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M. S. Gurupadaswamy

(M. S. GURUPADASWAMY)

MINISTER OF PETROLEUM AND CHEMICALS

REPORT OF THE
COMPTROLLER AND AUDITOR GENERAL
OF INDIA

UNION GOVERNMENT

NO. 7 (COMMERCIAL) OF 1989

AN ANALYSIS OF OIL PRICING
ARRANGEMENTS

REPORT OF THE
COMPTROLLER AND AUDITOR GENERAL
OF INDIA

THE GOVERNMENT OF INDIA

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AN ANALYSIS OF OIL PRICING
ARRANGEMENTS

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OFFICE OF THE
COMMISSIONER OF EDUCATION

ALBANY, N. Y.
1901

REPORT OF THE
COMMISSIONER OF EDUCATION
FOR THE YEAR 1901

ALBANY, N. Y.
1902

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ALBANY, N. Y.

ADMINISTRATIVE REPORT

CHAPTER I
GENERAL STATEMENT OF THE
EDUCATIONAL SITUATION IN 1901

CHAPTER II
EDUCATIONAL STATISTICS



OVERVIEW

I. The prices of petroleum products have been continuously rising during the last several years. From the year 1980 to 1988, the prices of four major products, Motor Spirit (Petrol, MS), High Speed Diesel Oil (HSD) and Superior Kerosene Oil (SKO), Liquefied Petroleum Gas (Cooking Gas, LPG) have increased between 51.12 per cent and 75.49 per cent.

The prices of petroleum products are decided by administered prices which, while taking the total costs into account, provide for a scheme of cross-subsidisation of various products depending on their ultimate use. The total cost of main consumer products, Motor Spirit (Petrol), HSD, SKO, LPG consisted of the following elements and their proportion on 9-1-1988 was as given below :

Nature of cost	Percentage to total cost			
	MS	HSD	SKO	LPG
(a) Crude Oil	19.87	58.65	91.10	77.98
(b) Refining	2.15	5.34	8.89	5.80
(c) Excise Duty	28.80	10.66	17.04	7.61
(d) Marketing	1.30	2.12	3.52	18.47
(e) Surcharge	8.84	21.97	34.74	19.71
(f) Adjustment for product prices.	39.04	1.26 (—)	55.29 (—)	43.19
(g) Filling charges	..	..	..	13.62
TOTAL	100.00	100.00	100.00	100.00

(Paras 1.2, 1.3 and 1.4)

II. Since 1961, the Government appointed a number of Committees to enquire into oil prices. The more important Committees are Oil Prices Committee (OPC), 1976 and Oil Costs Review Committee (OCRC) 1984. The present pricing arrangements are based on the recommendations of OCRC, 1984. Initially, when the bulk of Country's requirement of petroleum products was met from imports, the prices of locally manufactured petroleum products were based on the principle of import parity. This policy continued till the retention price concept was introduced in respect of refineries based on interim recommendation of the Oil Prices Committees in July 1975. The retention prices, which consisted of three major elements viz. cost of input refining/marketing costs and return on capital were basically meant to enable the refining and marketing Companies to meet their basic refining/marketing

costs for a given pre-determined quantum and also to have a reasonable return on capital employed. The Government, however, reserved the right to determine the final consumer prices. The next change in the policy of oil pricing came with the recommendations of Oil Cost Review Committee in 1984. While the concept of retention prices was largely retained, the Government allowed higher margins to the Oil Companies with a view to enable them to generate internal resources for financing future investments in refining, pipeline and marketing sectors.

(Paras 1.7, 1.8 and 1.9)

III. The OPC, 1976 adopted the principle of long run social marginal cost of domestic crude. While recommending the base price for the crude oil, the OPC encountered many constraints since the production of crude oil from off-shore installations had barely started and the Committee had to go largely by the estimates of costs and productivity furnished by Oil and Natural Gas Commission. In view of this, the Committee recommended a review after three years. However, no such review has been done so far despite significant variations in all the relevant factors. Further, the price of indigenous crude oil, which is the basis of the oil pricing, has not been determined on the basis of any detailed study since 1976, as it was kept beyond the purview of the Committee (OCRC, 1984) appointed subsequently. From 11-7-1981, the base price of indigenous crude was revised steeply from the level fixed by OPC without any systematic study having been made. From 1-3-1987, the price of indigenous crude has been kept at a level even higher than the international prices. The cost of production of indigenous crude was far below the base price fixed by the Government.

This approach has resulted in generation of large profits and internal resources at the hands of ONGC. At the same time, a balance of Rs. 5533.43 crores as on 31-3-88 out of the proceeds of the oil development cess, which is specifically meant for investment in oil industry according to provisions of Oil Industry (Development) Act, 1974, has not been handed over to the Oil Industry Development Board. No payment out of the cess collection has been made to OIIB since 1983-84. The rate of oil development cess was stepped up from Rs. 300 to Rs. 600 per tonne from March 1987. The proceeds of the cess are retained by the Central Government. The rate

of royalty which is also an element in fixation of crude price and which accrues to the Government of an oil producing State, continues to remain at Rs. 192 per tonne since 1-4-1984.

(Chapter 2)

IV. Although the refining cost ranges between 2.15 percent to 8.89 per cent of the total price of various petroleum products, in absolute terms it was approximately Rs. 630 crores for the total production during 1986-87. The following trends and features having a significant impact on the pricing arrangement envisaged for refining operations were noted:

- (a) Standard thruput, which is that level of thruput and production at which a refinery gets full compensation of all its costs as well as a return on investment, is not fixed at the optimum achievable level. In case of most of the refineries, actual thruput was seen to have exceeded the standard thruput. Detailed examination of fixation of standard thruput in one case revealed that adequate cushion was left in fixing it.
- (b) Fuel and loss allowable for operations were decided on the basis of historical data and there was no deterrent against a higher percentage of fuel loss.
- (c) Although the standard thruput for the refinery was determined, the standard manpower to achieve this thruput had not been determined. Actual thruput per employee widely varied among different refineries.

(Chapter 3)

V. The marketing cost mainly consists of expenditure on installations, distribution and administration. An analysis of marketing costs booked in 1982-83 under various heads of account revealed that more than 70 per cent of the total expenditure was incurred on salaries, wages and overheads. There has been a steep increase in the per unit marketing cost over the years. The reimbursement for expenditure on marketing is made on the basis of historical costs. No norms for either manpower or uniform margins have been laid down. There is, therefore, no incentive provided in the system to reduce the marketing costs.

During the years from 1982-83 to 1986-87 the volume of sale per employee in case of Indian Oil Corporation has declined by 6.43 per cent. This is in spite of the fact that it controls over 50 per cent of total sales and over 80 per cent of direct sales which should give it a great benefit of the economies of scale.

(Chapter 4)

VI. There are a large number of pool accounts for various purposes. The main purpose of these accounts is to achieve stability in ultimate selling price by equalisation of various elements of cost such as crude, refining, marketing, freight and freight surcharge and to administratively adjust the prices of various products by means of cross-subsidisation.

A review of balances of various Industry Pool Accounts and surplus on account of Oil Development Cess during six years ending 31-3-1988 revealed that there had been an overall surplus of Rs. 13937.77 crores in all as a result of operation of pricing mechanism. The surplus is mainly attributable to (i) Oil Development Cess (Rs. 5508.67 crores); (ii) Cost and Freight Adjustment Account (Rs. 8252.85 crores); and the balance (Rs. 176.25 crores) is accumulation in other pool accounts. Although all the above accounts were created for specific purposes, they have been operated in such a way that they have become a continuous source of generating extra-budgetary resources for the Government.

(Paras 5.1, 5.18, 5.19 and 5.20 read with para 7.1 & 7.4)

VII. For the accuracy of pool accounts, the Oil Coordination Committee is heavily dependent on the company managements and the audited statements certified by the Chartered Accountants appointed by managements themselves. The internal control by Oil Coordination Committee is inadequate. The test check of these accounts revealed a number of instances of re-imbursements of substantial amounts not allowed by the pricing arrangements which resulted in adventitious gains to oil companies.

(Paras 6.3 to 6.14)

CHAPTER 1

Introduction

1.1 Oil and Petroleum Industry occupies a predominant place in the economy of the country as a whole and the public sector in particular. There are two organisations viz. Oil & Natural Gas Commission and Oil India Limited which produce crude oil in India. Apart from the crude produced in India, crude is also imported. The crude oil is refined in twelve refineries at present. There are three major marketing companies which market these petroleum products, (viz. Indian Oil Corporation Limited., Hindustan Petroleum Corporation Limited., and Bharat Petroleum Corporation Limited). A special feature of Oil Industry in India is that it is entirely in the Public Sector. Petroleum Sector contributes a major share of net profits of Public Sector Undertakings.

1.2 The prices of petroleum products have been revised upwards several times during the last eight years. Figure 1 (Page 2) shows the trend of the prices Motor Spirit (MS), Diesel (HSD), liquified petroleum gas (LPG) and kerosene (SKO) which are common consumer products.

1.3 In case of all the four products the prices have increased by 51.12 per cent to 75.49 per cent over a period of eight years between 1980 to 1988. The last increase in the prices was announced in January, 1988. The "Price", paid by the consumer for every unit of the product consists of several elements of costs as well as margins allowed by the pricing arrangements apart from Sales Tax and Octroi if leviable. Briefly, the various costs and their percentages are approximately as follows :

Ex-storage point price of M.S., H.S.D., S.K.O., L.P.G., with effect from 9-1-1988

	Rs. KL MS-87	% MS	Rs. KL HSD	% HSD	Rs. KL SKO	% SKO	Rs. MT (Domestic) LPG	% LPG
1. Crude cost	1529.56	19.87	1815.60	58.65	1782.42	91.10	2688.95	77.98
2. Refinery Margin	165.33	2.15	165.33	5.34	174.03	8.89	200.13	5.80
3. Ex-Refinery Price	1694.89	22.02	1980.93	63.99	1956.45	99.99	2889.08	83.78
4. Excise Duty	2215.56*	28.80	330.00*	10.66	333.59	17.04	262.50	7.61
5. Marketing margins	99.60	1.30	65.61	2.12	69.02	3.52	637.21	18.47
6. Surcharge	680.00	8.84	680.00	21.97	680.00	34.74	680.00	19.71
7. Product Price Adj (PPA)	3004.02	39.04	39.01	1.26	(1082.13)**	(55.29)**	(1489.81)**	(43.19)**
8. Filling charges							470.00	13.62
9. Ex-storage Price	7694.07	100.00	3095.55	100.00	1956.93	100.00	3448.98	100.00

** These are minus adjustments.

* Net excise duty after adjustment of Rs. 111.94 and Rs. 17.49 in respect of MS & HSD respectively, which is absorbed in pool accounts.

