

ROBUSTNESS OF GOVERNANCE FRAMEWORK & LEADERSHIP ROLE IN HYDROCARBON EXPLORATION

The following issues have been reported upon in this chapter:

- Whether ONGC placed sufficient emphasis on its exploration efforts vis-à-vis Vision of the Government;
- Whether there were gaps in strategic and operational planning for exploration in ONGC;
- Whether the MoU targets of ONGC were fixed appropriately; and
- Whether ONGC has met the targets fixed and whether there is a robust system for performance measurement.

6.1 Mismatch between strategic objectives and planned targets of ONGC

6.1.1 Hydrocarbon Vision 2025 implemented in 2000 articulates an objective of undertaking a total appraisal of Indian sedimentary basins for tapping hydrocarbon potential and to optimize production of crude oil and natural gas in the most efficient manner so as to have Reserve Replacement Ratio²⁶(RRR) of more than 1. In order to achieve the objectives set out in the Hydrocarbon Vision, ONGC formulated an Exploration & Production Strategy in July 2001. The document articulated a short, medium and long term exploration strategy spanning 2002 to 2020 (three phases). The strategy envisaged doubling of initial in-place volume of hydrocarbons (IIH)²⁷ from 6 Billion Tonnes (BT) to 12 BT by 2020. This doubling is to be done in three phases – 1.2 BT by 2007, 2.2 BT by 2014 and 2.6 BT by 2020. Audit noticed that while ONGC's strategic objective envisaged 2.2 BT by 2014, ONGC's XI Five Year Plan (2007-2012) projected only 1.001 BT IIH by 2012. This leaves 1.2 BT IIH to be achieved in the remaining two years if the strategic objective is to be met. The possibility of achievement of 1.2 BT IIH in two years (averages 0.6 BT IIH per year) was, however, remote considering its performance of the last four years (2007-11) which averaged 0.239BT IIH per year.

6.1.2 While discussing the reserve accretion targets for the XI Plan, the CMD, ONGC mentioned that private players set a target of 3 Million Metric Tonne (MMT) reserve accretion per well as against ONGC's target of 1.537 MMT per well. This also supports the view that ONGC's planned targets did not have the required stretch for achieving envisaged reserve accretion.

In its response, ONGC stated that (March 2012), strategic goals could by no means be equated to the achievement of an assigned target. ONGC achieved its first 6 BT of IIH

²⁶Reserve Replacement Ratio is the ratio of new reserves accreted to hydrocarbon produced.

²⁷Initial in-place hydrocarbons are the volumes of crude oil, condensate, natural gas, natural gas liquids and associated substances anticipated to be present in known accumulations at a given time.

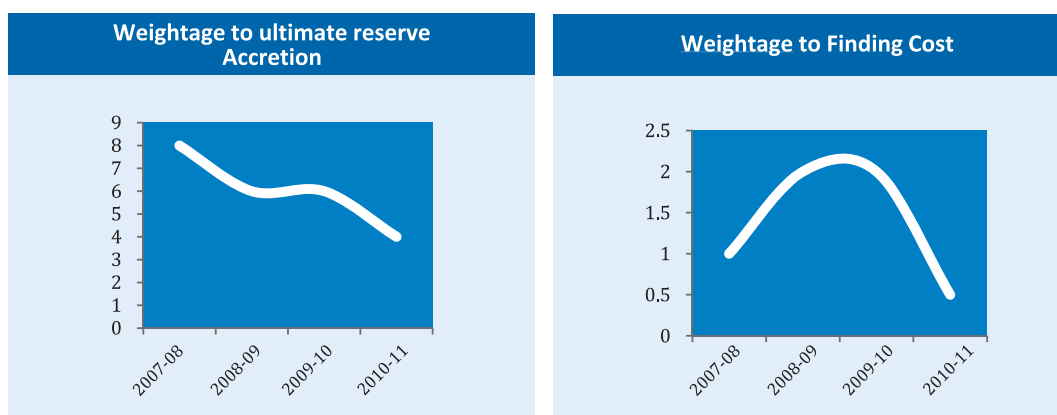
accretion after close to five decades of exploration and, hence, the same to be achieved in two decades was clearly an ambition but not insurmountable “Strategic Goal”.

