CHAPTER V: MINISTRY OF FINANCE (DEPARTMENT OF FINANCIAL SERVICES)

India Infrastructure Finance Company Limited

5.1 Review of Loans to Road Projects

5.1.1 Introduction

India Infrastructure Finance Company Limited (IIFCL), is a wholly-owned Government of India company set up (January 2006) to provide long term finance to viable infrastructure projects through the scheme for financing viable infrastructure projects under its policy documents referred to as SIFTI. The sectors eligible for financial assistance from IIFCL broadly include transportation, energy, water, sanitation, communication, social and commercial infrastructure. Resources for carrying out the loan activities are raised by IIFCL through bonds and loans from domestic sources and lines of credit from external sources like Asian Development Bank and World Bank etc.

IIFCL provides loans to road projects being executed under Public-Private Partnership (PPP) model, based on Concession Agreement (CA) signed between a Concessionaire (the developer) and a Concessioning Authority[1]. Financing activities of IIFCL were largely concentrated in road sector at 44 *per cent* (₹31,051 crore) as on March 2019. Gross non-performing assets (NPA) in road sector were significant as 37.25 *per cent* (₹5,187 crore) of the amount was outstanding as on 31 March 2019 and the net NPA in road sector was much higher at 17.84 *per cent* against internally approved overall limit for net NPA at 2.75 *per cent* of total loan outstanding across all sectors.

In view of the deteriorating position of NPAs pertaining to loan accounts of road projects, Audit selected to review the mechanism in vogue for sanction, disbursement, restructuring and monitoring of loans of road sector by IIFCL during the period 2016-17 to 2018-19. The audit sample was selected based on Stratified Random Sampling Method using IDEA from the total disbursements made as indicated below {details of loan are given in (***Annexure-II***)}:

Table 5.1.1: Details of sample selected

Categories of loan cases during 2016-17 to 2018-19)	Total no. of loan cases	No of loan cases selected	Percentage
NPA cases	49	9	18
Disbursement only	33	9[2]	27
Sanction having disbursement	12	3	25
Prepayment	32	4	12
Restructuring	4	3	75
Sanction only	18	4	22
Total	**148**	**32**	**21**

[1] *National Highways Authority of India (NHAI)/ State Government Agencies*

[2] *Includes one case under Takeout Finance Scheme. All other selected cases are under Direct Lending Scheme*

5.1.2 Audit findings

Audit has commented on 24 cases out of 32 cases as in four cases, borrowers have fully paid the loans and in other four cases of sanctioned loan, no Lending Confirmation Notice (LCN) was received till completion of field audit. Audit findings on 24 loan cases are given in the succeeding paragraphs:

5.1.2.1 Failure to ensure availability of land/ Right of Way (RoW) to the concessionaires

In road financing, the lenders have negligible physical security against the loan dues as the main assets of the project i.e. land, road and other structures thereon constructed by the concessionaire (borrower) are owned by the Concessioning Authority. The loan is serviced mainly from toll revenue generated from operations of commercially viable road project completed under BOT model. In case the project remains incomplete for any reason, there exists *inter alia* no mechanism in the CA to compensate the borrower for the work done so that the lenders are paid their dues as discussed below:

- If CA is terminated by Concessioning Authority for Concessionaire's default, a termination payment (equivalent to 90 *per cent* of debt dues) would be payable by the Concessioning Authority to the Concessionaire provided the project is issued the Project Completion Certificate[3]/ Provisional Project Completion Certificate i.e., Certificate of Provisional Commercial Operation Date (PCOD) by Concessioning Authority. PCOD is issued by the Concessioning Authority only after completion of atSleast 75 *per cent* work on the project, thereby permitting the Concessionaire to collect toll revenue from operations of the project, pending completion.

- The Appointed Date, which shall also be deemed to be the date of commencement of concession period, shall generally be fixed only on or after each and every condition precedent to the CA including availability of unencumbered right of way to the land (RoW) to the Concessionaire to the extent of at least 80 *per cent* of the total area of project is either satisfied or waived off by the Concessioning Authority.

The above provisions in the CA increase the risk level of the road projects if the Concessionaire commences the work in the project before having possession of the required RoW and the project is unable to achieve PCOD.