1.4 The cost attributable to the refining and marketing margins ranges from 3.45 per cent to 24.27 per cent of the total cost in respect of different products. The bulk of the remaining cost is made up of duties, surcharges and royalty. A study by audit of these arrangements with a view to evaluate their

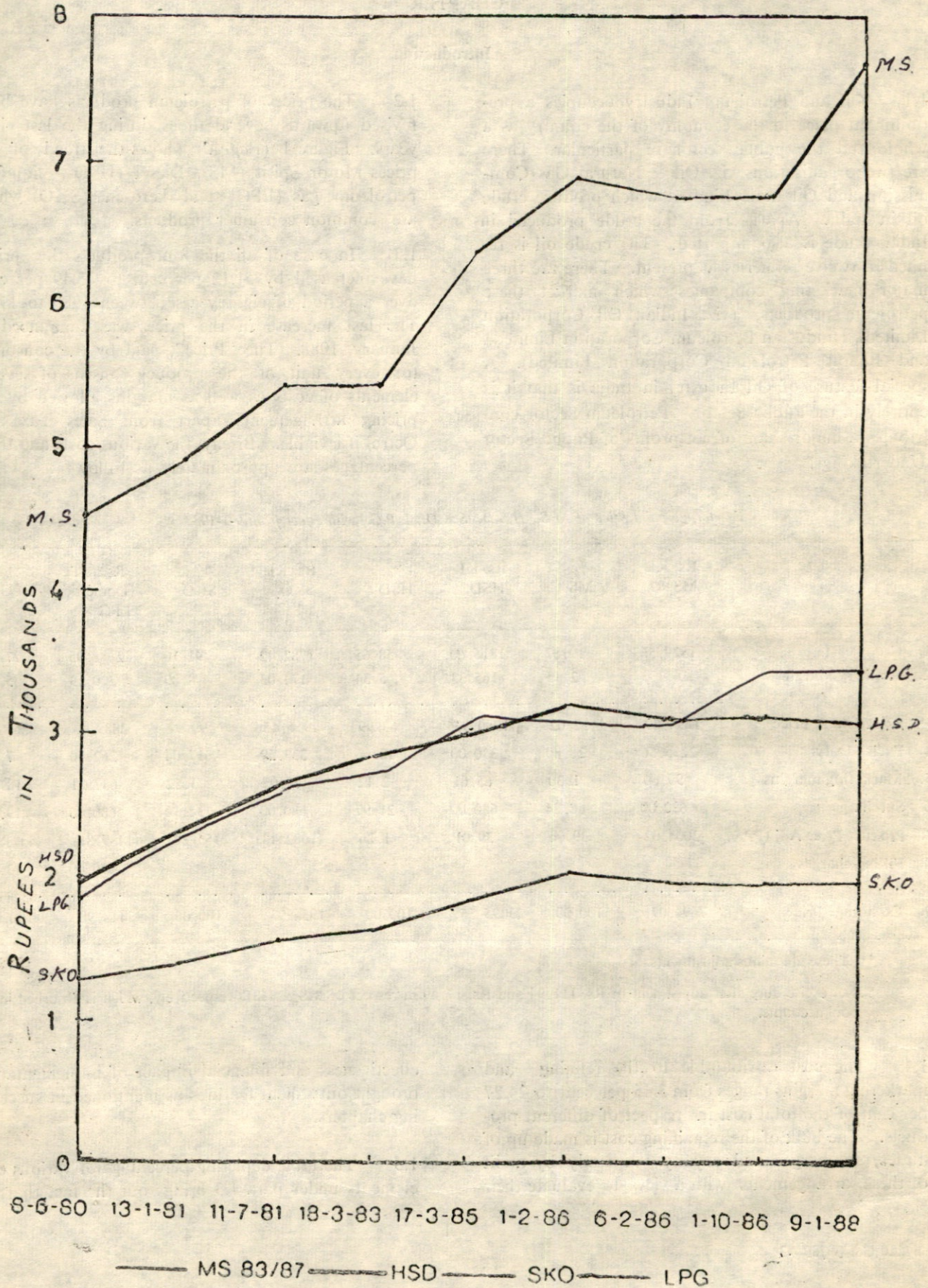
effectiveness and financial impact of implementation brought out salient features as mentioned in succeeding chapters.

1.5 The table depicting percentage of various cost elements under para 1.3 brings out the fact that the

BASIC CEILING SELLING PRICE EX-STORAGE POINT BOMBAY

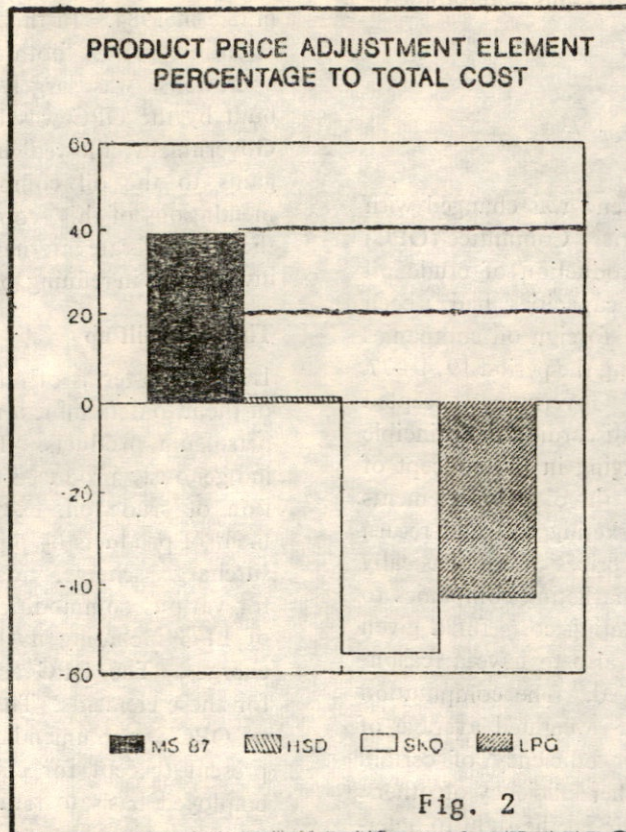
Rs. PER KL/MT

Fig. 1



product price adjustment varies from product to product in certain products increasing the final price

in certain products reducing the final price as depicted below in figure 2.



Historical Background

1.6 In April, 1950 the Burma Shell Company entered into an agreement with Government of India for fixation of prices on a formula known as "Valued Stock Account" under which the prices were determined on the basis of landed costs of imports. The other oil companies, although having no such formal agreement with Government, in practice charged the same prices as Burma Shell. This arrangement was terminated by mutual consent of the parties in May, 1958 when the oil companies agreed to certain ad-hoc reductions in prices which were mopped up by the Government through the imposition of additional duties. The prices remained unchanged to the consumers.

1.7 From 1961 onwards the Government had set up a number of Committees to enquire into oil prices. Starting with the oil prices Enquiry Committee headed by Shri K.R. Damle, there was a working group on oil prices in 1965, Oil Prices Committee (OPC) of 1969, Oil Prices Committee of 1976 and finally Oil Cost Review Committee (OCRC) which submitted

its recommendations in July, 1984. The recommendations of OCRC have been made effective by the Government with effect from 1-4-1984.

Evolution of Oil Pricing Policy

1.8 A Survey of the reports submitted by various Committees indicated that the evolutionary trend in the oil pricing could be broadly summed up in the following three phases:

(a) *The Policy of Import Parity*

In the first phase, after taking into account the operation of agreements with the international oil companies permitting them to maintain prices at a level not exceeding the landed cost of imports and the level of production of crude oil in India as well as the total refining capacity with reference to demand, the prices of locally manufactured petroleum products were based on the principle of import parity. This was mainly because imports constituted the bulk of the products and differentiation between domestic

and imported products would have made it difficult to administer the policy. This policy continued till the retention concept was introduced in respect of refineries based on interim recommendation of OPC in July, 1975.

(b) *The policy of Retention Prices*

In the second phase, the trend was changed with the recommendations of Oil Prices Committee (OPC) in 1976. By this time the production of crude oil in India as well as refining capacities had been established quite well and the foreign oil companies had also been nationalised during the period 1974-77. In this different scenario, the Government accepted the recommendations of OPC discarding the principle of the import parity and bringing in the concept of retention prices consisting of three major elements viz. cost of input, refining/marketing cost and return on capital. The retention prices were basically meant to enable the refining/marketing companies to meet their basic refining/marketing costs for a given pre-determined quantum and also to have a reasonable return on capital employed. The computation of costs was largely based on weighted average of historical costs so that lower efficiency of certain units was compensated by higher efficiency of others. The Government however, reserved the right to determine the final consumer prices.

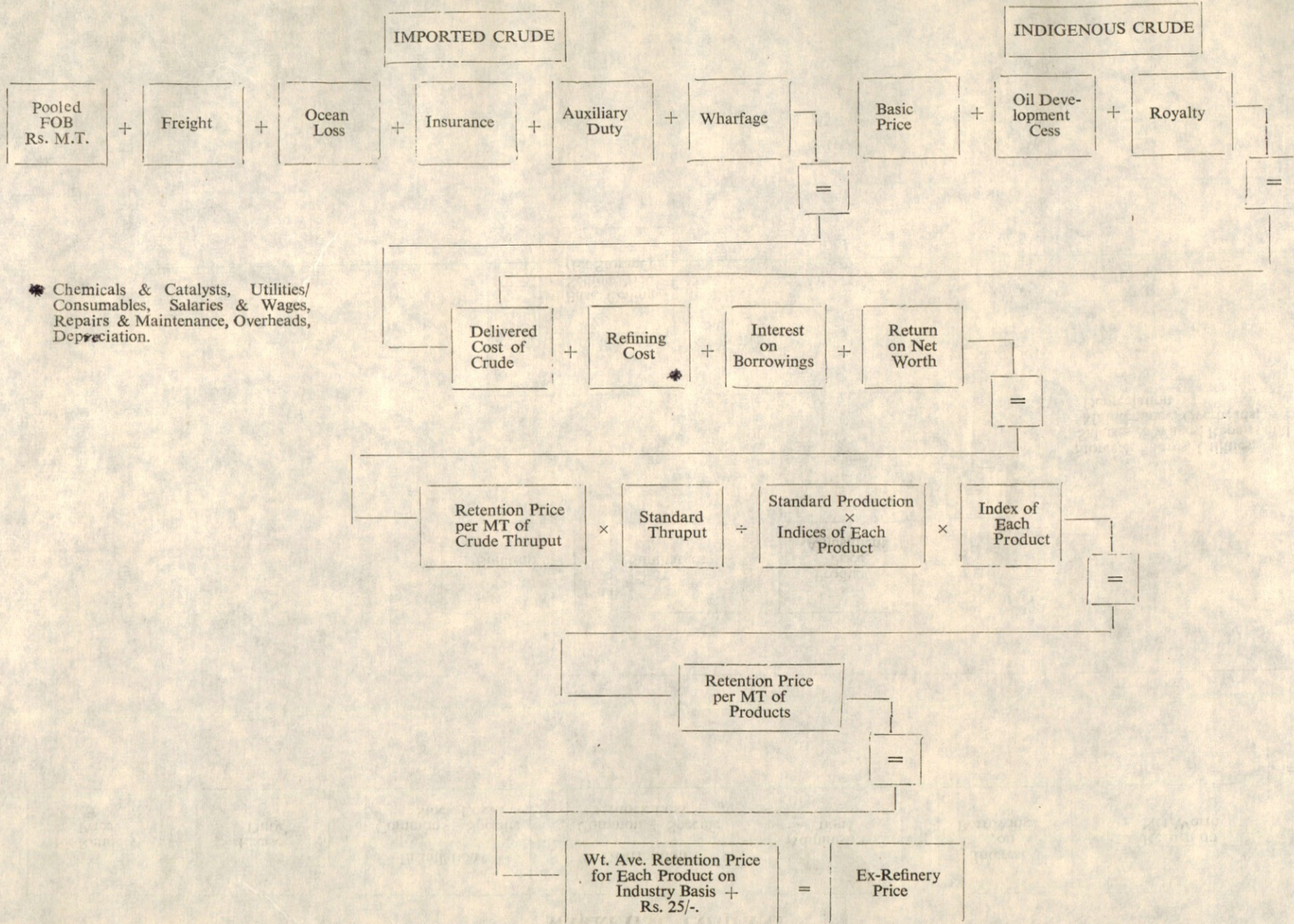
(c) *The policy of Higher Margins*

The next change in the policy of Oil Pricing came with the recommendations of Oil Cost Review Committee in 1984. In this change, while the concept of retention prices, both for refining and marketing operations, was largely retained and the structure built by the OPC was by and large kept intact, the Government allowed higher margins/generation of gains to the oil companies based on the recommendations of this committee with a view to enable them to generate internal resources for financing future investments in refining, pipelines and marketing sectors.