The response of ONGC is not acceptable as the Company had set itself long, medium and short term E&P strategy to meet the strategic goals. A road map for this had also been drawn up by the Company which includes improved management of existing major fields, fast tracking of production from deep water wells, field specific cutting edge technology in marginal fields, etc. Besides, the fact that the Company took five decades to achieve 6BT of IHH accretion should not colour its future outlook, given the phenomenal improvements in technology and E&P experience gained by the NOC.

Thus, ONGC did not align the five year and annual plans with the envisaged accretion of IHH in its strategic goals.

6.2 Declining emphasis on exploration in the MOU between MOPNG and ONGC

6.2.1 There were only two exploration parameters included in the MOU targets of ONGC – (i) ultimate reserve accretion²⁸ and (ii) finding cost. Though exploration is a core business of ONGC, the weightage given to these parameters has reduced over the period 2007-11, from 8 per cent to 4 per cent for reserve accretion and 2 per cent to 0.5 per cent for finding costs. In fact, the MOU for 2010-11 indicated a weightage of 5 per cent for Corporate Social Responsibility while the combined weightage for the core activity of exploration remained at 4.5 per cent as depicted below:



Source: MOUs signed by ONGC with MOPNG during 2007-11.

ONGC in reply stated (March 2012) that the MOU parameters of Central PSUs like ONGC are drafted as per the MOU Guidelines issued every year by the DPE. The Ministry was yet (July 2012) to respond to this audit comment.

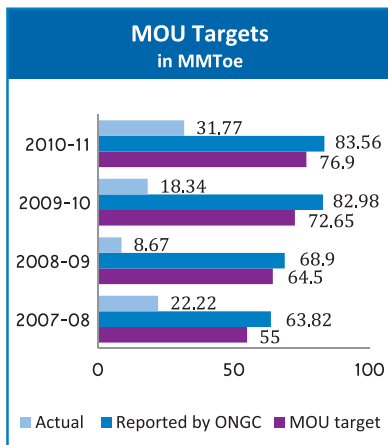
Reply of ONGC is not acceptable as exploration is the core activity of ONGC employing 22.9 per cent of the total financial resources and 20 per cent of the manpower (over 2007-11). As such, performance on exploration parameters ought to be measured and monitored closely and given due weightage in the MOU. The MOU provided a 50 per cent weightage on non-financial parameters. Given that exploration is a fundamental

²⁸ Ultimate reserve accretion is an approximation of the quantity of oil or gas that is potentially recoverable from a reserve or well.

activity of ONGC, a 4.5 per cent weightage to it was entirely lop-sided and its compliance would further dilute the emphasis on exploration.

6.3 Difference in criteria for setting and reporting on MOU target

6.3.1 Audit observed that the MOU targets for reserve accretion were based on the BE targets in ONGC's annual plans.

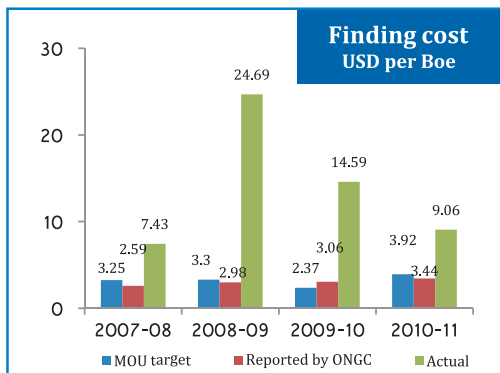


Source: MOUs and data of ONGC for 2007-11

The BE targets pertained to reserves accreted through exploratory wells, wildcats and appraisals and were further divided into Basin wise targets. However, while reporting on reserve accretion, ONGC considered reserve accretion not only through exploratory wells, wildcats and appraisals, but also through development drilling and reinterpretation misleading the stakeholder. It is interesting to note that reserves accreted by ONGC through exploratory wells, wildcats and appraisals actually formed only 13 per cent to 38 per cent of the reported reserve accretion. The reserve accretion through reinterpretation was 59 per cent to 63 per cent and through development 3 per cent to 27 per cent during 2007-11. Thus, actual reserve

accretion by ONGC fell far short of the MOU targets. This is further alarming in the backdrop of the low prioritization of its exploration efforts in MOU targets.

