Chapter 1: Introduction

1.1 Introduction

IFCI Limited is a Systemically Important Non-Deposit taking Non-Banking Financial Company (NBFC-ND-SI) under the regulatory control of Reserve Bank of India (RBI) and administrative control of the Department of Financial Services (DFS), Ministry of Finance (MoF), Government of India (GoI). IFCI was initially established as a statutory corporation in 1948 under the Industrial Finance Corporation of India (IFCI) Act, 1948 as the first development finance institution in the country to cater to the needs of the industrial sector for long-term finance. It was registered later as a company under the Companies Act, 1956 by virtue of IFCI (Transfer of Undertaking and Repeal) Act, 1993. The effect of enactment of the Repeal Act, 1993 was that provisions[1] of IFCI Act, 1948, pertaining to control by the Union Government over the affairs of IFCI Limited, its accounts and audit, continued to apply even after the repeal for the purposes of exercising Government Control.

1.2 Conversion of IFCI into Government Company

The Union Cabinet approved (10 August 1992) the conversion of IFCI Limited (erstwhile Statutory Corporation) into a new Government Company under the Companies Act, 1956**.** The Union Government decided that 51 *per cent* shares of IFCI Limited would be retained by the RBI/Government owned or controlled institutions like Public Sector Banks (PSBs) / Financial Institutions (FIs) / Insurance Companies which held the shares of IFCI.

Subsequently, in the context of the deteriorating financial status of IFCI and likely systemic impact of IFCI defaulting on its liabilities, the Government decided (2001) to infuse ₹ 400 crore in the form of 20-years Convertible Debentures. Thereafter, a special financial assistance package of ₹ 5220 crore was recommended by Ministry of Finance for IFCI in the form of Optionally Convertible Debentures (OCDs) with duration of 20 years. As part of this package, the first tranche of ₹ 523 crore was released (28 March 2003) in the form of Optionally Convertible Debentures. However, subsequent releases (2003-04 onwards) under this package were converted to Grants-in-Aid. This package received *ex-post facto* approval of the Cabinet in February 2005. An amount of ₹ 2409.31 crore was released as Grant-in-Aid[2] from 2003-04 to 2006-07[3]. However, releases under this financial package were stopped in the year 2007-08, since IFCI started generating profits.

The equity holding of Government Controlled Institutions in IFCI remained above the threshold limit of 51 *per cent* till 2003-04. Thereafter, IDBI and State Bank of India and some of its subsidiaries, nationalized banks and financial institutions like Life Insurance Corporation of India, General Insurance Corporation etc. diluted their equity holdings as a result of which the shareholding of Government Controlled Institutions fell below 51 *per cent* (by March 2005). Resultantly, IFCI lost its status of a deemed Government Company.

[1] Sections 33, 34, 34A, 35 and 43.
[2] Assistance to IFCI was subsequently converted into Grant–in-aid (2003-04) in the supplementary budget.
[3] ₹ 1573 crore (2003-04), ₹ 316 crore (2004-05), ₹ 300 crore (2005-06) and ₹ 220.31 crore (2006-07).

However, the Ministry of Finance with the approval (August 2012) of Union Cabinet restored the status of IFCI as a Government Company by converting Optionally Convertible Debentures valued at ₹ 923 crore into equity. With this conversion, IFCI became (2012-13) a deemed Government Company. Subsequently, IFCI became a Government Company w.e.f. 7 April 2015 when the Government acquired six crore preference shares from the existing preference shareholders (Scheduled Commercial Banks) of IFCI.

1.3 Non-banking Financial Companies in India

Non-Banking Financial Companies (NBFCs) have emerged as an integral part of the financial system in India by providing a valuable alternative to conventional banking. However, NBFCs continued to face a challenging economic environment in the last few years on account of slow economic growth and relatively high credit costs arising from increased risk perception.

NBFCs witnessed stress in asset quality during the last few years due to the economic downturn and weak operating environment, as the payback capacity of the companies continued to be affected resulting in increase in non-performing assets (NPAs) despite higher restructuring of accounts. The growing asset size of NBFCs has increased the need for risk management in the sector especially in the context of their increasing NPAs. In this context, non-deposit taking NBFCs having an asset size of ₹ 100 crore were classified as systemically important NBFCs by RBI. However, from November 2014, this threshold criterion was raised upwards to ₹ 500 crore.

1.4 Functions and objectives of IFCI Limited

IFCI Limited, as an NBFC-ND-SI regulated by RBI, had been providing financial assistance in the form of short, medium or long-term loans or equity participation primarily to agro-based industries, service sector, infrastructure and capital & intermediate goods industry. IFCI also promoted subsidiaries[4] in the financial / consultancy sector.