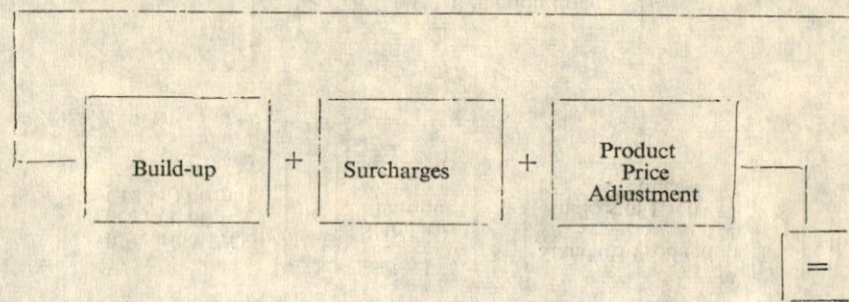
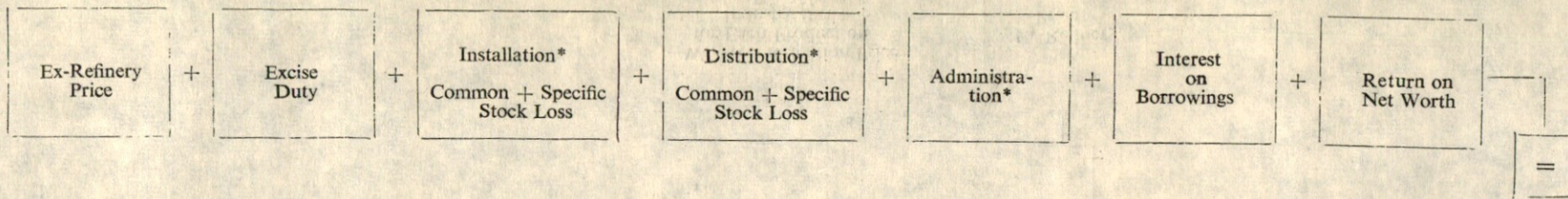
The cost built up

1.9 The terms of reference of OPC 1976 required of them to determine a number of elements of cost of petroleum products. These included the price of indigenously produced crude oil, cost of transportation of crude oil, ex-refinery costs, cost of movement of products by pipeline, streamlining the freight surcharge scheme, rate of commission for dealers for various commodities and the manner of pricing of LPG including its loading, unloading and other charges. The OPC accordingly obtained the costs for these elements. The cost built up as an outcome of OPC's recommendations, which is valid even at present (except for change from return on capital employed basis to return on net worth plus interest on borrowing basis), are presented in the chart at page 5 & 6.

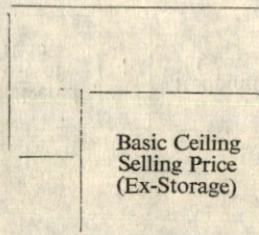
REFINERY COMPANY



MARKETING COMPANY



*Stores & Spares, Utilities,
Salaries & Wages, Repairs and
Maintenance, Overheads,
Depreciation



CHAPTER—2

Pricing of Indigenous Crude

2.1 The process of pricing of any petroleum product has to start with the pricing of crude oil. As mentioned earlier, the costs of crude oil both from imported and indigenous sources are pooled together for the pricing arrangements. Since the cost of imported crude oil is governed by prices in international market and import duty etc., the pricing arrangements deal only with the indigenous crude.

2.2 The pricing of indigenous crude was one of the main terms of reference to the OPC 1976. The previous oil price committees were not required to deal with the question and the prices of crude oil were determined on the import parity concept. The main reasons for this approach seems to be that the source of crude oil was mainly imports. The OPC (1976) taking note of the gradual increase in the production of indigenous crude oil over a period and assuming that additional requirement of crude in future would be met through increases in indigenous output recommended that the price of indigenous crude should be based on the long run social marginal cost of domestic crude i.e. the level at which the discounted present value of the social cost and revenue streams associated with the projects of increasing annual output will be equal taking 15 years as the 'life' of the project and a social discount rate of 10 per cent. The recommendation was accepted by the Government and the base price of the crude per MT was fixed at Rs. 203.41 in respect of on-shore and Rs. 331.65 in respect of off-shore crude from 16-12-1977.

2.3 While recommending the base price for the crude oil, the OPC encountered many constraints, since the production of crude oil from off-shore installations had barely started and the Committee had to go largely by the estimates of costs and productivity furnished by Oil and Natural Gas Commission (ONGC). In view of these factors, the committee recommended that a review of their recommendation could be made in about three years' time when a clearer picture of productivity and cost should be available.

2.4 The review as recommended by OPC 1976 was not made thereafter. There were large number of factors which required such a review. The pro-

duction of off-shore crude oil started to pick up from a level of 4.75 mmt during 1980-81 to 19.56 mmt during 1984-85 as against the level of 10 mmt during 1980-81 to 1984-85 envisaged by OPC and Revenue from associated gas was Rs. 540.63 crores during 1982-83 to 1984-85 which was completely ignored by OPC. Similarly, estimates on expenditure, which were not available to OPC on realistic basis, were also available subsequently. All the relevant factors had shown markedly upward increase, justifying the review of price of crude oil recommended earlier. However, the pricing of crude oil was not within the purview of OCRC in 1984.

2.5 The Govt. raised the base price of crude on ad hoc basis to Rs. 1021 per MT w.e.f. 11-7-1981 on the following considerations.

- (i) The observation of planning commission that domestic crude prices are underpriced and that readjustment of domestic crude prices could give a substantial revenue over the plan period.
- (ii) In view of the continuing strain on balance of payment and the need for moderating the growth of demand for petroleum products, it would be sound economic policy to price indigenous crude at par with price paid on imported crude.
- (iii) Cost of oil exploration and development projects have of late escalated steeply requiring substantially increased outlay by ONGC/OIL on their expanded programme.

The base price of Rs. 1021 per MT fixed in 1981 continues till date.

2.6 Since OPC (1976) had recommended price of indigenous crude based on long run social marginal cost, it also recommended an increase in ceiling on oil development cess from Rs. 100 per tonne to Rs. 150 per tonne. The rate of cess prevalent at that time was Rs. 60 per tonne. The rate of cess was increased to Rs. 100 per tonne by Government from 11-7-1981 to generate required funds for development of various

areas of oil industry. The cess was further increased to Rs. 300 per MT w.e.f. 15-2-1983 and Rs. 600 per MT w.e.f. 1-3-1987. In addition, royalty is also included in the price.

2.7 The following table indicates the comparative position of the prices of indigenous crude (including development cess and royalty) vis-a-vis the international price of crude oil.

	(Rupees/MT)							
	16-12-1977		1-4-1981		11-7-81	15-2-83	1-4-84	1-3-87
	On Shore	Off Shore	On Shore	Off Shore				
International crude price	..	..	..	..	2516.41	2612.44	2683.85	1574.45
Indigenous crude @	305.41	433.65	324.41	452.65	1182.00	1382.00	1513.00	1813.00
* Base price	203.41	331.65	203.41	331.65	1021.00	1021.00	1021.00	1021.00
Oil Development cess	60.00	60.00	60.00	60.00	100.00	300.00	300.00	600.00
Royalty	42.00	42.00	61.00	61.00	61.00	61.00	192.00	192.00
Percentage of cess to base price	29.50	18.09	29.50	18.09	9.79	29.38	29.38	58.77

* W.e.f. 11-7-1981 the price of both off-shore and on-shore crude was fixed at the same level.

@ This is a sum total of Base Price Oil Development Cess and Royalty.

(Source : Indian Petroleum & Natural Gas Statistics published annually).

2.8 The above would indicate that after giving up of import parity principle for pricing of indigenous crude, the only time the indigenous crude prices were arrived at by a systematic study was by OPC in 1976 which remained in operation for a brief period. Thereafter from 11-7-1981, the base price was revised steeply from the level fixed by OPC without any systematic study having been made by any Com-

mittee. Such an exercise seems to be necessary particularly in view of the fact that the price of indigenous crude is higher than international price from 1-3-1987.

2.9 As against the base price (Rs. 1021 per MT) fixed by the Government, the cost of production of indigenous crude as intimated by the major producer of indigenous crude viz ONGC were as follows :

Cost of production of crude of ONGC

Year	(Rupees/MT)					
	Cost of production including Royalty and Cess		Royalty	Cess	Net Cost of production	
	Off-Shore	On-Shore			Off-Shore	On-Shore
1982-83	660.55	525.65	61	100 300 (w.e.f. 15-2-1983)	499.55	364.65*
1983-84	726.56	835.97	61	300	365.56	474.97
1984-85	1006.52	1042.82	192	300	514.52	550.82
1985-86	877.29	937.32	192	300	385.29	445.32
1986-87	884.58	1006.05	192	300 600 (w.e.f. 1-3-1987)	392.58	514.05*

*As the increased rate of cess was applicable in only one month this is ignored in calculating Net Cost of Production.

2.10 This pricing policy has resulted in generation of huge profits and internal resources at the hands of ONGC as given below :

(Rupees in crores)		
Year	Retained Profit ONGC	Net internal Resources available for plan ONGC*
1982-83	665.44	653.31
1983-84	774.80	1286.75
1984-85	849.84	1340.83
1985-86	1267.92	1949.51
1986-87	1448.46	1905.10

*Net internal resources have been computed after adjustment of utilisation of such resources in repayment of loans, working capital and temporary investments.

(Source : Performance Budgets of the Ministry.)

2.11 While higher crude prices generated huge internal resources for ONGC, the money collected by Government by means of Oil Development Cess for specific purpose of investment in oil industry, were not handed over to the Oil Industry Development Board either partially or in full from 1983-84 onwards. The following table shows the amount received by the Government from the Oil Industry Development Cess and the amounts handed over to Oil Industry Development Board for funding the development of Oil Industry.

(Rupees in crores)

Sr. No.	Year	Net proceeds of cess credited to consolidated fund of India	Payment to OIDB under Section 16 of the Act	Grants/Assistance to Oil Industry by OIDB		
				Grant	Loan	Total
1.	1974-75	30.20	16.01	..	16.00	16.00
2.	1975-76	49.05	62.27	0.20	61.63	61.83
3.	1976-77	52.35	48.19	0.25	51.69	51.94
4.	1977-78	63.08	50.10	0.20	54.67	54.87
5.	1978-79	68.20	20.00	1.20	26.11	27.31
6.	1979-80	69.00	140.00	0.22	165.56	165.78
7.	1980-81	59.80	25.01	1.04	91.51	92.55
8.	1981-82	137.58	142.92	1.59	187.90	189.49
9.	1982-83	266.14	100.00	0.46	235.44	235.90
10.	1983-84	804.67	..	1.01	124.87	125.88
11.	1984-85	876.24	..	4.89	233.20	238.09
12.	1985-86	892.19	..	7.36	70.97	78.33
13.	1986-87	974.93	..	9.52	165.04	174.56
TOTAL		4,343.43	604.50	27.94	1,484.59	1512.53

2.12 The collection from the above cess is specifically meant for providing assistance to the organisations engaged in the development programme of the oil industry. However, it would be observed from the above table that out of the Net Collection of Rs. 4343.43 crores upto 1986-87 on account of cess only Rs. 604.50 crores have been handed over to O.I.D.B. The balance amount of Rs. 3,738.93 crores had been used as a general budgetary resource by the Government. The effect of increase in cess on the other hand has been that the cost of indigenous crude has been going up steadily.

2.13 The above data also indicates that the OIIB was in a position to finance the requirement of the oil industry based on its own internal resource generation. In addition all segments of oil industry also

generate substantial surplus funds. In these circumstances the need for continuance of cess itself is not clear. The Government stopped the payment of Oil Development Cess to OIIB with effect from the year 1983-84, while the rate of cess has been raised to Rs. 600 per tonne in March 1987. It was noticed as mentioned above, the collection from the cess are being used by Government as a regular budgetary source and not for the purpose for which the cess is levied under the provisions of Oil Industry (Development) Act, 1974.

2.14 The different elements of price of crude oil also have an impact on the Central and State finances. As mentioned in para 2.7 above, the price of crude oil includes the royalty as well as the Oil Development Cess. While the royalty is payable to the State in

which the crude oil is produced, the collection of cess is completely retained by Central Government. The royalty is being paid at the rate of Rs. 192 per tonne (18.8 per cent of the base price) and there has been no revision of this rate after 1-4-84. However, the Oil Development Cess has been revised upwards from Rs. 300 per tonne (29.38 per cent of base price) to Rs. 600 per tonne (58.77 per cent of base price) with effect from 1-3-87. The considerations that weighed with the Government in revising the rate of cess could not be known since the papers relating to the enhancement of rate of cess were not made available to Audit. The matter was reported to Ministry of Petroleum & Natural Gas in June 1988 and August 1988 and the papers were asked for. No reply was received from Government. While forwarding this Analysis for Government's comments, it was also brought to the notice of the Secretary of the Ministry that these papers were not made available.

Pooled F.O.B. Cost of Crude

2.15 Uptil February 1974, the principle of 'import parity' constituted the basis for pricing of indigenous crude. With effect from March 1974, the ex-refinery prices of products were revised on the basis of recommendations of the Shantilal Shah Committee linked to the weighted average price of imported and indigenous crude (pool price) which also necessitated setting up of an industry account called the crude oil price equalisation account (COPE).