The condition for availability of minimum 80 *per cent* RoW before first disbursement was stipulated in 14 cases (58 *per cent*) examined in Audit, while the condition of 100 *per cent* RoW for loan disbursement after appointed date was found included in only two cases (eight *per cent*). Deficiencies in the Common Loan Agreements (CLAs) and also the observations pertaining to non-compliance of the stipulated conditions in the above cases are discussed below:

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[3] ***In case of four to six laning, Project Completion Certificate is issued on 100 per cent completion of the project and commercial operation date (COD) commences from the Appointed Date or the date of Financial Closure, whichever is later.***

(i) In six cases, the pre-disbursement conditions of CLAs either did not quantify (i.e. stipulated only 'reasonable availability of RoW') or did not include any specific clause on the issue of requirement of RoW. As a result, the loan was sanctioned without mitigating the risk of non-availability of atleast 80 *per cent* RoW of the project on appointed date before disbursement of first loan installment and it was one of main reasons that out of six loans, three[4] loans amounting to ₹674.35 crore turned into NPA and one loan (NJTBPL) had to be restructured. These four cases are indicated as under:

Table 5.1.2

Sl. No.	Name of contractor	Name of project	Length of road in KM	Provision of availability of RoW in CA as on Appointed Date in *per cent*	Actual availability of RoW at the time of first disbursement by IIFCL in *per cent*	Date & amount of first disbursement	
						Date	Amount (₹ in crore)
1	IIGTL[5]	4 laning of Indore to Gujarat	155.15	80	51.43	January 2011	18.20
2	BKEL[6]	4 lane highway on the Barasat-Krishnagar	84.317	80	14.73	December 2011	21.54
3	BHPL[7]	2 lane road on NH 24 from Bareilly to Sitapur	151	80	72	June 2011	16.92
4	NJBPL[8]	Development of a Greenfield alignment connecting NH-31	50.943	80	23.55	August 2012	7.69

IIFCL continued to disburse the loan despite NHAI not making available the balance land within six months of appointed date or de-scoping the work on non-available land, which is indicative of the fact that lenders including IIFCL did not adequately protect their interest before disbursement of loan.

IIFCL replied (April/ May 2020) that NHAI has been declaring Appointed Date without complying with agreed terms of providing RoW. Besides, NHAI often declares availability of RoW at 3C/ 3D[9] stage whereas the RoW is supposed to be declared at 3G/ 3H[10] stage. IIFCL in case of BHPL and BKEL replied that NHAI neither made the balance RoW available within six months of Appointed Date nor de-scoped the RoW, which was not made

[4] ***IIGTL(₹299.72 crore), BKEL(₹121.18 crore), and BHPL(₹253.45 crore)***
[5] ***IVRCL Indore Gujarat Tollways Limited***
[6] ***Barasat-Krishnagar Expressway Limited***
[7] ***Bareilly Highways Project Limited***
[8] ***Navayuga Jhanvi Toll Bridge Private Limited***
[9] ***3C denotes stage of hearing of objections, 3D denotes stage of notification for acquiring the land***
[10] ***3G denotes stage of determination of amount of compensation of land, 3H denotes stage of deposit of amount of compensation with competent authority to pay to the respective persons***

available, resulting in erosion of viability of the road project. NHAI delayed handing over of RoW in case of IIGTL while in case of NJTBPL, it failed to fulfill its duty to provide RoW within the scheduled period, which adversely affected the project. IIFCL added that as per SIFTI, it was supposed to follow the appraisal carried out and disbursements made by the lead bank, which was adhered to by IIFCL. The Ministry endorsed (June 2020) the views of Management.

The reply is to be viewed against the fact that as per SIFTI, IIFCL is to finance viable projects only. Without the required unencumbered RoW for construction of road, the viability of the project cannot be established and that in itself is a risk. IIFCL was required to safeguard its interest by ensuring inclusion of suitable pre-disbursement clauses in the CLA on pre-availability of RoW and its compliance to mitigate the risk, which was not done. Further, the Inter Creditor Agreement[11] also required the lenders to decide on sanction/ disbursement of loan based on their independent judgement without reliance on information provided by any other lenders. This requirement also remained unfulfilled.

(ii) As per CA, the concessionaire is eligible for payment in case of default subject to completion of 100 *per cent* work in respect of widening the roads from four to six lane. As such, the condition of 100 *per cent* pre-availability of encumbrance free RoW with requisite forest clearances should have been stipulated in the CLAs, so as to plan the work and execute it smoothly.

