Report on Audit / inspection of accounts of CY-ONN-2002/2
Period: FY 2016-17 and 2017-18
Operator: Oil and Natural Gas Corporation Limited (ONGC)

1. Scope:

The Scope of audit of accounts for producing E&P Blocks for the years 2016-17 and 2017-18 is as stated in Annexure – IV(a) to the letter No. MM-12016/3/2018-DGH/C-3770/ENQ-122/ORD/385 from Directorate General of Hydrocarbons dated 15-10-2018.

While conducting the audit, the provisions contained in the Production Sharing Contract (PSC) dated February 6th, 2004 and the Auditors report issued by the auditors appointed by Management Committee audit the transactions for the years 2016-17 and 2017-18 respectively have been considered and relied upon by us.

2. Background:

Block CY ONN 2002/2 (Unincorporated) Joint Venture has been set up under a Production Sharing Contract (PSC) dated February 6th, 2004 entered into between the Government of India and Oil & Natural Gas Corporation Limited ("ONGC") and Bharat Petroleum Corporation Limited (now represented by BPRL, Subsidiary of BPCL) for the purposes of prospecting, exploring and production of petroleum from Block CY ONN 2002/2.

All joint operations under this agreement are conducted by the operator i.e., ONGC.

Besides the operations of block CY-ONN-2002/2, ONGC also has operations in other blocks. The common expenses of operator are incurred for all its operations and the share of expenses allocated to CY-ONN-2002/2 as per the process consistently followed for each of the ONGC operated Blocks.

3. Observations:

We have conducted the audit of accounts of CY-ONN-2002/2 field for the years 2016-17 and 2017-18 with respect to above stated scope and the limitations. Details of our verification and observations on such audit are furnished below:

3.1 Production Sharing Contract

3.1.1 Mining Lease

Observation
As per Article 11.2 of PSC, application for Lease (Mining Lease) in respect of proposed development area to be submitted to relevant state government, Revised application for PML was made on 13.11.2015 to Tamilnadu Government District Collector (Geology & Mining Department, Nagapattinam), approval for the same is yet to be received.

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3.1.2 Consideration of Audit observations in MC Meetings

Observation

As per the DGH Inspection report for the FY 2015-16, Exception- 2 states that ONGC has been directed by MOP&NG to get their procurement procedure approved by MC. However we have noted that though the Operator had already submitted 75th OC Resolution for getting MC approval and the same is pending for approval by MC.

3.2 Operations

3.2.1 Site Restoration fund

We have reviewed the requirement of creation of SRF as per Production sharing Contract.

Observation

As per Article 14.10, block has to create SRF but the same has not yet been created by the block.

3.2.2 Insurance

Observation

We have noted that well-MDDC 9 is covered in the Insurance for FY 2016-17; However, the same is not covered in policy effective for FY 2017-18.

3.2.3 Measurement of Petroleum

As per article 13.1 of PSC, Petroleum for internal consumption for petroleum operations, flared, saved and sold from the contract area shall be measured by methods and appliances generally accepted and customarily used in modern oil field and petroleum industry practices and approved by the Management Committee and the government.

Observation

Procedures for Measurement of Petroleum is yet to be approved by the Operating Committee and Management Committee even though the commercial production has started from the financial year 2016-17 though the Operator has recently sent the measurement procedures to DGH for consideration through letter dated 18.12.2018.

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3.3 Procurement

3.3.1 Procurement Process:

The Joint venture does not follow the procedures laid down in PSC with regard to procurement of materials and services. Instead, it follows the procurement policy of the Operator (ONGC).

Also as per appendix F of PSC, a set of vendor qualifications criteria for each major category of contract or supply shall be proposed by operator and approved by Operating committee and Management Committee and such approval procedure was not followed for the block.

Inventory is procured by ONGC Corporate and Inventory costs are booked to the block based on actual consumptions.

In this regard ONGC has been directed by MOP&NG to get their procurement procedure approved by MC. In line with the said requirement, Operator has submitted 75th Operating Committee Resolution which is pending for approval by MC.

3.3.2 Procurement from Related Parties/affiliated entities

Based on the records examined by us, and on the basis of invoices / debit notes raised by ONGC to the block, the materials and services are provided at cost and no profit element is included therein.

3.4 Revenue

Observations

1. There is no separate agreement for Sale of Crude Oil to CPCL. Presently, sale is being made to CPCL as a part of Overall agreement (which also includes sales of crude generated by other NELP blocks of ONGC) executed between the ONGC and CPCL.