The pooled price of crude from time to time is as below :—

Effective Date	Pooled Price of crude (Rs. per MT)
14-7-75	510.00
16-12-77	623.50
17-8-79	867.00
8-6-80	1216.00
13-1-81	1358.00
1-4-81	1358.00
11-7-81	1696.00
15-2-83	1825.00
18-3-83	1680.00
1-4-84	1810.00
1-4-86	1700.00

2.16 Purpose of this account is to equalise the price of crude oil received from various sources, both imported and indigenous, for issue to the refineries for further processing at a uniform price (i.e., pooled

f.o.b. cost of crude). This would mean that in case the price of imported crude is higher, the difference between the imported price and the pool price will be borne by COPE Account. Similarly the refineries which are processing indigenous crude obtained at a lower price will contribute the difference to the pool account. Thus in principle these transactions in COPE Account should broadly balance each other. However, as the pool price is a pre-determined price fixed with reference to the prices prevailing at a particular date in the past, there are bound to be some surplus or deficit in this Account till necessary corrective action, based on the fluctuations in the crude prices, is taken to revise the pool price.

2.17 The Oil Price Committee (OPC 1976) and the Oil Cost Review Committee (July 1984) recommended the continuance of the above concept which is in vogue till date. The Account is being administered by Oil Coordination Committee (OCC) set up from 14th July, 1975 by the Government in pursuance of the interim recommendations of OPC. A review of the balances in this Account shows the following position (from 1977-78 to 1986-87) :

(Rupees in crores)				
1977-78	1978-79	1979-80	1980-81	1981-82
(42.36)	34.09	(331.52)	(348.84)	(208.60)
1982-83	1983-84	1984-85	1985-86	1986-87
(227.05)	(127.41)	(402.97)	(262.59)	384.89

NOTE : Figures in brackets indicate deficit balance.

2.18 As can be seen from above there has been large deficit balance in COPE Account over the years except during 1986-87 when there was a large surplus. The deficit balance in COPE Accounts came up because the pooled price was not revised upwards to match with the rising international prices of crude oil during these years. Similarly when the international crude prices dropped during 1986 and thereafter, the pooled price were not revised downwards. This resulted in surplus balance in COPE Account during 1986-87.

2.19 The deficits in COPE Account should not be viewed in isolation since they are met from surplus balances in other pool accounts which are meant for different purpose. The overall analysis of pool account balances has been given in Chapter 5.

CHAPTER 3

Refining Cost and Related Matters

3.1 The concept of retention price for each refinery introduced in 1975 in substitution of earlier concept of import parity price consists of three major elements viz., cost of input, refining cost and return on capital and is based on :

- (i) the delivered cost of crude;
- (ii) the level of crude thruptut;
- (iii) pattern of production;
- (iv) the cost of processing and refining; and
- (v) a reasonable return on capital employed.

3.2 The aspects regarding delivered cost of crude have already been discussed. As mentioned in para 1.3, refining cost ranges from 2.15 per cent to 8.89 per cent of total cost of petroleum products. The total refining cost of petroleum products in 1986-87 was approximately Rs. 630 crores.

Standard Thruptut

3.3 For the purpose of calculating the retention price for the products for each refinery, OPC 1976 fixed a standard thruptut and standard product pattern for each refinery taking note of crude availability,

secondary processing facilities available, off-site facilities and other relevant technical factors. OCRC (1984) revised the standard thruptut for each refinery based on a detailed study made by technical teams of OCC after visits to most of the refineries.

3.4 The fixation of standard thruptut and product pattern for each refinery is important as it is at this level of thruptut and production that refinery gets full compensation for the costs incurred by it and the return on its investment. In other words, standard level of thruptut thus fixed is designed to ensure full recovery of their cost/return through the unit rate fixed. If the refineries are not able to achieve the standard thruptut, there will be under-recovery in respect of fixed expenses and return and in case refinery achieves a thruptut more than the standard fixed, it gets an extra margin.

3.5 It was observed that out of 12 refineries the actual thruptut had clearly exceeded the standard thruptut in all the cases mentioned below and in case of three refineries it was substantially more than the standard thruptut fixed for these refineries as indicated in the table below :

Standard Thruptut V/s. Actual Thruptut of Selected Refineries for the last three years

(In Million MT)

	1984-85		1985-86		1986-87	
	Standard	Actual	Standard	Actual	Standard	Actual
Haldia	2.350	2.331	2.350	2.828	2.350	2.626
Mathura	5.400	6.263	5.400	6.087	5.400	6.357
Gujarat	6.800	7.805	6.800	7.798	6.800	7.855
BPCL	Upto 31-12-84		Upto 31-12-85		5.670	5.572
	5.000	5.454	5.450	6.378		
	From 1-1-85		From 1-1-86			
	5.450		5.670			
HPCL, Bombay	3.200	3.287	4.300	4.375	4.900	5.015
			(w.e.f. 15-5-85)				(w.e.f. 15-5-86)
HPCL, Visakh	1.000	1.270	3.000	2.637	3.900	3.717
			(w.e.f. 1-2-85)				(w.e.f. 1-2-86)
MRL	2.600	3.394				

NOTE : Actual thruptut is excluding intermediate stock difference as given in Audited Pool Statements.

3.6 As a test case, the standard thrupt fixation of Haldia Refinery for the period 1-4-1981 to 31-3-1984 was taken up and examined in depth. The standard thrupt of 2.300 mmt was fixed for the refinery. The maximum thrupt capacity was taken as 7500 mts per day. Thereafter a shut down allowance of 24 days per year was given and further another 10 per cent allowance was given for contingencies for crude availability, despatch facilities etc. With effect from 1-4-1984 the standard thrupt was fixed at 2.35 mmts based on maximum thrupt of 7650 mt per day. It was noticed that the refinery had made a considerable number of modifications to increase the processing capability and improve efficiency/run length of process units and the refinery was actually processing 7900-8000 tonnes/day as against the design capacity of 7500 tonnes/day. The actual thrupt from 1983 onwards is as high as 8000 mts/day. The planned shut down is once in 18 months. Average number of days of actual planned shut down time was 18 days in 1979-80, whereas it went upto as high as 30 days in 1980-83. If the yardstick of 7500 tonnes/day thrupt is to be applied as it existed in 1979-80 then only 18 days shut-down is to be allowed. The OCC while fixing standard thrupt has allowed for 24 shutdown days/year but the thrupt capacity has been retained at 7500 mts/day. In addition a contingency of 10 per cent was also allowed.

3.7 In respect of secondary processing units the service factor was taken at 85 per cent, i.e., an allowance of 15 per cent was given. The Refinery was also allowed to retain the benefits drawn by executing various energy conservative measures since 1979-80.

3.8 The OCC explained as follows :

- (a) The thrupt level of 7900 mt to 8000 mt per day was attained in adverse conditions and resulted in higher shut down time of 30 days.
- (b) 10 per cent allowance towards contingencies was allowed as a policy measure after taking into account various factors like crude availability, mode of transport and other locational constraints.
- (c) 15 per cent contingency factor was adopted for secondary processing facilities after taking into account the planned shut down, power failure and unforeseen break down of equipment.
- (d) The refineries are retaining the benefits of energy conservation measures according to the agreement for incentive scheme reached in May 1980.

3.9 The level of thrupt has not been matched with the time taken for shut down, although both are inter-related. The actual thrupt achieved by the refinery during 1985-86 and 1986-87 was 8442 MT/day and 7839 MT/day respectively (based on 336 stream days per year; allowing for shut down for 30 days per year). These other explanations should also be viewed in the light of the fact that in respect of all the contingencies mentioned, the OCC itself is the planning and co-ordinating agency and is in possession of all the facts. Moreover, the contingency factor of 15 per cent for secondary processing facilities amounts to allowing twice for the same factor to a substantial extent. Also the shut down allowed for contingency in respect of secondary process unit amounted to 80 per cent of planned shut down days allowed (i.e., 30 days planned and 24 days contingency) which is quite high. As mentioned in para 3.7 above, the refineries were allowed to retain benefits of energy conservation measures, irrespective of their over-all performance in energy consumption in the absence of scientific norms.

3.10 The fixation of realistic figures for standard thrupt is absolutely necessary in view of the present arrangement for allowing full margins for incremental thrupt w.e.f. 1-4-84. Till that date, in accordance with OPC's recommendation, for any incremental thrupt, the refinery was to get the incremental refining cost with the return on working capital, but not the margins. However, the OCRC (1984) recommended that in addition to what is recommended by OPC, the margins should also be allowed. In other words, all the fixed costs are reimbursed on standard thrupt and for any additional crude refined, the company gets full reimbursement of its retention price. The lower fixation of standard thrupt will thus result in reimbursement of large sums in addition to meeting full costs and allowance of margins.

3.11 The above position would indicate that in these cases the standard thrupt has been fixed at a level lower than the level which these refineries are able to achieve, resulting in extra margins. The extra margin in respect of Haldia Refinery alone for (1985-86 and 1986-87) works out to Rs. 11 crores which illustrates the impact of foregoing data.

3.12 To reinforce the point the case of Mathura Refinery also can be taken as another illustration. The refinery was set up in January 1982 and its standard thrupt was fixed at 5.400 million MT per annum being 90 per cent of its installed capacity against which the actual thrupt during the last three

years ranged between 6.087 million MTs to 6.357 million MTs giving extra margin of Rs. 51.84 crores during three years ending March 1987.

3.13 It would be evident from the above data that a thorough technical study on fixation of standard thrupt in respect of each refinery is called for. Such a study should recognise and give due weightage to designed capacity, inherent over capacity originally built to give the designers the tradi-

tional margin, technical innovations, de-bottlenecking and expansion of facilities. The allowance of incentives on ad-hoc basis without such a reassessment of achievable capacity is likely to lead to continued higher margins.

3.14 The above will also be apparent from the following table showing the capacity vis-a-vis the actuals achieved by the various refineries as revealed in the printed Annual Reports of these companies.

(Capacity & Actual Thrupt in Million tonnes)

Refinery	Capacity	1984-85		1985-86		1986-87	
		Actual thrupt	%age of capacity	Actual thrupt	%age of capacity	Actual thrupt	%age of capacity
<i>Indian Oil Corporation :</i>							
Gujarat	7.300	7.777	106.5	7.830	107.3	7.835	107.3
Haldia	2.500	2.365	94.6	2.822	112.9	2.623	104.9
Mathura	6.000	6.239	104.0	6.075	101.3	6.353	105.9
Digboi	0.500	0.531	106.2	0.529	105.8	0.551	110.2
<i>Bharat Petroleum Corpn. Ltd.</i>	5.25	5.45	103.8	6.38	106.0	5.57	92.83
	*6.00						

*Increased to 6.00 mmt p.a. from 30-3-1985.

It may be noted that the capacity utilisation was as high as 112.9 per cent in case of Haldia Refinery for the year 1985-86 which further substantiates the foregoing picture on fixation of standard thrupt.

Fuel and Loss

3.15 In the course of refining process, the refinery itself consumes certain quantity of oil as fuel and certain quantity of crude is lost. Since both these factors ultimately reduce the net availability of crude oil for refining, they should be minimised with reference to a given pattern of production to achieve the maximum efficiency. For the purpose of working out the retention price, certain fixed percentages are allowed towards the fuel and loss for each refinery company.

3.16 OPC 1976 recommended certain ceilings of fuel and loss in their interim report which were later on revised in their final report based on the detailed study conducted by the technical wing of OCC. These ceilings were further revised by OCRC 1984 taking into account the latest crude mix and secondary processing facilities which had been added to various refineries since OPC 1976. After the revision was effected on the basis of OCC's recommendation in respect of five refineries which went through the expansion after submission of OCRC report, the position of the ceiling in force in respect of each

refinery along with the position obtaining after OPC 1976 and OCRC 1984 reports is given below :

Percentage ceiling of fuel & loss

(Figures in percentage)

Refinery	OPC 1976	OCRC 1984	Ceilings applicable after expansion, if any
BPCL, Bombay	5.81	5.06	6.35
HPCL, Bombay	5.36	5.94	5.21
HPCL, Visakh	7.44	8.64	6.10
MRL, Madras	8.77	7.36	6.21
CRL, Cochin	5.58	4.03	5.59
IOC, Gauhati	9.00	9.00	9.00
IOC, Barauni	7.55	7.17	7.17
IOC, Gujarat	5.35	7.50	7.50
IOC, Haldia	9.56	8.48	8.48
IOC, Mathura	..	6.61	6.61
IOC, Digboi	5.24	3.40	3.40
BRPL, Bongaigaon	..	11.00	11.00

3.17 At present ceilings of the fuel and loss ranges between 5 per cent (except Digboi 3 per cent) and 11 per cent. As compared to OPC 1976, in case of three refineries (BPCL, Gujarat and Cochin) the ceilings have been revised upwards. As per OCRC 1984 report, the addition of secondary processing facilities increase the total quantum of fuel and loss of the refinery. It is, however, noticed that in cases

of HPCL Bombay, HPCL Visakh and MRL Madras, where also such an addition of facilities has taken place, the ceiling has been revised downwards from 5.94 per cent to 5.21 per cent, 8.64 per cent to 6.10 per cent and 7.36 per cent to 6.21 per cent respectively. This would indicate that either the limits fixed earlier were on higher side or the reduction was ad hoc.