1.5 Organizational set-up

The Company is managed by a Board of Directors assisted by the Chief Executive Officer & Managing Director (CEO&MD) and Deputy Managing Director (DMD). Further, Executive Directors (EDs) govern the operations of the Company with the assistance of Chief General Managers and General Managers heading respective departments.

The Company operates through various departments mainly Credit Appraisal, Monitoring & Industry Research, NPA Acquisition, Resolution and Legal.

1.6 Rationale for selection of subject for audit

Performance Audit of 'Credit Risk Management' in IFCI Limited was taken up in view of the following:

[4] IFCI Factors Limited, IFCI Financial Services Limited, IFCI Infrastructure Limited, IFCI Venture Capital Fund Limited, MPCON Limited and Stock Holding Corporation of India Limited.

- Existence of high level of NPAs of ₹ 3544.54 crore as on 31 March 2016 corresponding to 13.05 *per cent* of total outstanding loans;
- Principal amounting to ₹ 1637.87 crore written-off from the books of accounts during the Audit period viz. from 2012-13 to 2015-16;
- Increase of ₹ 40,638.98 crore in unrealized interest during the period from 2012-13 to 2015-16;
- Substantial financing by Government of India to the tune of ₹ 3332.31 crore;
- Deficient credit appraisal procedures, improper sanctions / disbursements observed during previous CAG audits.

1.7 Audit Objectives

The objectives of this Performance Audit were:

- To examine compliance with General Lending Policy of the Company.
- To check the existence of sound credit appraisal mechanism including due diligence in sanction and disbursement of loans.
- To examine the effectiveness of recovery mechanism.
- To examine the efficiency of credit monitoring mechanism.

1.8 Audit Criteria and Methodology

The criteria for reviewing the performance of the Company were drawn from the following sources:

- RBI Guidelines for NBFCs-ND-SI
- Guidelines / circulars of the administrative Ministry
- Industry practices
- Lending Policy of the Company
- Business Plan of the Company
- Credit Appraisal System
- Sanction / disbursement conditions
- Loan agreements
- Recovery policy
- Legal documents relating to cases

Audit Methodology:

Entry conference was held on 7 April 2016 with the Management of IFCI and representative of DFS, MoF to discuss the audit scope, objectives, criteria etc. Field audit was carried out during April 2016 to July 2016. The draft Report was issued to IFCI on 19 September 2016 and replies thereto were received on 4 November 2016. After incorporating the response of the Management, the draft performance audit report was issued to the Ministry on 10 January 2017. The Ministry's replies (16 February 2017) as well as response received during the exit conference (17 February 2017) have been duly considered while finalizing this performance audit report.

1.9 Scope of Audit and Sample Selection

Audit reviewed the Company's performance in credit appraisal, sanction process, post-sanction monitoring and credit recovery procedures. Compliance with the guidelines issued by RBI and effectiveness of monitoring by administrative ministry was also reviewed.

The period covered in audit for review of loans sanctioned, was four years from 2012-13 to 2015-16.The review included examination of compliance with financing guidelines, loan agreements and RBI Guidelines relating to sanction and disbursement of financial assistance. However, as regards review of NPAs, the period prior to 2012-13 was also covered to examine the sanction, monitoring and recovery etc. This was due to the fact that as per guidelines issued by RBI, the assets in respect of which the interest or principal remains due for more than five months, are classified as NPA. Further, the assets which remained NPA for a period not exceeding 16 months[5] were to be classified as sub-standard assets while the assets which remained sub-standard for a period exceeding 16 months were to be classified as doubtful asset.

Sampling:

Audit reviewed the sanctions and disbursements of loans during the period of Performance Audit, Non Performing Assets and Loans Written Off. The sample selection was as follows:

A. Sanctions and Disbursements: Audit segregated the loans sanctioned by the Company on the basis of amount sanctioned for selection of sample, as depicted below:

Amount sanctioned	Less than ₹100 crore	Between ₹100 crore and ₹200 crore	More than ₹200 crore
Sample (*per cent*)	20	40	100
No. of cases selected	36	45	47

The year-wise sample selected for each stratum through Stratified Random Sampling method are as shown below:

Table-1: Sampling of Sanctions and Disbursements

Year	Total Sanctioned Cases (Population)		Sample Size	
	No.	Amount (₹ in crore)	No.	Amount (₹ in crore)
2012-13	20	1,911.53	8	1,008.04
2013-14	53	8,915.18	32	7,056.50
2014-15	127	11,144.17	45	6,038.54
2015-16	130	10,854.69	43	5,252.69
Total	**330**	**32,825.57**	**128**	**19,355.77**

B. Non-Performing Assets and loans written-off:

There were 413 cases of NPA (including cases written off) as on 31 March 2016. Out of these, Audit reviewed 43 NPA cases which were sanctioned from 2008-09 onwards as well as 11 cases of principal written-off during the audit period.

5 Revised to 16 months w.e.f. 2015-16 from the earlier norm of 18 months.