In four cases {SEW LSY Highway Limited (SLHL), Barwa Adda Expressway Limited (BAEL), Pune Satara Toll Road Private Limited (PSTPL) and DA Toll Road Limited (DATRL)}, CLAs stipulated the condition of minimum 80 *per cent* to 85 *per cent* RoW for disbursement of first loan installment, but did not stipulate the condition of 100 *per cent* RoW for subsequent disbursements of loan within 90 days from the Appointed Date. This has resulted in non-completion of work in two[12] loan cases i.e. SLHL and BAEL mainly due to non-availability of clear RoW. These projects were not eligible even for termination payments due to Concessionaire's default occurring prior to commercial operation date (CoD). Both loan cases turned into NPAs with outstanding principal amount of ₹439.42 crore.

Besides this, in other two loan cases i.e. PSTPL and DATRL, due to non-availability of RoW, the projects got delayed and the loans had to be restructured thrice with extension of time for original Scheduled COD (as per CLA) from January and April 2016 to January and April 2019 in respect of DATRL and PSTPL respectively. The work is still under progress, (January 2020) and the loan of IIFCL amounting to ₹591.78 crore (DATRL: ₹400 crore, PSTPL: ₹191.78 crore) in the projects is still at high risk.

IIFCL replied (April/ May 2020) that:

- In case of SLHL and BAEL, NHAI declared availability of RoW at 3C/ 3D stage (issue of notification/ gazette) whereas the RoW is supposed to be declared at 3G/ 3H

[11] ***Signed among the consortium lenders***
[12] ***SLHL and BAEL***

(deposition of compensation and right to enter) stage. In case of SLHL, as per the borrower, land was available to the extent of 95.67 *per cent*. In case of BAEL, at the time of sanction/ disbursal, more than 80 *per cent* of RoW was available with the Concessionaire, and thus it complied with the provisions of CLA.

- In case of PSTPL, three years after first disbursement (April 2018), availability of hindrance-free land was 96 *per cent* and as the project is tolling for 100 *per cent* stretch there is no revenue risk.
- In case of DATRL, provisional completion certificate (PCC) may be issued by the Independent Engineer, if construction work is completed on all the lands for which RoW has been granted by the Authority within 90 days of the Appointed Date.

The Ministry endorsed (June 2020) the views of Management.

The reply is to be viewed against the fact that, there is no provision in CAs to issue PCC for incomplete road and tolling for 100 *per cent* stretch from the existing four lanes would not mitigate the risk of non-recovery of debt in case of termination of Concession Agreement before completion of the Project.

(iii) In case of Concast Path Bameetha Satna Road Projects Private Limited (CPBSRPL), the CLA stipulated (May 2013) the condition of 100 *per cent* availability of RoW before disbursement of any loan. Yet, the loan was disbursed with availability of 64 *per cent* RoW only. Non-availability of required RoW resulted in non-achievement of CoD, termination (January 2018) of CA and the loan amounting to ₹43.20 crore of IIFCL turned NPA on 30 September 2017.

IIFCL replied (April/ May 2020) that as informed by the Concessioning Authority, 100 *per cent* RoW was handed over to the Concessionaire and the pre sanction inspection was done by the lead bank. The Ministry endorsed (June 2020) the views of Management.

The reply is to be viewed against the fact that non-availability of 100 *per cent* RoW to the project was known to the lenders including IIFCL before disbursement of second installment (December 2013) as Lenders Independent Engineer (LIE)'s report (December 2013) mentioned that MPRDC[13] has not awarded the construction permit in the entire stretch of 12 km of reserved forest and some land acquisition was required in some places which was under inspection.

5.1.2.2 Not ensuring availability of necessary clearances/ approvals

One of the conditions for loan disbursement in all CLAs was that the Concessionaire shall obtain all requisite statutory and other necessary approvals, including the forest, environmental and pollution clearances/ approvals before commencing disbursement.

Status of the compliance of pre-disbursement conditions before first disbursement of loan in the selected cases is given as under:

[13] *Madhya Pradesh Road Development Corporation Limited (MPRDC)*

Table 5.1.3: Details of compliance to the conditions of clearances/ approvals

Category of Loan	Sample size	Compliance to pre-disbursement condition of all clearances/ approvals	
		Yes	No
NPA	9	3	6
Fresh sanction & disbursement	3	3	0
Old sanction & disbursement	9	8*	0
Restructuring	3	2	1
Total	**24**	**16**	**7**
*One case pertained to take out finance where clearance issue was not applicable			

As such, in 29 *per cent* (7 out of 24) cases, the loans were disbursed despite non-compliance of the pre-disbursement conditions of obtaining environment/ forest clearance and other necessary approvals before first disbursement. Delay of 13 months to 95 months in obtaining statutory clearance has resulted in delay in completion of work and consequently turning of six[14] loan cases in NPAs and restructuring of one[15] loan case.