3.18 In the year 1981, the Oil Co-ordination Committee in a report on fuel and loss stated that an improvement of about 20 per cent in fuel and loss consumption would result in a saving of about 400,000

tonnes of Standard Refinery Fuel per year amounting to approx. Rs. 75 crores per year. In this report, besides highlighting the planned savings, the various measures to achieve these savings were also outlined. Thus, the standards fixed by OCRC in 1984 should have been substantially lower than the earlier OPC 1976 levels. However, these ceilings have not come down drastically. Instead, in some cases these have gone up.

3.19 Table given below indicates the position of the actual losses vis-a-vis their respective ceilings in respect of six refineries.

Percentage Fuel & Loss of Selected Refineries

	1984-85			1985-86			1986-87		
	Standard	Actuals	%age of excess of standard over actuals	Standard	Actuals	%age of excess of standard over actuals	Standard	Actuals	%age of excess of standard over actuals
1. Gauhati	9.00	8.51	(5.44)	9.00	8.98	(0.22)	9.00	8.20	(8.89)
2. Gujarat	7.50	6.47	(13.73)	7.50	6.25	(16.67)	7.50	5.61	(25.20)
3. Haldia	8.48	8.67	2.24	8.48	7.66	(9.67)	8.48	7.15	(15.68)
4. Mathura	6.61	5.64	(14.67)	6.61	5.79	(12.41)	6.61	5.47	(17.25)
5. B.P.C.L.	5.06	4.57	(9.68)	6.35	6.04	(4.88)	6.35	5.65	(11.02)
				(From 1-1-85 onwards)					
H.P.C.L. Bombay	5.94	4.67	(21.38)	5.21	4.59	(11.90)	5.21	4.13	(20.73)

NOTE : The actual fuel and loss as per PPA is only for Fuel Sector and as given in Audited Pool Statements.

3.20 From the above it would be evident that as compared to ceilings fixed there has been saving in fuel and loss during all these three years in terms of percentage the saving ranged between :

- (i) 13.73 and 25.20 in case of Gujarat.
- (ii) 11.90 and 21.38 in case of HPCL, Bombay.
- (iii) 12.41 and 17.25 in case of Mathura.
- (iv) 2.24 and 15.68 in case of Haldia.
- (v) 4.88 and 11.02 in case of BPCL.
- (vi) 5.44 and 8.89 in case of Gauhati.

3.21 It was seen that the percentage for fuel and loss for each refinery are basically arrived with reference to the historical data which is adapted or modified with reference to the product pattern. In other words, the percentage of loss in the previous years are made the basis for allowing the loss of

future years. There is therefore no deterrent against a higher percentage of fuel and loss. On the other hand, inefficient operations get the advantage of higher percentage of fuel and loss which had been adopted as the basis for compensation. Wherever the standard fixed on this basis is higher than the achievable quantum of fuel and loss, the effect would be that a lower percentage of fuel and loss is obtained without any added efficiency resulting in better product pattern and consequential gain as provided in pricing arrangement. Here also proper norms based on detailed technical study for each refinery is absolutely essential in the interest of efficiency.

Other Elements of Refining Cost :

3.22 This includes expenditure on Chemicals, Catalysts, Consumables, Utilities, Salaries & Wages, Overheads, Depreciation, Repairs and Main-

tenance. The relative incidence of various items of such costs for all the refineries taken together for the year 1982-83 is given below :

Item of Cost	(Rs./Crores)	Percentage
Chemicals and Catalysts	17.66	10
Consumables	4.53	2
Utilities	15.28	8
Repairs & Maintenance	36.30	19
Salaries & Wages	43.37	23
Overheads	22.03	12
Depreciation	47.56	26
TOTAL	186.73	100

3.23 The OPC 1976 fixed the refining cost based on the actuals of 1975. The refining cost was updated by OCC on the basis of 1980-81 actuals. The updated costs became effective from 1st April, 1981. Thereafter the OCRC based on the moderated actual expenditure of 1982-83, estimated the levels of expenses for further years taking note of trends in the past, the projections given by the Companies for future and the need for keeping the increases within reasonable limits and fixed the compensation for Refining costs.

3.24 Another varying but crucial element noted was incidence of establishment cost. The OCRC while considering the expenses on salaries and wages worked out the rate per MT of establishment cost of different refineries for the year 1982-83 as under :

Refinery	Amount (Rs./MT)
BPCL, Bombay	9.78
HPCL, Bombay	7.98
HPCL, Visakh	16.61
MRL, Madras	5.51
CRL, Cochin	4.75
IOC, Gauhati	43.08
IOC, Barauni	28.41
IOC, Gujarat	9.20
IOC, Haldia	14.85
IOC, Mathura	9.64
IOC, Digboi	69.52
BRPL, Bongaigaon	27.85

3.25 The OCRC among other things commented that a critical review of manpower in the refineries be made and where there was any surplus manpower these should be more usefully deployed in new activities/projects in the long run. However, no such review has been made so far.

3.26 A very important aspect that emerged was that while the standard thruptut was fixed, the standard manpower required to achieve the level of standard thruptut had not been fixed.

3.27 The following table shows the thruptut per employee in respect of selected refineries.

Refinery	Actual thruptut per employee for 1986-87 (Thruptut taken as per PPA Statements)
	(MTs)
BPCL, Bombay	2060.65
HPCL, Bombay	4575.73
HPCL, Visakh	3769.78
IOC, Gauhati	580.38
IOC, Barauni	1086.79
IOC, Gujarat	2933.16
IOC, Haldia	1686.58
IOC, Mathura	3892.84

NOTE : For arriving at the thruptut per employee only the employees of the companies have been taken into account. The contract/casual Labour employed, if any, by the companies have not been taken into account. The actual thruptut per employee may vary if the contract/casual labour is also taken into account.

3.28 From the above it could be seen that there is wide variation between each refinery in terms of thruptut per employee.

CHAPTER 4

MARKETING COST

4.1 The elements of cost incurred after the refinery stage are all included in marketing costs. The marketing companies are compensated for their operational costs and stock losses plus return on net-worth and interest on borrowings.

4.2 The marketing cost mainly consists of expenditure on installations, distribution and administration, which account for three-fourth of the total cost of oil marketing companies. The table below gives the percentage share of each item of cost analysed by OCRC 1984 (for the year 1982-83) under the conventional accounting heads.

Express Head	Amount (Rs. in crores)	Percentage
Salaries and wages	53.51	40
Stores and spares/power and fuel	7.90	6
Repairs and Maintenance	14.98	11
Overheads	40.70	31
Depreciation	15.57	12
	132.66	100

Thus salaries and wages and overheads account for over 70 per cent of the total expenditure on marketing.

4.3 There has been a steep increase in the unit marketing costs as seen from the details relating to four marketing companies.

Unit Marketing Cost

Company	OPC 1976 Rs./KL	Interim Rs./KL	1982-83 Rs./KL	Percentage increase of (4) over (2)
(1)	(2)	(3)	(4)	(5)
IOC	12.21	18.25	20.68	69.40
BPCL	20.93	21.94	26.53	26.70
HPCL	18.96	19.50	22.37	18.00
IBP	11.71	14.81	17.69	51.10

4.4 The above unit costs are exclusive of product losses and return on capital employed. These relate to fuel products only. It is observed that the marketing costs are showing upward trend in the case

of all the companies. Even in case of larger companies like IOC which has a larger share of market, the cost has not shown a downward trend commensurate with the nature and size of transactions. In this connection, the OCRC had commented that "we feel concerned over this steep increase in cost as this goes against the normal expectation that economies of scale could well operate in IOC with its large market participation". The anomaly of steep increase in cost with largest volume of sales becomes all the more pronounced as IOC in addition to its large market participation, has a substantial share of Direct Sales (sold to bulk consumers like Railways, RTC's etc. and not through retail outlets) of products which should reduce its costs rather than increase it. The following table shows the percentage of direct sales of MS & HSD by IOC during 1982-83 to 1986-87.

Percentage Share of IOC in Direct Sales of the Industry

	1982-83	1983-84	1984-85	1985-86	1986-87
M.S.	91.7	92.2	92.1	90.0	92.4
H.S.D.	88.8	87.6	85.5	84.2	83.8

4.5 Such a situation has arisen on account of the computation of retention costs on the basis of historical data instead of on the basis of costs based on work standards. The OCRC considered the question whether, to continue the retention concept (Marketing) (i.e. to compensate the oil companies at varying levels depending upon the costs of individual oil company) or to adopt uniform margin to ensure efficiency in operation and to promote economies in future and recommended a uniform marketing margin for all companies. However, the Government did not accept the recommendation and continued with the retention concept for marketing companies.

4.6 Since the basis for arriving at the cost are the actual historical costs incurred by the company in the previous years and such costs have no relation to the norms evolved by a systematic study which determines the standard cost in achieving the sales target, the relative efficiency of the companies are not recognised.

4.7 Norms for manpower required to achieve the projected sales can be one important area as salaries, wages and overheads account for about 70 per cent of marketing costs. The existing system of retention

cost in marketing has not helped to improve the employee productivity either.

The following table gives the volume of sales achieved by IOC, HPCL, and BPCL per employee during the period 1982-83 to 1986-87.

(Figures in MTs)

Sales per Employee	1982-83	1983-84	1984-85	1985-86	1986-87
IOC	1721.11	1604.08	1552.07	1533.21	1610.48
BPCL	1140.87	1159.83	1250.22	1292.91	1184.82
HPCL	1371.84	1335.12	1328.52	1312.49	1303.71

NOTE: For arriving at sales per employee only Marketing Division employees of the Companies taken into account.

4.8 It is seen from above that sales per employee have declined by 6.43 per cent in case of IOC in spite of its lion's share in Direct sales. There is also a decline of 4.97 per cent in case of HPCL and a marginal improvement of 3.85 per cent in case of

BPCL. This index has been computed only with reference to regular employees. If casual and contract workers are taken into account, the productivity factor will further go down.

CHAPTER 5

POOL ACCOUNTS

5.1 The retention prices and marketing margins provided in pricing arrangements represent the norms and averages. In case of each unit there will be variation with reference to this level; partly due to local conditions and partly on account of general increase in price levels. OPC (1976) recommended that these variations should be adjusted through a number of pool accounts so as to have a stability in the ultimate selling prices of petroleum products. One such account called Crude Oil Price Equalisation Account (COPE) has already been mentioned in para 2.15 to 2.18 above. The other main pool accounts are :

- (1) Cost and Freight (C&F) Adjustment Account
- (2) Freight Surcharge Pool (F.S.P.) Account.
- (3) Product Price Adjustment (PPA) Account.

C&F Adjustment Account :

5.2 This account receives the debits/credits representing the short/excess recoveries on account of variations between the actual amount incurred and those included in the price build up covering various elements of cost of transportation, margins, etc. *(Details as given in Annexure)*

5.3 To compensate the net under-recoveries in C&F Adjustment Account, a C&F Surcharge is levied at a uniform rate on sale of petroleum products.

5.4 The OPC (1976) had recommended a C&F Surcharge on all petroleum products at the rate of Rs. 25 per KL/MT be imposed to meet the net debits in the C&F Adjustment Account as against the then existing surcharge of Rs. 50 per KL/MT.

5.5 The following table shows the rate of C&F Surcharge levied by the Government on petroleum products from time to time.

