**

Annex- F

(Refers to paragraph 4.6.2)

Variations in the elements of marketing margins allowed to companies

	Difference		**Avoidable excess margin allowed**
	Rs (Per kl)	**Quantity (in lakh kl)**	**(Rs in crore)**
A. Installation common cost			
IBP	15.74	234.91	36.98
B. Distribution common cost			
BPCL	12.69	738.40	93.70
HPCL	13.03	701.26	91.37
IBP	12.53	234.91	29.43
			214.50
C. Administration common cost			
IOC	4.30	1961.73	84.36
BPCL	5.53	738.40	40.83
IBP	26.63	234.91	62.56
			187.75
D. Return on net fixed assets			
BPCL	26.17	738.40	193.24
HPCL	25.49	701.26	178.75
IBP	25.27	234.91	59.36
			431.35
E. Return on working capital			
IOC	11.63	1961.73	228.15

Total excess margin allowed	**(Rs in crore)**
Installation common cost	36.98
Distribution common cost	214.50
Administration common cost	187.75
Return on net fixed assets	431.35
Return on working capital	228.15
	1098.73