IIFCL replied (April/ May 2020) that the Concessionaire had issued the draw down notice confirming that all the pre-disbursement conditions in CLA had been satisfied and all the necessary certificates had already been provided. As per SIFTI, IIFCL disbursed the amount in line with what the lead bank disbursed in the Project. The Ministry endorsed (June 2020) the views of Management.

The reply is to be viewed against the fact that the Inter Creditor Agreement required the lenders to decide on sanction/ disbursement of facility based on their independent judgement without reliance on information provided by any other lender.

5.1.2.3 Adjustment/ funding of overdue IDC

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, IIFCL adjusted a higher proportion of loan against IDC than what was approved during loan sanction. With these adjustments, the loan account remained 'standard' though no repayment was made by the borrower as per the loan servicing schedule. Audit noticed six such instances in the sample audited wherein ₹284.47 crore was adjusted against the admissible limit of ₹124.89 crore. This has resulted in excess adjustment of IDC by ₹159.58 crore and deferment of NPAs by 4 months to 43 months as detailed in table 5.1.4.

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[14] *(i) BHPL, (ii) Sion-Panvel Tollways Private Limited (SPTPL), (iii) SLHL,(iv) SSRPL, (v) HHPL, and (vi) IIGTL*

[15] *NJBTPL*

Table 5.1.4
Statement showing details of selected loans wherein IDC was excess adjusted

(figures in ₹crore)

Sl.No.	Name of borrower	Inbuilt portion of IDC in loan (IIFCL)	Actual IDC adjusted by IIFCL	Excess adjustment	IDC adjustment through self disbursement	Deferment of NPA
1	BKEL	14.89	44.00	29.11	--	March 2016 to March 2017
2	BHPL	56.82	71	14.18	--	
3	IIGTL	23.98	87.42	63.44	--	July 2013 to January 2017
4	SLHL	9.66	29.7	20.04	5.88	November 2015 to September 2016
5	CPBSRPL	4.52	10.71	6.19	--	--
6	SSRPL[16]	15.02	41.64	26.62	4.02	May 2018 to December 2018
	Total	**124.89**	**284.47**	**159.58**	**--**	--

IIFCL stated (May 2020) that they have disbursed as per LCN's issued by Lead Bank to maintain the basic consortium spirit. It is to be mentioned here that all other consortium members also disbursed the fund on the basis of LCN's issued by the Lead Bank. The gap in the means of finance was funded by the Company, once the allocated IDC was exhausted. After that, IDC portion is continuously funded by the promoter to keep the account standard till date. The Ministry endorsed (June 2020) views of the Management.

Reply of IIFCL is to be viewed against the fact that the promoter had not funded the IDC after exhausting of limit. This has resulted in excess adjustment of IDC by ₹159.58 crore and deferment of NPAs by 4 months to 43 months.

5.1.2.4 Sanction of loan for cost overrun without obtaining approval from the Concessioning Authority

The CAs provided that, in the case of termination of CA, the Concessioning Authority shall make termination payment towards the 'debt dues' of senior lenders subject to the condition that the amount of debt due shall be determined with reference to the terms of Financial Agreements (including CLA). The CLAs stipulate that *'The promoter/ sponsor of the Concessionaire company gives a shortfall undertaking that they would invest additional funds in the project in case of any cost overrun and/ or gap in means of financing due to whatever reasons.'* As such, any loan disbursed towards cost overrun (by signing supplementary agreements with the concessionaire) without getting the project cost revised

[16] *Sidhi Singrauli Road Project Limited*

from the concessioning authority may not constitute the 'debt due' for the purpose of termination payment.

Audit observed that IIFCL sanctioned and disbursed loans of ₹356.88 crore and ₹347.85 crore towards cost overrun including additional IDC, without ensuring prior approval of revised project cost from the concessioning authority in four cases as detailed below:

Table 5.1.5

Detail of loans where cost overrun was sanction without approval of Concessioning Authority

(figures in ₹ crore)

Particulars	Sanction of cost overrun	Disbursement	Remarks
BHPL	58.69	53.45	The promoter company had also suffered substantial operating losses and was under Corporate Debt Restructuring with one of the directors of the promoter company being arrested in July 2015 for an alleged real estate fraud.
HHPL	51.96	51.96	At the time of sanction of both the above stated cost overruns by IIFCL, the promoter company had suffered loss of ₹773.09 crore by 31 March 2014 and was under Corporate Debt Restructuring. The release of additional fund under such circumstances was highly risky.
IIGTL	108.64	108.64	Profitability of the promoters had turned into NPA since 2012-13 and credit rating had gone down to 'D' in 2013-14.
REPL[17]	137.59	133.80	-
Total	**356.88**	**347.85**	-

IIFCL stated (May 2020) that after initial disbursement it is not feasible to stop further disbursement on account of non-compliance of CLA which are of regular/ renewal in nature as stopping funds availability during construction phase may had led to zero recovery for lenders as in accordance with the terms of CA project is eligible for termination payment only after achievement of PCOD/ DCCO. The Ministry endorsed (June 2020) the views of Management.

