EXECUTIVE SUMMARY

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).

A significant proportion of loans extended to IPPs became stressed/turned Non-Performing Assets (NPAs). 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. The audit findings are summarised below:

REC and PFC did not conduct appropriate due diligence during credit appraisal and in the process assumed higher risks on the loan accounts. Both REC and PFC deviated from their internal guidelines and also did not conform to the Reserve Bank of India guidelines in this regard. The experience and ability of the promoters to develop the projects was not assessed objectively. The experience of project promoters were assessed based on individual judgement and promoters who did not have relevant sector experience were found eligible for loans. Audit noticed that many of projects, where the promoter had poor experience, were not completed within schedule.

(Paragraph 2.1)

The financial capacity of the promoter to bring in equity for the project in the face of competing demands was not adequately assessed. In the sample selected by Audit, nine projects had to be restructured multiple times which increased the interest during construction by ₹13312.78 crore in six loan cases and resulted in NPAs of ₹3038.44 crore in three loan cases.

(Paragraph 2.2)

To ensure viability of projects, the internal guidelines of REC and PFC provided that the debt service coverage ratio (DSCR) should be a minimum of 1, average DSCR should be more than 1.2 and the internal rate of return(IRR) should be more than internal reference rate of interest of REC and PFC for sanction of initial loan. No guidance was provided by REC and PFC in its internal guidelines regarding adoption of tariff rates for assessment of viability of projects for which Power Purchase Agreement had not been signed. Audit observed that 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. In all these cases, the levelised generation cost was higher than the actual levelised tariff, and thus the viability of the project was doubtful, *ab-initio*.

(Paragraph 2.3)

The guidelines of REC and PFC do not envisage a situation where the contractors engaged by the promoter for implementation of a project are related parties of the promoters. Audit noticed that in seven loan cases, the contractor and the promoter were same/ related entities. In these cases, the loan sanctioned by REC and PFC to the promoter for execution of the project remained with the promoter group and the actual stake of the promoter in implementing the project was difficult to assess. It was also noticed that the credit worthiness of the contractors and their ability to fulfil contractual obligations was not being appraised by REC and PFC.

(Paragraph 2.4)

As per the Common Loan Agreement (CLA), loan funds were to be disbursed after fulfilling the pre-disbursement conditions mentioned in the loan agreements. These conditions were incorporated in the loan agreements in order to mitigate the risks perceived at the time of detailed appraisal of the borrowers regarding their ability to bring in required equity funds and for recovery of loan within the prescribed time. Audit, however, observed that the pre-disbursements conditions were relaxed by REC and PFC from time to time in five loan cases. After the first disbursement, subsequent disbursements were often made to save the funds already disbursed, further relaxing the conditions and extending the timelines.

(Paragraph 3.1.1 to 3.1.5)

CLA provided for charging of additional interest in case of non-compliance of any of its conditions or conditions set in other financing documents related to the sanction of loans. Audit noticed that REC short recovered additional interest of ₹169.75 crore from four borrowers.

(Paragraph 3.1.6)

The loan for a project is sanctioned based on the project financials, including, *inter alia*, the proportion of interest during construction (IDC) in the project cost. Audit noticed that during disbursement of loans amounting to ₹3294.35 crore to M/s Lanco Babandh Power Project, M/s Lanco Vidharbha Thermal Power Project and M/s Lanco Amarkantak Power Project, REC adjusted ₹496.02 crore towards IDC beyond the IDC approved at the time of loan sanction. With these adjustments, the loan account remained 'standard' though no repayment was made by the borrower as per the loan servicing schedule. Had the interest not been adjusted in this manner, these loan accounts would have become NPA in 2013 itself. Audit also noticed such adjustment of IDC after a project was commissioned, which violated the internal guidelines of REC.

(Paragraph 3.2.1 to 3.2.4)

As per RBI guidelines (July 2013), financing agencies should not depend entirely on certificates issued by Chartered Accountants but strengthen their internal controls and credit risk management system to enhance the quality of their loan portfolio. However, no policy in REC and PFC was in place to ensure end utilization of funds by the borrower and both the Companies were solely dependent on Auditors Certificate regarding end use of the funds. Audit noticed siphoning/diversion of ₹2457.60 crore by the borrowers/promoters in the sample reviewed.

(Paragraph 3.5)

RBI guidelines provide that projects should be financially viable at the time of restructuring of loans. For assessing the financial viability of projects during re-structuring, it is to be seen that the levelised tariff is higher than levelised cost of generation and that DSCR and IRR are adequate. Audit noticed that additional loans were sanctioned to seven projects by REC and PFC though these projects were not financially viable at the time of restructuring the loans.

(Paragraph 4.1)

As per the prudential norms of REC and PFC, 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. Apart from this, as per RBI guidelines, the promoter should bring in 100 *per cent* equity for financing the cost overrun upfront. Audit, however, noticed that REC and PFC sanctioned additional loans for meeting cost overrun in number of cases by relaxing these conditions.

(Paragraph 4.2 to 4.4)

Audit Recommendations:

- 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.
- 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.