Effective Date	C&F Surcharge	
	Formula products	Lubricants
	(Rs. KL/MT)	(Rs. MT)
16-12-1977	25	501
17-3-1979	115	100
08-06-1980	315	340
13-01-1981	495	520
15-02-1983	555	580
17-03-1985	780	805
01-10-1986	640	NIL

5.6 The OCRC (1984) reviewed the inflow/outflow in the C&F Adjustment Account especially in the context of additional outflow arising out of its recommendations for revised increased margins for the refining/marketing/pipeline and transportation activities and recommended that if the existing ceiling selling prices of petroleum products have to be maintained, the C&F Surcharge will have to be revised. The Committee estimated that the revised C&F Surcharge should be Rs. 320 per KL/MT on the sale of all petroleum products falling under administered price system as against the then existing surcharge of Rs. 555 per KL/MT. The Government had raised the C&F Surcharge to Rs. 780 per KL/MT with effect from 17-3-1985 while awaiting the OCRC recommendations.

5.7 Though the recommendation of OCRC envisaged a reduction in the rate to Rs. 320 per KL/MT, the Government fixed an amount of Rs. 640 per KL/MT as C&F Surcharge on all Formula products with effect from 1-10-1986. The following table shows the position of receipts, payments and surplus under C&F Adjustment Account during the five years ending 31st March, 1987.

	(Rs. in crores)				
	1982-83	1983-84	1984-85	1985-86	1986-87
Collection	2201.44	2510.85	2894.28	4150.67	3713.81
Payments	1394.74	1203.80	1749.01	2483.86	1888.57
Surplus	806.70	1307.05	1145.27	1666.81	1825.24
Sales (Lakhs/MT)	346.57	358.41	387.93	408.71	436.73
Surplus Generated per MT of products sold RS/MT	232.48	365.09	295.17	407.53	417.67

5.8 The above indicated that the surplus per MT on products sold has been rising steadily from 232.48 per MT in 1982-83 to Rs. 417.67 per MT in 1986-87 except during 1984-85 when there was a fall to Rs. 295.17 per MT as this was attributed to the increase in cost of import of finished products and escalation in refining and marketing costs.

5.9 From the above, it is not clear as to whether the Govt. anticipated such surpluses and if so, how they proposed to utilise the same. The Govt. should have a data base to determine the rate of surcharge from time to time. It is not known whether such a data base has been maintained.

Freight Surcharge Pool Account (FSP)

5.10 Each refinery has an economic supply area earmarked for it. As the demand logistics and the

production of the refinery located in the area do not always match, movement of products within and outside the economic supply area becomes necessary to meet the demands. These out of zone movements involve under recovery in transportation cost as the price recovered from the customer includes only the notional rail freight from the normal supply point. To compensate the Oil Companies for these under recoveries, a FSP surcharge on products at Rs. 15 per KL/tonne was included in the ceiling selling price build up. This surcharge had remained unchanged over the years till 1-10-1986 when it was raised to Rs. 40 per MT/KL on all petroleum products based on the recommendations of OCRC.

5.11 The following is the position as regards the collection and payments under the FSP Account.

(Rupees in crores)

	1982-83	1983-84	1984-85	1985-86	1986-87
Collection	76.60	82.33	96.19	107.71	228.70
Payments	195.62	186.29	188.80	208.05	290.06
Deficit	(119.02)	(103.96)	(92.61)	(100.34)	(61.36)
Sales in Lakhs MT	346.57	358.41	387.93	408.71	436.73
Under Recovery per MT of products sold	(34.30)	(29.04)	(23.87)	(24.53)	(14.04)

As can be seen, the payments from this account have always been more than the collections resulting in a negative balance throughout.

5.12 It can also be seen that the incidence of under recovery per MT of petroleum products sold has been showing a gradually declining trend (except for a slight increase in 1985-86) and a steep decline in 1986-87 due to the increase in rate of surcharge to Rs. 40 per MT from Rs. 15 per MT with effect from 1-10-1986 based on the recommendations of OCRC, which took into account the steep increase in railway freight rates since the time of OPC 1976 and other relevant factors.

Product Price Adjustment Account (PPA)

5.13 The difference between the ceiling selling prices and the prices built up on the basis of norms and parameters is adjusted by a balancing account termed as product price adjustment account. Also the system of differential pricing of various products for different consumers is operated through this S/220C&AG/89-6

Account. Over the years, the increase in administered prices of products has also been adjusted in this account by raising the PPA element especially in the case of MS over the last 4/5 years.

5.14 The following table shows the balance in PPA from 1982-83 to 1986-87 :-

(Rupees in crores)

	1982-83	1983-84	1984-85	1985-86	1986-87
Balance in PPA Account	(297.76)	(78.73)	(66.76)	265.19	257.44

(Bracket indicates Net Payments)

5.15 From a review of balances of PPA Account it appears that the policy during the last two years has been such that on an over-all basis the sum total of ceiling selling prices of all products where PPA element is involved, has been more than their sum total of costs, margins and surcharges. The file relating to the principles on which the PPA element is determined were not made available to audit.

Overall Pool Accounts Balances

5.16 The following table shows the total balance in the various Industry Pool Accounts during the last five years :—

	(Rupees in crores)				
	1982-83	1983-84	1984-85	1985-86	1986-87
Opening Balance	(169.07)	489.98	2006.19	3153.70	4977.65
<i>Net impact of transactions during the year</i>					
COPE	(227.05)	(127.41)	(402.97)	(262.59)	384.89
Cost and Freight Adjustment Account (C&F) (net)	805.82	1305.90	1144.06	1665.43	1823.69
P.P.A.	(297.76)	(78.73)	(66.76)	265.19	257.44
F.S.P.	(119.02)	(103.96)	(92.61)	(100.34)	(61.36)
BH Swap/Export					
Surplus	517.07	443.55	452.24	84.75	(0.16)
Others	(20.01)	76.85	113.55	171.51	35.43
Closing Balance	489.98	2006.19	3153.70	4977.65	7417.58
Overall surplus generated during the year	659.05	1516.21	1147.51	1823.95	2439.93
Surplus on Oil Development Cess	166.14	804.67	876.24	892.19	974.93
Total surplus (Pool surplus plus Oil Development cess surplus).	825.19	2320.88	2023.75	2716.14	3414.86
Deposits in Public account as at the end of the year	327.40	1568.77	2510.96	4111.50	6370.90

NOTE : (i) Closing Balance of 1983-84 regrouped in 1984-85 Accounts of OCC. Regrouped figures for 1983-84 as per accounts of 1984-85 taken.

(ii) Figures in brackets indicate excess of claims over surrenders in the Pool Accounts.

(iii) The net balances under C&F Adjustment Account have been arrived at after deducting administrative expenses of OCC.

(iv) BH Swap/Export surplus account depicts the balance (surplus/loss) on Export/Swap deals on Bombay High Crude.

5.17 As can be seen from above, the overall surplus generated from pool accounts has been rising year after year. These surpluses are around 10 per cent of the turnover of oil marketing companies. The major surplus is being generated in C&F Adjustment account. The C&F surcharge has not only compensated short/excess recoveries in the C&F Adjustment Account but has also more than compensated the deficit on account of FSP and PPA and COPE Account over the years. Even PPA and COPE Accounts have generated a surplus in 1985-86 and 1986-87 adding to the overall surplus in pool funds.

5.18 When OPC (1976) recommended the creation of various pool accounts, it was not contemplated that there will be huge surplus amounts for a long period. In fact OPC had observed (para 13.9) that 'surplus in one account should be available for setting off the deficits in another pool account'. Each pool account was meant for equalisation of specific cost element. It was also recommended by OPC

(1976) that annually a review of the balances in each account should be made and surplus, if any, after taking into account the likely debits of the oil industry should be credited to Oil Industry Development Fund administered by the Oil Industry Development Board.

5.19 The review of major accounts reveal that instead of adjusting costs increases and equalising the prices, the pool accounts have developed into sources of extra-budgetary resources for Government. No purposeful review of balances is conducted annually to adjust the rate of surcharges. The surplus funds are not credited to Oil Industry Development Fund but are kept in public account.

5.20 A review of balances of various Pool Accounts and surplus on account of Oil Development Cess presented in para 5.16 will show that there has been an overall surplus of Rs. 11,300.82 crores in all during five years ending 31-3-1987 as a result of operation of the pricing mechanism. Broadly

speaking, this surplus is attributable to accumulation in the following accounts :

- | | |
|--|--------------------|
| (a) Oil Development Cess | Rs. 3714.17 crores |
| (b) Cost and Freight Adjustment Account. | Rs. 6744.90 crores |
| (c) Accumulation in other Pool Accounts. | Rs. 841.75 crores |

5.21 Each of the above accounts, which has resulted into huge surplus as on 31-3-1987, was created for specific purpose. Oil Development Cess was required to be passed on to Oil Industry Development Board for being credited to the Oil Industry Development Fund. Upto 31st March, 1987 only an amount of Rs. 604.50 crores was passed on to this Board. The remaining amount to the extent of Rs. 3738.93 crores is still lying with the Government as a part of Consolidated Fund of India. In addition to this, Oil Industry Development Board itself had a surplus of Rs. 327.25 crores lying with them.

5.22 Oil Industry Pool Account includes Product Price Adjustment Account. The primary purpose of this account is to subsidise certain products like superior kerosene oil and Liquefied Petroleum Gas. This subsidy is provided by charging higher price on other products. Even this account over the last five years has accumulated a small surplus of Rs. 79.38 crores.

5.23 However, the largest balance is represented by the cost and freight adjustment account as mentioned earlier in para 5.2. This account was created mainly to adjust major variations in various elements of cost and freight. It is, therefore, natural to expect that this account should have been squared up by continuous adjustment with the changing variation in cost and freights. However, its continuously increasing accumulation which amounts to Rs. 6744.90 crores during last five years ending 31st March, 1987, points out that the receipts on this account have been much more than the actual variations in costs and freights and an account created for adjustment with actual cost has been turned into a continuous source of funds.

CHAPTER 6

ADMINISTRATION OF POOL ACCOUNTS

6.1 All the pool accounts are being administered by a body known as Oil Coordination Committee (OCC) which was set up as per Government Resolution issued in July 1975. Besides the administration of pool accounts, this Committee was also entrusted with the work relating to allocation of crude oil and fixation of monthly product pattern, coordinating the transportation arrangements for crude oil Imports and Coastal movements etc. The expenditure of this Committee was to be met out of C&F Account.

6.2 Detailed functions of this Committee as originally stipulated in the Government order dated 31-12-1977 were further enhanced by a Committee which reported in August 1981. Accordingly OCC was also made responsible for preparing O.E.B. (Oil Economy Budget); Planning and Recommendation of Crude/Product Import, Planning of facilities, Planning of Refinery Production Pattern, allocation of crude to various refineries and transport arrangements thereof, maintaining an information system and Data Bank for the purpose of control of various activities etc.

6.3 The OCC heavily relies on the managements of the oil companies for the accuracy and conformity of the statements which go to build up the pool accounts. These statements are being certified by Chartered Accountants appointed by the companies themselves. The OCC audit wing does the local audit of the various divisions of the companies for test check of the transactions. Although total amount passing through pool accounts is of the order of approximately Rs. 6,000 crores per annum in respect of transactions of 12 refineries and three major marketing companies besides the pipelines division, the audit wing of the OCC consists of only five persons. As such, checking of pool accounts by OCC audit wing cannot be deemed adequate and effective.

6.4 The following cases are some instances of over recoveries etc. not detected by OCC or detected late and other similar related matters.

Incorrect claims allowed by Oil Coordination Committee in respect of Ocean Loss

6.5 Ocean loss on import of products is allowed to be claimed by the companies from the pool accounts

upto the permissible percentage of each product. Any loss over and above the permissible loss is not to be claimed from the pool. The present procedure for settlement of claims on account of ocean losses is as under.

6.6 Under the fortnightly cash settlements made for the imports, the difference between the total landed cost of the product and the ex-refinery price is adjusted in the C&F Adjustment Account. At the year end an annual statement is prepared wherein the difference between the actual loss (already fully claimed vide C&F Adjustment fortnightly) and the permissible loss (at the different ceilings fixed for each product) is calculated and claim/surrender, as the case may be, is made from/to pool accounts.