The reply is to be viewed against the fact that since cost overrun was funded by the lenders without ensuring approval of revised project cost by the Concessioning Authority and despite the deteriorating financial position of the Concessionaires/ promoters, IIFCL had written off loan amounting ₹410.42 crore in case of BHPL (₹253.46 crore), and HHPL (₹156.96 crore) as the Conessioning authority had terminated the CAs. Loan to IIGTL, had turned into NPA.

[17] *Rayalseema Expressway Private Limited*

5.1.2.5 Advances disbursed by concessionaires

The CLAs inter-alia stipulated that lenders shall review the EPC contract before making disbursement of first installment of loan. In case of all the selected projects, the EPC contracts were awarded by the concessionaires to their promoter companies and these contracts provided for allowing interest free advance without any security and any time limit for recovery, except in one case (BKEL) where provision for a BG was included. Audit noticed that there were deficiencies in release/ adjustment/ recovery of the advances in the following cases:

(i) SLHL awarded the EPC contract to SEW Infrastructure Limited i.e. main promoter of SPV. SLHL granted mobilisation advance of ₹359.19 crore to its EPC contractor which was almost equivalent to equity contribution of main promoter i.e ₹384.74 crore. This advance was given without any security. The Concessioning Authority terminated CA as only 13.61 *per cent* of work was completed which was far less than the scheduled completion. Resultantly, the outstanding amount of mobilisation advance of ₹359.19 crore, extended by SLHL to the EPC contractor remained unadjusted/ unrecovered. IIFCL has written off its portion of loan amounting to ₹89.07 crore.

IIFCL replied (April/ May 2020) that the project was delayed due to the Concessioning Authority's faults which hampered the work progress and recovery of the mobilisation advance. IIFCL also responded that Arbitration award of ₹935 crore has been given in favour of Concessionaire against the Concessioning Authority wherein lenders have the first right to recover their dues. However, the Concessioning Authority has not yet honoured the award. The Ministry endorsed (June 2020) views of the Management.

The fact remains that mobilisation advance has not been recovered so far and promoters had invested very meager amount in the SPV. Main investment of promoter was from the mobilsation advance.

(ii) CPBSRPL had awarded its EPC contract to M/s Concast Infra Tech Limited i.e. main promoter of SPV. EPC contractor was paid advance of ₹58.54 crore by CPBSRPL which was equivalent to equity contribution of main promoter i.e. ₹58.03 crore. As per LIE Report (February 2017), the project had achieved physical progress upto 51.66 *per cent.* Accordingly, 50 *per cent* of the mobilisation advance (i.e., ₹20.86 crore) was due for adjustment. However, only ₹3.73 crore could be adjusted leaving an unadjusted advance of ₹54.81 crore (March 2017) with the promoter company. Audit noticed that neither the CA certificates nor LIE's reports contained the details of the mobilisation advances paid/ adjusted. Further, the lenders including IIFCL did not monitor the utilisation/ adjustment of advance. The project was eventually delayed, and the Concessioning Authority terminated the CA in January 2018. IIFCL has written off its loan of ₹43.20 crore to the project.

While remaining silent on advance without security, IIFCL replied (April/ May 2020) that disbursement of fund of IIFCL is governed by SIFTI, whereby the lead bank is responsible for regular monitoring and periodic evaluation of compliance of project with agreed milestones. IIFCL further stated that the EPC agreement is between the Concessionaire and the EPC contractor; accordingly, lenders have limited maneuverability in the matter. The Ministry endorsed (June 2020) views of the Management.

The reply is to be viewed against the fact that as per the CLA, the lenders including IIFCL had the right to vet the EPC contract and the lenders could have insisted for inclusion of suitable clauses for ensuring safe recovery of the advances to the EPC contractor. Further, SIFTI did not restrict IIFCL from taking up the above issue with the lead bank for corrective action and also having independent monitoring mechanism. Inter Creditor Agreement required the lenders to decide on disbursement of facility based on their independent judgement without reliance on information provided by any other lender.