3.4.1 Payment of Royalty

Observations

1. Initial lease fee and preliminary expenses of Rs.2.00 Lakhs and Rs.1.20 Lakhs respectively, are to be charged in accordance with the PSC provisions.
2. An amount of Rs.14.12 Crores and 23.48 Crores paid towards royalty for the Financial year 2016-17 and 2017-18 respectively in anticipation of Mining License applied with Tamilnadu Government on 23.11.2015. We have also noted that MOP&NG vide letter dated 14.03.2016 requesting Tamilnadu Industrial Secretary to grant Mining lease for period of 20 years commencing from 16.10.2015.

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3.4.2 Main office expenses are charged to the block as per Article 2.6.1 of Appendix C to the Production Sharing Contract based on circular issued by ONGC Corporate Office.

3.4.3 HR Policy

There is no block specific HR policy and policy of operator is being followed. As per the Management there is no expatriate manpower in the block.

We have verified the process of allocation of manpower cost to the block by the ONGC and noted the same is in line with PSC.

3.5 Governance

Observations

1. As per Article 25.4.3, audited accounts shall be approved by the MC within 90 days from the end the year. However, we have noted that audited accounts were approved by the MC for FY 2016-17 and 2017-18 with delay of 16 Months and 4 Months respectively.

2. As per the article 6.7, Management Committee meeting shall be conducted at least once in every three months or more frequently at the request of any member. We have noted that the same is not in practice.

3.6 Statutory Litigations

With reference to note no.9 of notes forming part of financial statements for financial year 2017-18, it was noted that there was a contingent liability in respect of Service Tax and GST payable on royalty payments for the period 01.04.2016 to 31.03.2018. In this regard, payment of Rs. 6.22 Crores was made under protest in FY 2018-19 against demand notice issued by Commissioner of GST and Central Excise Puducherry.

Also in respect of above, we have noted that there is no expenditure booked in FY 2016-17 & FY 2017-18 towards GST on Royalty.

3.6.1 Maintenance of Books of accounts:

The contractor is maintaining all the records in JV module in SAP system where all the incomes and expenses relating to JV can be verified.

Proper records for the purpose of preparation of Statements as required under the PSC have been maintained so far as appears from our examination of those records.

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The operator prepares the financial statements for the financial year by making appropriate adjustments. Certain adjustments were made to the balances, as per trial balance, for the purposes of preparation of statements submitted to the DGH.
We have no observations to report in this regard.

3.6.2 Bank Guarantees

Since the Block has completed Minimum Work Programme, hence no bank guarantees/performance guarantees as per provision of PSC (article 29.2) is required.

3.7 Audit Report and Statement of audited accounts

3.7.1 Appointment of Auditors

Annual audit of accounts of the block for the two financial years was carried out by an independent firm of chartered accountants, whose appointment was approved by the Management Committee in MC meeting No: 52 dated 21.03.2017.

3.7.2 Accounting policies

We observed that the significant accounting policies adopted by the JV are in accordance with the requirements of PSC.

3.7.3 Adjustments for Observations of DGH Auditors and Statutory Auditors

There were no adverse observations having financial impact have been given by the Auditors appointed by DGH. Hence no adjustment was made.

There were no adverse observations having financial impact have been given by the Auditors appointed by the operator. Hence no adjustment was made.

3.7.4 Validation of Statements with PSC

A. Statement of Sources & Utilization of funds

   We have perused the audited statements of accounts and found that the statement of sources and utilization of funds along with its various schedules are as per Format-1.

B. Value of petroleum produced and sold including the government's share of profit petroleum and sales schedule.

   We have verified the statement of Petroleum produced and sold with format prescribed and same are in line with format prescribed in PSC and also cross verified the petroleum produced with production records.

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Since cost petroleum is higher than the revenue generated, government's share of profit petroleum not applicable for Financial Years 2016-17 and 2017-18.

C. Extent of allowable and recoverable costs and Profit Petroleum

Statement of extent of allowable and recoverable costs and Profit Petroleum prepared by the block are same in line with PSC.

3.7.5 Calculation of Notional Income tax, Investment Multiple/PTRR

We have reviewed the Cost petroleum calculation and were also confirmed by the management that the JV has not yet reached the stage of profit petroleum. The same has also been verified in the audited financial statements.

Hence calculation of Investment Multiple and the Notional Tax Liability were not applicable.