6.3.2 ONGC computed the finding cost by dividing the cost of exploration efforts



Source: MOUs and data of ONGC for 2007-11

by reserves accreted from exploratory wells, wildcats and appraisals, reinterpretation and development drilling. However, as pointed out in para 6.3.1 above, the actual exploration efforts included only exploratory wells, wildcats and appraisals. If ONGC considers the actual cost of exploration based on the above the finding cost would range from US \$ 7.43 to US \$ 24.69 per boe which was much higher than the MOU target of US \$ 2.37 – US \$ 3.92 per boe during all the years from 2007-08 to 2010-11 and exceeded by US \$ 4.84/boe (129 per cent) to US \$ 21.71/boe (648 per cent).

6.3.3 ONGC got an 'excellent' grading on reserve accretion and mixed grading of 'poor' to 'excellent' on finding cost during the four years period under consideration. This contributed to a 'very good' grading of the Company during 2007-11 which led to an eligibility for a high percentage of Performance Related Pay (PRP of 80 per cent) for the executives. If the reporting were to be matched to the targets, the actual grading on both the parameters would have been 'poor', leading to depressed rating which would adversely impact the PRP of employees.

6.3.4 ONGC in its reply (March 2012) stated that there was no differing criteria for target setting and reporting on exploration parameters and added that reserves accreted were reported under four broad heads of 1) new find, 2) new pool, 3) delineation and 4) reinterpretation. All these four represent exploration efforts. The Management also contended that in the target of BE, only exploratory well, wildcats or appraisals were taken into account. Accretion of reserves through reinterpretation is due to re-assessment of the area with new concept, new additional seismic data, reprocessing of seismic data and re-evaluation of all G&G data obtained till date, which form a part of exploration.

6.3.5 The reply is not acceptable as ONGC contradicted its own stand in the reply. While on one hand it stated that there was no differing criteria for target setting and reporting on exploration parameters, on the other it admitted that in the target of BE, only exploratory well, wildcats or appraisals were taken into account. Thus, accretion targets did not include accretion through development drilling and reinterpretation as per Company's own admission. There was, thus, a mismatch between the criteria for setting MOU targets for reserve accretion and reporting on them. Moreover, in review by the Executive Committee (EC) on 17 May 2010, the fixation of performance benchmarking of the Basins, Assets, etc., the EC was of the opinion that in order to assess the real performance of the Basins through exploration efforts, reserve accretion through re-assessment and reinterpretation may need to be segregated from those due to fresh discoveries.

6.4 System of Performance Assessment

6.4.1 The existing performance assessment mechanism in ONGC consisted of Basin-wise performance contracts signed between Director (Exploration) and the Basin Manager every year. The contracts were based on Key Performance Indicators (KPIs) formulated under the four balanced scorecard perspectives of operation, process, finance and people. Each KPI was given a separate weightage. The KPIs during the period 2007-11 are detailed below:

KPI during 2007-11	
Perspectives	KPIs
Operational	Ultimate reserve accretion, new prospects generated and O+OEG production of associated assets.
Process	PEL ²⁹ to ML ³⁰ area conversion, 2D/3D acquisition, exploratory wells drilled, exploratory wells success ratio, exploratory discovery index, interpretation projects completed, out of box ideas.
Financial	Finding cost, exploratory wells cost, 2D/3D survey cost, austerity in non plan expenditure and bills clearing.
Human resources	Oil Industry Safety Directorate (OISD) audit compliance, Lost time, injury frequency, knowledge management.

²⁹ PEL: Petroleum Exploration License.

³⁰ ML: Mining Lease.