(iii) BKEL awarded the EPC contract to Madhucon Projects Limited i.e. holding company of the SPV. EPC contractor was disbursed an advance of ₹238.42 crore for mobilisation (₹170.21 crore) and material (₹68.22 crore), whereas promoters contributed the equity of ₹184.15 crore. The Concessioning Authority terminated CA as only 29.88 *per cent* of work was completed which was far behind the schedule completion. Out of this advance of ₹238.43 crore, an amount of ₹209.91 crore remained unadjusted. Though there was provision for BG in EPC contract, availability/ invocation of BG could not be traced.

IIFCL replied (April/ May 2020) that advance to EPC contractor is provided to meet preliminary expenses and to ensure physical progress. However, due to non-availability of RoW from the Concessioning Authority, the project witnessed delays and cost overrun, resulting in the Concessionaire terminating the project. Since the EPC agreement is between the Concessionaire and the EPC contractor, lenders have limited maneuverability in the matter. IIFCL further added that the issue has been taken up with lead bank. The Ministry endorsed (June 2020) views of the Management.

The reply is to be viewed against the fact that the above situation is a fallout of lenders agreeing for advances to the EPC contractor without any encashable security in their possession. Further, lenders' fund was also at stake as EPC contract was awarded to a related party.

(iv) In case of SSRPL, the EPC contract provided for mobilisation advance of 15 *per cent* of the contract value which worked out to ₹146.25 crore. The EPC contractor was, however, paid ₹163.10 crore as advance without any security. Neither the CA certificates nor the LIE reports gave details of mobilisation advance paid and/ or adjusted. In the absence of such details, it was not clear as to how the lenders including IIFCL monitored the release/ adjustment/ recovery of the advance paid to the EPC contractor.

IIFCL did not offer (April/ May 2020) any comments on the issue of release of mobilisation advance beyond the agreed amount and on non-reporting of details of release/ adjustment/ recovery of advance in CA certificates and LIE reports.

(v) In case of HHPL, the EPC contract provided for 10 *per cent* mobilisation advance of ₹146.23 crore and an additional advance of five *per cent* on request/ justification basis. Adjustment of the advance was to commence after certified work completion of 20 *per cent* and the said adjustment was to be over before 80 *per cent* completion of work. In this case, Audit observed that an advance of ₹190.88 crore was released based on revised contract cost of ₹1,272.54 crore whereas equity contribution from promoters was ₹215.20 crore. However, the advance recovery schedule was modified at 28 *per cent* to 90 *per cent* of the contract value, instead of 20 *per cent* to 80 *per cent* without approval of lenders including IIFCL. This led to the contractor retaining the advance for a longer period. Further, an additional advance of ₹44.66 crore was also released as mobilisation advance towards the cost overrun, after reporting of physical progress of 43.12 *per cent.* The same was financially imprudent as mobilisation of resources was not required after commencement of the work.

On termination of CA, the unadjusted/ unrecovered advance of ₹51.03 crore remained with EPC contractor, which could not be recovered in the absence of security.

(vi) In case of BHPL, mobilisation advance of ₹172.36 crore was paid to EPC contractor till December 2011. The project had achieved 75 *per cent* progress in October 2017, when contractually, the unadjusted balance of the advances was to be ₹14.36 crore, against which actual amount of unadjusted advance was ₹56.24 crore.

IIFCL replied (April/ May 2020) in respect of HHPL and BHPL that due to defaults committed by Concessioning Authority, project progress got stalled and the advance could not be recovered. IIFCL added that it is governed by SIFTI under which, IIFCL follows the lead bank. The Ministry endorsed (June 2020) views of the Management.

The reply is to be viewed against the fact that SIFTI did not restrict IIFCL to raise the visible issue of non-adjustment/ recovery of the mobilisation advance with the lead bank.

(vii) In case of NJTBPL, in the initial EPC contract (October 2010) there was no provision for mobilisation advance, however, the same was included in a supplementary EPC agreement (September 2013), whereby the EPC contractor was allowed revolving mobilisation advance not exceeding 20 *per cent* of total contract value. The set off amount from the mobilisation advance was to be decided by the Concessionaire, subject to a minimum set off of 25 *per cent* from each EPC bill. Audit observed that mobilisation advance is paid for mobilisation of resources for start of work. Hence, continuous release of mobilisation advance throughout the contract was not justified. Further, the CA certificates indicated the amount of mobilisation advance lying with EPC contractor, but neither the CA certificates nor the LIE reports gave any details of mobilisation advances released and adjusted/ recovered from time to time. In the absence of such details, it is not clear as to how the advances were being monitored by lenders including IIFCL.