6.7 It was observed that IOC (the sole canalising agents for import of petroleum products except LPG), while preparing the annual statement for adjustment of losses between actual and permissible losses had made incorrect adjustments in cases where there had been gains in the shipments. According to the normal procedure, the cost for entire quantity mentioned in the Bill of Lading is reimbursed to the company in the first instance. Thereafter, losses of more than specified percentage of the particular product are to be borne by the company and hence are required to be surrendered to the Pool Accounts. The gains, if any, are to be retained. It was seen that while computing the amounts to be surrendered/claimed, the gains (which need not figure at all) were reckoned as negative losses, thereby reducing the net surrenderable amount. This had resulted in excess claim from pool to the extent of Rs. 103.49 lakhs for 1985-86 and 1986-87 alone. The above procedure has been in operation since 1979, and the OCC has been passing such claims. This could be attributed to inadequacy in internal check by OCC while making pool account payments. Thus, a thorough review of claim procedures appears necessary.

Incorrect Claim of Rs. 6.45 crores by Hindustan Petroleum Corporation Limited

6.8 M/s. Hindustan Petroleum Corporation Limited submitted revised statements of pool accounts

for the Incentive Scheme pattern for the period 1-4-81 to 31-3-85. The claim made in June, 1986 for the Lube Sector by the refinery amounted to Rs. 6.61 crores. This statement stood certified by Chartered Accountants (pool accounts auditors). However, while making the claim, the company as against the correct rate of 563.77 per MT (being refining cost and return of Lube thruput) claimed at the rate of Rs. 3059.15 per MT (being the retention price). This resulted in the company claiming an excess amount of Rs. 6.45 crores.

6.9 However, this could not be detected till June, 1987 (*i.e.* a full year after the claim was made from pool), when OCC noticed the incorrect claims and asked the company to surrender the excess claim of Rs. 6.45 crores allowed in June, 1986 along with interest. The Company made adjustment in pool only to the extent of Rs. 6.45 crores and has not made any surrender of interest on the amount. It is worthwhile noting that out of a total claim made on this account for Rs. 6.61 crores, an amount of Rs. 6.45 crores was found excess. In spite of such glaring difference, it remained undetected for a period of one year.

Non-Surrender of over recoveries of Sales Tax on Composite Billing by Oil Companies

6.10 Due to the difference between the rate of sales tax paid by the companies in respect of inter-company transactions and those recovered from the selling prices at applicable rate at the place of sale by the companies to the consumers (*i.e.* Major Installation, Top's Depot), the oil companies have over recoveries on this account. These over recoveries were required to be surrendered to pool accounts as per OCC's directives. However, the two major oil marketing companies (HPCL and BPCL) have not surrendered these over recoveries of sales tax on composite billing amounting to Rs. 16.48 crores for the years 1984-85 and 1985-86.

LPG Compensation

6.11 Based on the recommendations of the Oil Cost Review Committee (OCRC) and as accepted by the Government the oil companies were compensated

towards depreciation, return on investment and maintenance costs on LPG cylinders as under :

	Rs. per MT
Depreciation	252
Return on Investment	196
Maintenance Cost	80
	528

6.12 The quantum of depreciation included in the price build up given above was based on the calculation on a 15 years life expectancy of cylinders and a residual value of 5%. It also took note of the deposits made by customers with the oil companies, customer cylinder ratio, estimated life of cylinder keeping in view the effect of hot repair and also consumption per customer per year.

6.13 During November, 1986 the OCC sent a proposal to the Government for 100 per cent compensation for depreciation on cylinders charged during the year after adjusting the depreciation and return recovered through the price as given above (*i.e.* Rs. 252 + 196 = Rs. 448). In other words they asked for reimbursement of the entire depreciation charged by the oil companies in the books of accounts on the cylinders as compared to the amount allowed by OCRC based on calculation of 15 years life taking into account various other factors. This proposal of OCC was approved by the Government in March, 1987. The OCRC recommendation was thus vitiated due to the above decision. Accordingly, oil companies (IOC, HPCL and BPCL) were authorised payments of Rs. 218.68 crores over and above what was recovered through price mechanism for the years 1985-86 and 1986-87.

6.14 One of the main reasons advanced for such compensation was that the companies were charging 100 per cent depreciation in the year of acquisition against which the reimbursement through price mechanism was based on 15 years life expectancy and therefore falling short of depreciation as charged in the books of accounts on 100 per cent basis. However, due to the recent amendment to the Companies Act, in 1988 the rate of depreciation prescribed under Schedule XIV thereto in respect of cylinders is 16.21 per cent (SLM) as a result the main reason advanced for 100 per cent compensation itself has lost relevance. Even then, the oil companies are continuing to charge 100 per cent depreciation in books and claiming full depreciation from pool accounts.

CHAPTER 7

TRENDS IN 1987-88

7.1 The analysis of over-all pool balances and the surpluses generated therein till 1986-87 has already been discussed in Chapter 5. In this chapter the subsequent position of pool balances during 1987-88 and the surplus generated therein are indicated.

The following table shows the overall position of pool balances during the year 1987-88 :—

(Rs. in crores)

(a) Opening balance	7417.58
(b) Net impact of transactions during the year	
COPE	(274.99)
Cost and Freight Adjustment Account (C&F) (Net)	1507.95
PPA	11.86
F.S.P.	(147.71)
BH SWAP/Export Surplus	NIL
Others	(254.66)

(c) Closing Balance	8260.03

(d) Overall surplus in pool accounts generated during the year, i.e., (c)—(a)	842.45
(e) Net accretions on account of Oil Development Cess	1794.50
(f) Total surplus generated during 1987-88 (Pool Accounts + OIL Development Cess), i.e., (d) + (e).	2636.95
Deposits in Public Account as at the end of the year.	7630.05

(Figures in brackets indicate deficit balance)

NOTES : 1. For the year 1988-89 audited figures of Balances in various pool accounts are not yet available (Nov. 1989). Hence the updation for 1988-89 could not be done.

2. In the year 1988-89, out of total collection of Oil Development Cess amounting to Rs. 2025.15 crores, a sum of Rs. 63.09 crores has been paid by the Central Government to Oil Industry Development Board.

3. In the budget for 1989-90, passed by Parliament, a sum of Rs. 2,300 crores has been earmarked for transfer from the Pool Account to Consolidated Fund of India.

7.2 As in the earlier years, the major surplus was contributed by the C&F Adjustment account amounting to Rs. 1507.95 crores. The surplus from Oil Development Cess has substantially increased from Rs. 974.93 crores in 1986-87 to Rs. 1794.50 crores in 1987-88. No amount was however credited to Oil Industry Development Fund during the year 1987-88.

Withdrawal of Interest on Deposits in Public Account

7.3 The surplus funds generated in the Pool Accounts are required to be transferred as deposits with Government of India in Public Account. At the end of March, 1988 an amount of Rs. 7630.05 crores was lying as deposit in Public Account. These balances in Public Account were being credited with interest at the rate of 5 per cent on the minimum monthly balance standing to the credit of the Public Account. The Government decided in 1987 that these deposits are non-interest bearing and ordered the write back of the entire interest on the deposits amounting to Rs. 150.91 crores. Accordingly the OCC in its accounts for the year 1987-88 has written back the amount of Rs. 150.91 crores. This had the effect of reducing the balance in Pool Accounts by Rs. 150.91 crores.

Reply from the Ministry

7.4 The analysis was issued to the Ministry of Petroleum & Natural Gas in October, 1988. A reminder was also issued in November 1988 requesting the Ministry to furnish their reply by December 1988. No reply by way of any comments as regards

the factual position as brought out nor any clarification of facts and figures stated therein have been received from the Ministry so far (October 1989). It had therefore to be further processed and finalised in the absence of replies and clarifications from the Ministry.

New Delhi,
Dated :

14 MAR 1990

K. Tyagarajan

(K. TYAGARAJAN)
Deputy Comptroller and Auditor
General-Cum-Chairman Audit Board

Countersigned

New Delhi,
Dated :

14 MAR 1990

T. N. Chaturvedi

(T. N. CHATURVEDI)
Comptroller & Auditor General of India

PS Addendum to this Report at page 27-31

K. Tyagarajan

K. Tyagarajan

ANNEXURE

Cost and Freight Adjustment Accounts (C&F)

The following are the major adjustments that may be allowed under this account

- (a) Variations in the crude cost element, like freight, insurance, auxiliary duty and wharfage.
- (b) Variations in the ocean loss element on account of change in crude mix/change in the rate of crude.
- (c) Difference between the ex-refinery price and the retention prices of the products.
- (d) Variations in the product pattern compared to the standard pattern adopted by us for determining the retention prices.
- (e) Variations in the cost of bitumen drum due to variations in the cost of steel and excise duty.
- (f) Variations in the return on net worth on account of change in the interest on long term deposits of five years duration with the banks.
- (g) Variations in the interest on borrowings due to change in the average interest rate of borrowings of the companies over the rate considered by us.
- (h) Over/under-recoveries in respect of LPG/bitumen filling charges.
- (i) Claims on account of price escalation in respect of LTS and other admissible items of cost.
- (j) The increase in the working capital entitlement on account of changes in the pooled FOB price of crude/cost of sales of the products.
- (k) Letters of Credit charges incurred by companies for imported crude.
- (l) Demurrages on crude/products subject to approval by OCC.
- (m) Difference between the duty free landed cost of imported products including lube base stocks and the domestic price (ex-refinery price) for all products under administered pricing system.
- (n) Difference between the ceiling selling prices and the bunker prices.
- (o) Variations between the ceiling selling prices and the bunker prices.
- (p) Any under/over recovery in the operation of freight surcharge in Assam and North-East border areas and subsidy on transportation to Andaman & Nicobar Islands and Lakshadweep & Minicoy Islands.
- (q) Claims/surrender under the incentive scheme for improvement in the product pattern and fuel and loss.
- (r) Adjustments covering the operating expenses/returns on TKDs.
- (s) Adjustments of under/over recovery on transportation of LPG cylinders as per the existing scheme.
- (t) Irrecoverable Sales Tax/Octroi recommend that the existing procedure of developing surcharge scheme to compensate the irrecoverable/non-recoverable sales tax/octroi levies be adjusted in the C&F account.
- (u) Claims on account of working capital entitlement for the crude mandatory tankages.
- (v) Adjustments on account of permissible R&D expenses.

REPORT OF THE COMPTROLLER
AND AUDITOR GENERAL OF INDIA

UNION GOVERNMENT NO. 7 (COM-
MERCIAL) OF 1989

ADDENDUM

1. After the issue of the final version of the analysis to the Ministry on 1st January 1990, the Ministry stated (12.1.1990) as follows :

“The audit study entitled ‘Analysis of Oil Pricing arrangements’ sent with your D.O. letter No. MAB II/T-270/87/298 dated 12.10.1988 is under examination. In your reminder dated 29th November 1988 you have expressed the hope that Government views would be received by the end of December 1988. However, as there were no reminders subsequently and also as this item did not feature in the Audit Report it was presumed that the matter was not being pursued by Audit.

It is now seen that there are many variations in the revised draft report sent to us. I shall therefore be grateful if six weeks are allowed to this Ministry to consult OCC and to send the Government’s reply as per normal practice.”

1.1 It was intimated to the Ministry (18th January 1990) in reply that they were not informed at any stage, that the proposed audit study was no longer being pursued by audit and therefore it was not clear how the Ministry had presumed that the matter was not being pursued. No other Audit Report pertaining to this Ministry was presented to Parliament after the Analysis was sent to the Ministry. Therefore the significance of “this item did not feature in the Audit Report” is also not clear. It also looks strange that the Ministry should expect that after an audit review has been sent, continuous reminders should be issued to elicit Government’s reply in order to keep the audit review alive. However, in February 1990, the Ministry replied to the over-view of the Analysis stating that a more detailed reply on the main body of the report will be considered and forwarded to Audit subsequently. This was the first reaction of the Ministry to a review sent in October 1988. By then, having waited for over one year and three months, the Analy-

sis was finalised and sent for printing. Just at that stage, when the printed report was to be countersigned, the reply of the Ministry dated 13 February 1990 arrived. Therefore, this addendum to the already printed report became necessary. It deals with the comments of the Ministry on the over-view of the analysis. As the response to the draft review sent in October 1988, was received in February 1990, the Ministry cannot reasonably expect that the Audit should interminably wait for its further comments as more than adequate time was available with the Ministry for an informed response to the totality of the review. It may be pointed out that the practice of addendum cannot be followed by Audit in every case of such delayed response by the Ministry, in future as a matter of course.