3.7.6 Cost and Profit Petroleum:

Cost recovery taken by the block is in line with article 15.9 of the PSC which states that Maximum amount of cost petroleum to which contractor shall be entitled shall be 100% of total value of the Petroleum produced and saved from the contracted area.

Further noted that statement of Profit Petroleum is prepared in line with formats as specified in PSC.

3.7.7 Insurance:

A comprehensive insurance policy covering all the NELP blocks have been taken by ONGC centrally at corporate level covering a period of Insurance for two financial years and the premiums are allocated to the blocks.

Operator has included the name of GOI as co-insured in its insurance policies with waiver of subrogation against GOI.

3.8 Imports

3.8.1 Essentiality Certificates

Materials procured under the EC was issued to the designated Mining Lease areas and we have verified all the conditions with regard to Essentiality certificates on sample basis, and in this regard, we have no observations to report.

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3.9 Procurement

Further, we have selected and verified a sample of procurements covering both the financial years with respect to costs (i.e. Fixed Assets, Services, Materials & Imports) under Major Heads (i.e. Exploration, Development and Production) and noted that procurements are done at competitive prices.

3.10 Inventories and Assets

3.10.1 Cost Recovery Statement

The Joint Venture/Block does not own any inventory, as inventory is procured by ONGC corporate and inventory costs are booked to the venture/block based on actual consumption by the block.

3.10.2 Inter block Transfers

We were given to understand that there are no transfers between the blocks, since procurement is made by ONGC and booked to block only at the time of consumption.

3.10.3 Physical Verification of Inventory

We have verified the physical verification reports of finished goods for two financial years. The block did not maintain any inventories other than finished goods.

3.10.4 Sales Revenue

Subject to grant of Mining Lease, from FY 2016-17 onwards, the block is considered as under "Commercial Production" and sale revenue from exploratory & developments wells were recognized on accrual basis separately as sales income.

We have verified compliance with PSC in respect of billing cycle and receipt of sales revenue from the Chennai Petroleum Corporation Limited.

Further we have cross verified the production records for the audit period with billed quantity to the customer and found in order.

Royalty: We have verified the royalty payment for two financial years and we noted that the value of the same was determined correctly and payments were made within time as per PSC provisions.

Cess: As it is a NELP block, Payment of cess is exempted by Government of India.

License Fee: Initial license fee for ML Rs.11.20 Lakhs include initial lease fee of Rs. 2.00 Lakhs, Security Deposit Rs.8 Lakhs and Preliminary expenses of Rs.1.20 Lakhs.

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3.11 Expenditure

3.11.1 Accounting of Expenditure

All expenditures relating to the JV have been accounted for as per PSC. The Significant Accounting Policies followed by the JV is attached to the audited Financial Statements as notes forming part of statement of Sources and Application of Funds dated 23.05.2017 and 15.05.2018 for the years 2016-17 and 2017-18 respectively.

3.11.2 Prohibited Expenditure

On our verification we have not come across any expenditure prohibited under section 3.2 of Accounting Procedure of PSC charge to revenue.

3.11.3 Classification of Costs and Expenditures

All costs and expenditures have been classified into proper heads of expenditure as envisaged in PSC viz., Exploration, Development, Production, Service and General & Administration Costs.

The contractor is maintaining all the records in JV module in SAP system where all the Costs and Expenditure relating to JV can be verified.

The transactions were test checked on sample basis and no discrepancies were noticed.

3.11.4 Overhead Allocation

All G&A Costs, G&G Costs and Exploratory Drilling Costs which are block specific and identifiable are charged directly to the block's books and in other cases the costs are allocated from ONGC Corporate books to the block on the basis of actual physical parameters.

3.11.5 Approval of all items of Cost

All the items of costs taken into cost recovery for both the financial years are in line with work programme budget approved by Management Committee

3.11.6 Functions of Operating Committee and Management Committee

Composition of Operating Committee and Management committee is being constituted in line with Requirements of the PSC.

M. BHASKARA RAO & Co.
Chartered Accountants
HYD.

3.12 Internal Controls

On our review of report of internal financial control over the books of accounts of the block and according to the information and explanation given to us, we have neither come across nor have been informed of any continuing failure to correct major weakness in the aforesaid internal control system.

3.13 Related Parties

As per the information and explanations given to us and based on the audited financial statements, the joint venture block has no related party transactions requiring disclosure as per accounting standards.

M. BHASKARA RAO & CO.
Chartered Accountants
HYD.