IIFCL replied (April/ May 2020) that EPC advances to EPC contractor is an essential aspect which is required for mobilisation of resources including material and manpower. IIFCL further stated that as per spirit of consortium banking, lead bank monitors/ decides in regard to mobilisation advance to be given/ recovered from EPC contractor as well as certification of RA Bills. The reply was, however, silent regarding the audit observation pertaining to CA certificates/ LIE reports. IIFCL also replied that in this project mobilisation advance facility was sanctioned by consortium at later stage to expedite the work at site. In this project, on the one hand, EPC contractor was given substantial mobilisation advance while on the other hand the promoters were also infusing money in the form of subordinate debt over and above their equity commitment which was noticed by the consortium. In the consortium meeting held on 22 March 2018, the company was directed to net off the mobilisation advance given to SPV with the subordinate debt. The same was done and can be seen in the CA certificates dated 01 March 2018 and 31 March 2018 in which the outstanding mobilisation advance (advance to EPC contractor) reduced from ₹143.90 crore to ₹33.31 crore. Hence, the observation in regard to non-recovery of mobilisation advance is addressed. The Ministry endorsed (June 2020) views of the Management.

The reply is not acceptable as this does not address the audit concern on letting the EPC contractor to have a revolving mobilisation advance as the spirit behind mobilisation advance for initial mobilisation of resources by the EPC contractor has been defeated and the Concessionaire/ EPC contractor has been favoured by allowing revolving mobilisation advance in this case. The project is not yet complete and any further mobilisation advance to the EPC contractor in terms of existing conditions of EPC contract cannot be ruled out.

(viii) In case of DATRL, the EPC contract was signed with REL Utility Engineers Limited (the promoter company) on 28 March 2011 which subcontracted the EPC contract to R-Infra. The R-Infra further subcontracted the same to L&T Limited on 21 August 2012. As per EPC contract, 10 *per cent* of contract value as mobilisation advance amounting to ₹267.30 crore (10 *per cent* of ₹2,673 crore) was payable whereas, as per the sub contract with L&T, advance was only to be five *per cent* of the total contract value (₹102 crore @ 5 *per cent* of ₹2,040 crore). Thus, an interest free advance of ₹65.30 crore (₹267.30 crore - ₹102 crore) was given to the promotor company. This was an undue advantage to the Concessionaire, but neither the EPC cost nor the advance differential was objected to by the lenders including IIFCL.

IIFCL replies (April/ May 2020) are silent on the issue of undue benefit to the EPC contractor in the form of mobilisation advance which was not actually fully passed on to actual working contractor. The Ministry endorsed (June 2020) views of the Management.

Thus, it is evident that in the above cases, the lenders including IIFCL did not monitor the release/ adjustment/ recovery of advances paid by the Concessionaires to their EPC contractors which are related parties, leading to undue benefit to contractors at the cost of project and lenders. Further, non-reporting of details of advances released and adjusted, by the CAs and/ or LIE in their certificate(s)/ report(s) across the board, was also indicative of deficiency in monitoring of release and utilisation of advances.

5.1.2.6 Inadequacies in review of financial and physical progress

As per the directions of RBI (July 2015), the banks/ financial institutions should not entirely depend upon CA certificates and need to strengthen their own internal controls and the credit risk management system to enhance the quality of their loan portfolio.

Audit examination of reports of LIE on the progress of work revealed wide differences between the financial progress vis-à-vis physical progress, indicating that the project funds were not utilised efficiently for the project work.

(i) In case of BHPL, against revised project cost of ₹2,601.89 crore, total funds (i.e., loan disbursement, equity contribution by promoter and grant of NHAI) provided to the Concessionaire till July 2017 were ₹2,417.95 crore (93 *per cent*), whereas, as per LIE's monthly progress report of August 2017, the physical and financial progress of the project was only 73.50 *per cent* and 77 *per cent* respectively. However, without giving cognisance to the unutilised funds laying with the Concessionaire, the lenders' consortium made (November and December 2017) further disbursement of ₹160 crore in two more installments towards cost overrun including IIFCL's share of ₹23.70 crore.

IIFCL replied (April/ May 2020) that the lenders had disbursed in the project as the project was more than 70 *per cent* complete and nearing PCOD. The Ministry endorsed (June 2020) views of the Management.

The reply is not acceptable as disbursing the loan without verifying the progress against the previous disbursements for achieving PCOD was not prudent.