2. Each paragraph of the overview gives a specific reference to the paragraphs inside the body of the Analysis. Therefore, it has not been considered necessary to give further supporting information as desired by the Ministry in its letter dated 13 February 1990.

3.1 In their reply dealing with para-III of Overview of the Analysis the Ministry stated that

- (i) The price (of indigenous crude) was fixed taking into account price of imported crude.
- (ii) The Advisory Board on Energy conducted a study (December 1987) and the study estimated the long term social marginal cost of indigenous crude oil at Rs.1050 MT exclusive of royalty, development Cess and sales tax. It would, therefore, appear that the price fixed in 1981 was not far removed from what was arrived at in the study subsequently.
- (iii) As per section 15 & 16 of the OIDB Act, the duties of excise (Oil Development Cess) which are levied, are first required to be credited to Consolidated Fund of India. Thereafter, the Central Government may, if Parliament by appropriation so provides, pay to OIDB from time to time out of such proceeds such sum of monies as it thinks fit for the purpose of this Act (Oil Industry Development Act).

3.2 The reply of the Ministry does not alter the position brought out in the review as discussed in the following paragraphs:

- 3.2.1 The basic point is that OPC'76 had fixed the price of indigenous crude oil after a detailed study and recommended a review of the price in three years time. No such review was conducted; instead the price was raised to Rs.1021 per MT in July 1981 on adhoc basis. How could the Ministry foresee that a study team to be appointed at a future date would arrive at nearly the same price six years after is not clear!
- 3.2.2 This should also be seen in the light of the fact that the OPC 76 had recommended enhancement in the ceiling of the rate of cess from the then existing level of Rs.100 per tonne to Rs.150 per tonne basically to supplement funds to ONGC to meet their requirement of funds for exploration programme as it was felt that ONGC would not be in a position to generate adequate internal resources to carry out approved programmes. Where as, the fact is that after the enhancement of the base price in 1981 by the Government there has been a large internal resource generation by ONGC which has been largely adequate to meet its planned outlay. In spite of that the Oil Development Cess was continued to be increased from time to time by Government notification.
- 3.2.3. The provisions of Section 15 & 16 of the Oil Industry Development Act, referred to by the Ministry in its reply bring out the legal and the procedural requirement of operating the Fund. The appropriation of funds for the purposes envisaged in the Oil Industry Development Act is approved by the Parliament on the basis of the proposals framed by the Central Government. Since the internal resources of ONGC were adequate to meet its planned outlay, the Government obviously did not consider it necessary to suggest any appropriations to be approved by the Parliament. This is the point which is being brought out in our Analysis viz. that despite the ONGC having adequate internal resources, the rates of Cess were increased

from time to time and on adhoc basis.

4. As regards para IV (a) of the Overview the Ministry has accepted the point that refineries have generally exceeded the standard thruput. It has been stated, however, that this is because refineries were asked to stretch their refining capacities to the utmost and therefore, increases in thruput cannot be considered as normal operation for the purpose of determining standard of performance. This reply does not take into account the facts already brought out in para 3.6 of the Analysis, which mention a number of factors responsible for fixation of standard thruput at lower level. The Ministry's reply does not meet these points. For example the shut down allowed has been increased whereas the thruput capacity has been retained at the original level. The level of thruput has not been matched with the time taken for shut down although both are inter-related.

4.1 Replying to para IV (b) of the Overview the Ministry stated that after due allowance for design parameters, improvement in facilities, actual operating conditions, the fuel and loss percentages were fixed. Though actual fuel & loss or the standard fuel & loss whichever is lower is taken into consideration while making pool adjustment according to the Ministry, it is not a fact that efficient refineries are penalised while inefficient ones are protected.

4.2 The Ministry has not specifically replied to the point that the percentages for fuel and loss for each refinery are basically arrived with reference to the historical data which is adopted or modified with reference to the product pattern. The analysis has specifically brought out the cases in para 3.17 where the fuel and loss percentages were lowered. A case in point is refinery of HPCL Bombay where actual fuel and loss percentage was showing a declining trend from 4.67 per cent in 1984-85, to 4.13 per cent in 1986-87. Accordingly, its standard fuel and loss has been lowered and set from 5.94 per cent to 5.21 per cent. Since, fixation of standard fuel and loss has a bearing on the standard product pattern of the concerned refinery based on which the retention prices are determined, the fixation of higher percentage of standard fuel and loss than the achievable quantum of fuel and loss would lead to the inefficient operations getting the advantage of higher percentage of fuel and

loss which had been adopted as the basis for compensation.

5. As regards para IV (c) of Overview the Ministry stated that the manpower strength varies from Company to Company based on technologies used, local conditions, etc, and so cannot be uniform. This reply is not tenable. When the standard thrupt has been fixed, it is only logical that standard manpower required to achieve the same is also determined. It is not the contention of Audit that uniform manpower norms should be laid down. What is intended is that for each refinery depending upon the technology & local conditions, a norm for standard manpower should be fixed so as to optimise the productivity. Such a norm does not exist at present.

6. In reply to para V of Overview dealing with marketing costs, the Ministry stated that once norms are fixed these are effective for a minimum period of 3 years. The Ministry further stated that the full cost retention is realised only on attainment of the capacity prescribed. Therefore, the costs are prescribed normatively and are under control.

6.1 The reply is not tenable. As already stated in the para 4.6 of the Analysis, once retention prices are determined based on historical cost, the incentive to reduce costs largely disappears. This should also be viewed in the light of the fact that salaries wages and overheads account for about 70 per cent of marketing costs. In spite of this position, norms for manpower with reference to sales have not been laid down. It has been clearly brought out in para 4.8 of the Analysis that manpower productivity has declined in two out of three major marketing companies.

7. Regarding para VI dealing with pool accounts the Ministry stated that the pool accounts are supposed to be balancing in nature in the long run when the costs are lower than the normative. There was accretion of surplus mainly due to external factors. When the costs go up as has happened in 1989-90 due to external factors such as import price and exchange rate variation the surpluses get depleted. The out flow from pool account from 1989-90 onwards has been much more than the inflow because of various external factors.

7.1 The position regarding the surplus and the reasons thereof for the last six years

ended 31 March 1988 has already been dealt with in the Analysis in chapter 5 and chapter 7. As already stated therein, there have been large surpluses in pool accounts. The overall balance in pool accounts as on 31 March 1989 has also increased compared with the balance on 31 March 1988. As regards 1989-90 the audited accounts of Oil Co-ordination Committee for the year 1989-90 are not available as the year 1989-90 itself is yet to be completed. As a result the final position of pool balances for the year, 1989-90 is not ascertainable.

8. The Ministry stated in respect of para VII dealing with the administration of pool accounts that the claims of the Oil Companies are admitted on the basis of audited statements certified by the Chartered Accountants appointed by the managements of the Companies as per the directions of the Company Law Board based on the recommendations of CAG.

8.1. It appears that the Ministry has not been able to appreciate the point made in Audit in para 6.3 of the Analysis. The Audit of the pool accounts maintained by the Oil Companies is conducted by the Chartered Accountants who are appointed by the management themselves. These Chartered Accountants are not appointed by the Company Law Board based on the recommendations of the CAG.

9. Ministry's comments on cases referred to in chapter 6 of the Analysis and our comments thereon are in the following paragraphs.

9.1 Ocean loss claim by Indian Oil Corporation(IOC)

The Ministry stated that in respect of cases where actual receipt is more than the Bill of lading quantity IOC is supposed to claim the difference between the actual receipted quantity and the bill of lading quantity the adjustment having been made initially for the bill of lading quantity, from the pool accounts. IOC is eligible to claim (in addition) the loss as per the specified norms from pool accounts. It also reiterated that the gains on this account will not accrue to the Oil Company in any other manner unless the same is claimed thus from the pool accounts for efficient management.

9.2. The reply is not tenable in view of the following:

- (i) Oil Cost Review Committee vide para 9.26 of their report stated that "we are not recommending any adjustment with the Oil Industry Pool account for any variation in the actual loss over the norms. As such the Oil Companies will retain the benefit of any reduction in ocean loss below the norms as they will bear the extra cost in case losses are over and above the norms."
- (ii) From (i) above it is clear that what is intended is that the importing company is given the incentive to reduce losses. i.e. in cases where there have been savings in terms of percentage loss with respect to the specified percentage the gain to the Company resulting therefrom need not be surrendered to pool and can be retained by them.
- (iii) In view of the position stated in (i) and (ii) above the practice followed by IOC to adjust against losses over the permissible percentage, the gains by way of quantities received in excess of Bill of lading quantity provides a fortuitous advantage to the company.

10. Claim for differential margin by Hindustan Petroleum Corporation (HPC)

10.1 The Ministry stated that the HPCL adopted different rate due to inadvertent error. This was detected by OCC Audit Wing, during local verification and the excess payment of Rs.6.45 crores was fully recovered. The levy of interest was not pursued as the error was an inadvertent one.

10.2 Ministry has accepted the facts of the case. It points out the weak internal control since the error also escaped the audit conducted by the Pool auditors.

11. Non surrender of over-recoveries of Sales Tax on composite Billing by Oil Companies.

11.1 The Ministry stated that on a representation from the Oil Companies the Government reconsidered the matter and decided that the Oil Companies need not surrender the amounts accrued to them on account of composite billing of sales tax during the years 1984-85 and 1985-86. Any under charging of sales tax would also not

have been payable by OCC to Oil Companies.

11.2 The reply of the Ministry does not meet the Audit observation. According to the direction of the Government, the Oil Companies were bound to refund the differential between the sales tax paid by them and the sales tax recovered through the price to the pool account. Since the sales tax rates paid by them in respect of inter-company transactions are lower than the sales tax recovered by them, the question of any under recovery should not normally arise.

12. L.P.G. Compensation

The Ministry stated that the decision to allow 100% compensation for LPG cylinders was taken after consideration of the following factors.

- (i) In terms of Section 5 read with Section 6 (a) of the 'Payment of Bonus Act, 1965 the allocable surplus is required to be computed after providing depreciation admissible under sub-section (1) of Section 32 of the Income Tax Act, 1961.
- (ii) Sub-Section (1) of Section 32 of I.T. Act, 1961 provides for 100% depreciation on items of 'Plant & Machinery' of value not exceeding Rs.5000 each. LPG Cylinders being less than Rs.5000 each qualify for 100% depreciation allowance.
- (iii) The Companies Act required prior to 1987 depreciation to be provided at a rate not less than that prescribed under the I.T. Act, and Rules.
- (iv) The Oil Companies are providing 100% depreciation for arriving taxable income.
- (v) Under retention concept, Oil Companies are eligible for a margin which covers reasonable costs and return on cylinders as per Income Tax Act and also as per the accounting policies and are providing the same in their Books of accounts, the same becomes a relevant cost for the purpose of compensation. Keeping this in view and also the factors listed above the decision to allow 100% depreciation on cylinders it is in line with accounting and pricing policies which are the same whatever the rate of depreciation.

(vi) As regards providing 100% depreciation the provisions of I.T. Act, and payment of Bonus Act, have not changed.

12.1. The reply given by the Ministry is not tenable. Various factors like statutory provisions were also known when the matter was examined by OCRC, which gave a report in 1986. In addition the OCRC had also taken into account a number of other factors like the deposits made by customers with oil companies, customer cylinder ratio, estimated life of cylinder keeping in view the effect of hot repair and also con-

sumption per customer per year. The recommendation of OCRC were accepted by Government. But soon thereafter the OCC sent a proposal in November 1986 to revise the rate of compensation at 100% for depreciation on cylinders which was accepted by the Government. As oil industry functions in an environment of monopoly and administrative prices, the compensation should be based on totality of circumstances and not on one particular factor. In this case the Ministry decided to reverse a considered decision on compensation without giving due weightage to all the relevant factors.

New Delhi
The

14 MAR 1990

K. Tyagarajan
(K.Tyagarajan)
Deputy Comptroller and Auditor General
(Commercial)-cum-Chairman Audit Board

Countersigned

New Delhi
The

14 MAR 1990

T. N. Chaturvedi
(T.N.Chaturvedi)
Comptroller and Auditor General of India

