Office of Comptroller and Auditor General of India

New Delhi: 10.08.2017

Press Release

CAG's report on Loans to Independent Power Producers by Rural Electrification Corporation Limited and Power Finance Corporation Limited tabled in Parliament.

Non-Performing Assets related to IPP loans, in both companies, increased sharply to ₹11762.61 crore over the three years period ending 31st March 2016.

Comptroller and Auditor General (CAG) of India's report No.34 of 2017 on Loans to Independent Power Producers by Rural Electrification Corporation Limited and Power Finance Corporation Limited was tabled in Parliament today.

Participation of private sector in power generation grew significantly with the enactment of the Electricity Act, 2003. Rural Electrification Corporation Limited (REC) and Power Finance Corporation Limited (PFC) also participated in these projects as lenders. Over 2013-14 to 2015-16 REC and PFC disbursed loans amounting to ₹ 47706.88 crore to Independent Power Producers (IPPs). Non-Performing Assets (NPAs) related to IPP loans, in both companies, increased sharply over the three years period ending 31st March 2016. At the end of 2015-16, total NPAs of ₹11762.61 crore for IPP loans was recognized in the books of accounts of REC and PFC, of which ₹10360.39 crore (86 *per cent*) were NPAs recognised during the three years ending 31st March 2016. Considering that REC and PFC had disbursed ₹47706.88 crore to IPPs during the same period (2013-14 to 2015-16), the NPA generation works out to a significant 21.72 *per cent* of the amount disbursed during 2013-14 to 2015-16.

In this context, Audit reviewed the procedures adopted by REC and PFC for appraisal, sanction and disbursement of loans to IPPs during 2013-14 to 2015-16.

Audit findings

- REC and PFC estimated a higher tariff at the time of appraisal of loan proposals which resulted in sanction of loans worth ₹8662 crore in six cases where the levelised generation cost was higher than the actual levelised tariff, rendering the viability of the project doubtful, *ab-initio*.
- Assessment of experience of project promoters was based on individual judgement and promoters who did not have relevant sector experience were often found eligible for loans. Many of these projects could not be completed within schedule.
- Nine projects had to be restructured multiple times, leading to increase in interest during construction by ₹13312.78 crore in six and NPA of ₹3038.44 crore in three loan cases. The financial capacity of the promoters was not appropriately assessed in these cases and the promoters failed to bring in equity for the project in the face of competing demands.
- In seven loan cases, the contractor and the promoter were same/ related entities. The loan sanctioned by REC and PFC to the promoter for execution

of the project remained with the promoter group and thus, the actual stake of the promoter in implementing the project was difficult to assess. The credit worthiness of the contractors and their ability to fulfil contractual obligations was not being appraised by REC and PFC.

- REC and PFC could not ensure end utilisation of funds by the borrowers. Audit noticed diversion of ₹2457.60 crore by the borrowers/promoters in five cases. Both the Companies were solely dependent on Auditors Certificate regarding end use of the funds, despite specific guidelines of Reserve Bank of India (RBI) (July 2013) which advised financing agencies to strengthen their internal controls and credit risk management system to enhance the quality of their loan portfolio.
- REC and PFC relaxed the pre-disbursement conditions from time to time. After the first disbursement, subsequent disbursements were often made to save the funds already disbursed, further relaxing the conditions and extending the timelines.
- REC adjusted ₹496.02 crore towards interest during construction (IDC) beyond the approved amount, during disbursement of loans to three projects. These adjustments ensured that the loan accounts remained 'standard' though no repayment was made by the borrower as per the loan servicing schedule. Without such adjustments, these loan accounts would have become NPA in 2013 itself. Audit also noticed adjustment of IDC after commissioning of a project which violated the internal guidelines of REC.
- REC and PFC sanctioned additional loans for meeting cost overrun in number of cases by relaxing conditions of internal prudential norms prescribing that the promoters/ borrowers should not be in default of servicing existing loans with any financial institution (including REC and PFC) and the core promoter should not have loss/ cash loss/ accumulated loss in its financial statements during the past three years, at the time of restructuring a loan.

Recommendation by Audit

- The process of appraisal of loan proposals, their sanction and disbursement may be strengthened. The existing appraisal norms may be revisited to design objective guidelines for assessing financial and technical capabilities of the promoters.
- Compliance with internal guidelines and RBI norms may be ensured at every stage of the loan appraisal, sanction and disbursement.
- Monitoring mechanism may be strengthened to ensure that loans disbursed are used for the specific purpose for which they have been sanctioned and incidence of siphoning/diversion of loan funds are eliminated.
- Particular vigilance is warranted in cases where the promoter or its group companies execute the project as the principal contractor. In such cases, it would need to be ensured that there is no over-pricing and that the money advanced to contractors is actually put to use on execution of the project and not re-designated as project equity.
- Independent verification of data submitted by promoters to ensure its accuracy may need to be considered. Information available from

independent credit rating agencies may also be considered to evaluate the financial capability of the promoter/borrower in a realistic manner.

- 3.6. Cost overrun of the projects vis-à-vis their viability needs to be monitored closely. Cost overrun may be allowed only in eligible projects, in compliance with the relevant internal guidelines/RBI norms.