6.4.2 Audit observed the following gaps in the performance measurement system:

(a) KPI's without target – In three out of seven Basins, namely Frontier Basin, MBA Basin and Western Onshore Basin, there was no activity on a set of KPIs (*viz.* new prospect success ratio, finding cost and 3D survey in respect of Frontier Basin, PEL to ML conversion in MBA Basin and 2D seismic acquisition in Western Onshore Basin). Thus, there could be no targets against these indicators for the above Basins. However, these Basins continued to be assessed with these critical parameters. This led to a curious situation where the Basins got full marks on the KPIs without carrying out any activity. In the Exit Conference ONGC accepted the aberrations and mentioned that same had been since rectified.

(b) Targets based on previous performance instead of current year projections – The KG Basin was allowed to set previous year's performance as the target for the current year. The Management replied (October 2011) that finding cost target could not be projected as it was based on reserve accretion. The reply is not tenable since for ONGC as a whole, the finding cost target for MOU was fixed on the targeted reserve accretion which could be set for this Basin also.

(c) Uniform target for exploratory well success ratio – A uniform target of 33 *per cent* of exploratory wells success ratio had been fixed for all the seven Basins instead of setting a target as per the prospectivity of each basin. The Management replied (October 2011) that target of 33 *per cent* were assigned to Basins based on achievement envisaged for ONGC. The reply is not tenable as assignment of uniform success ratio to all Basins was not correct since the Basins were assigned different reserve accretion targets for the ONGC's overall envisaged achievement. In the Exit Conference, ONGC agreed that 33 *per cent* success ratio for Frontier Basin was very high as no E&P Company had met with success in this region.

6.4.3 While evaluating the performance of the units, EC desired (November 2009) that the exploration's success be benchmarked with international norms. In the 369th EC meeting (May 2010), EC desired the benchmarking of E&P performance vis-à-vis international norms of 10 KPIs. However, Performance Management & Benchmarking Group had not benchmarked these KPIs with international norms. In April 2012, ONGC stated that they did carry out Internal Peer Benchmarking for parameters for similar units, the reports of which were presented to the EC every quarter. For external benchmarking, the Company had suggested a common body of the Government who could unambiguously standardize parameters for all domestic E&P companies and carry out benchmarking studies impartially.

6.5 Oversight on Hydrocarbon Exploration in ONGC

6.5.1 The Board of ONGC³¹ plays a leadership role in its exploration efforts and is responsible for strategic planning and approval of five year and annual plans. The Board also deliberates and decides on the MOU targets and results. As such, the Board is appropriately placed to address the planning and reporting gaps brought out by Audit at para 6.1 to 6.3 above. The Board is also in charge of monitoring performance and can address the comments brought out at para 6.4 above.

6.5.2 The DPE guidelines on Corporate Governance require the ONGC Board to have a formal statement of Board Charter which clearly defines the roles and responsibilities of the Board and individual directors so as to enable the Board to effectively perform its role. Audit observed that ONGC did not have such a Charter. While the CMD, at the 172nd Meeting held on 30 October 2007, informed the Board that the broad functions and responsibilities of the functional directors would be identified shortly – the Charter was yet (March 2012) to be prepared. ONGC stated (March 2012) that necessary action for formulating a Board Charter was on hand. As the matter had been pending since October 2007, the Charter needs to be prepared expeditiously.

6.5.3 The induction of independent directors on the Board is considered essential in order to make the Board more professional. As per requirement of clause 49 of the Listing Agreement, the Board of Directors of a company where the CMD is an executive director, at least half of the Board should comprise of independent directors. However, Audit observed that during the period 2007-08 to 2010-11, the Company did not have the requisite number of independent directors.

ONGC in reply brought out the compliance with the provisions of clause 49(IA) of the Listing Agreement for the subsequent period *i.e.* after 30 June 2011. The fact remains, however, that pre June 2011, ONGC was not in compliance with the SEBI guidelines.

ONGC further stated (March 2012) that the programme of work comprising RE & BE were put up for approval of the Board on annual basis, during which performance of the preceding year was also put up and deliberated. In addition, the MOPNG took Quarterly Performance Review Meeting every quarter which was attended by the entire EC including CMD where the exploration activities and shortfalls are discussed in great details. Thus, lack of monitoring could not be attributed to ONGC.

³¹ Board of ONGC consists of Functional Directors and Non-executive Directors (Part time official nominee Directors and Independent Directors).