(ii) In case of CPBSRPL, as per the CA certificate (February 2017), against EPC work of ₹208.61 crore, the Concessionaire expended ₹161.98 crore (77.74 *per cent*). However, Independent Engineer (IE) of the Concessioning Authority reported (April 2017) that 50 *per cent* work was complete physically. The gap of 27 *per cent* between financial progress and physical work, reflects poor monitoring of lenders including IIFCL over work progress.

IIFCL replied (April/ May 2020) that different methodologies are applied by different agencies such as LIE, IE for measurement of physical and financial progress. Therefore, they are two different set of statements which are normally not comparable. The Ministry endorsed (June 2020) views of the Management.

The reply is not acceptable as the difference was substantial and the same should have been reconciled from the concessionaire/ LIE.

(iii) In case of HHPL, against revised project cost of ₹1,645.25 crore, total funds (i.e., loan disbursement, equity contribution by promoter and grant of NHAI) provided to the Concessionaire till February 2018 were ₹1,525.03 crore (92.69 *per cent*), whereas, as per LIE's monthly progress report of February 2018, the physical progress of the project was only 73.73 *per cent*. Reasons for slow progress of work despite availability of funds were not ascertained to take corrective action by the lenders including IIFCL.

IIFCL replied (April/ May 2020) that the lenders had disbursed in the project as the project was more than 70 *per cent* complete and nearing PCOD. The Ministry endorsed (June 2020) views of the Management.

The reply is not acceptable as disbursing the loan without verifying the progress against the previous disbursements for achieving PCOD was not prudent.

5.1.2.7 Disbursement of loan without verifying utilisation of previous disbursal

As per the provisions of CLA, borrowers are required to certify while requesting for drawal of loan that '*the proceeds of the earlier drawdown have been applied only to finance the* *estimated project cost and the proceeds of proposed drawdown shall be applied to meet this cost'*. However, audit observed that borrowers submitted only general statements in the notice, such as (i) proposed disbursement shall be applied only towards the estimated project cost, (ii) the proceeds would be used in accordance with the CLA. These certificates did not provide reasonable details of road stretches/ activities on which the proposed loan would be spent. Such details were also not given in the LIE's draw down certificates enclosed with draw down notices and the LIEs generally certified that the proposed disbursement is reasonably and timely needed by the borrower to make payments for the project costs in accordance with the project completion schedule. Details such as road stretch/ activity where the fund would be used were essential in the drawl notice, for ensuring genuineness of the fund requirement from borrower and also for verifying the progress of work in real terms against the previous disbursals at the time of next disbursement. In the absence of such details, the prevailing internal control failed to provide due assurance on utilisation of the project fund. Audit noticed that loan of ₹1,182.58 crore was disbursed to BKEL (₹563.32 crore) and SLHL (₹619.26 crore) against the work done of ₹656.58 crore. As such, there was excess disbursement of loan amounting to ₹526 crore with respect to the work done and loans turned into NPA. IIFCL has written off its loan portion (₹210.24 crore) as CAs were terminated by NHAI.

IIFCL replied (April/ May 2020) that funds were disbursed on reimbursement basis against LIE certified bills. At any point of time the project progresses on multiple chainage and as such ascertaining on what chain funds were utilised is not possible. The Ministry endorsed (June 2020) views of the Management.

The reply indicates failure of lenders to effectively monitor the project expenditure as it could not ascertain on what chain funds were utilised.

5.1.2.8 Inadequacy in site visits

Lenders, in co-coordination with the Concessionaire, conduct site visits to monitor the progress of work. Such visits also support the lenders in verifying the work progress reported by LIE, CA and the Concessionaire.

As per the Credit Policy of IIFCL of 2012 (revised in 2015), the site visit will be arranged by the lead bank or the borrower, and it was desirable for IIFCL to join the first visit before commencing any disbursement. Subsequently, IIFCL was to ensure atleast one visit in a year for each project. Audit noticed the following:

(i) In four cases {Sai Maatarini Tollways Limited (SMTL), BPMCPL, AETPL and YATL}, the lead banks had conducted the first site visit before first disbursement of loan. IIFCL, however, did not join the same. In case of AETPL, IIFCL attended only one site visit (February 2017) during the period 2016 to 2019.

(ii) In five cases (BKEL, HHPL, NJTBPL. PSTPL and SSRPL,), the lenders had not made any site visit before making first disbursement. The first site visits were conducted with a lapse ranging from 2-18 months from the dates of first disbursement.

Thus, it was evident that IIFCL did not consider the site visits as an important tool of monitoring the project, despite stipulation in their Credit Policy.

While noting the audit observation for future compliance in cases of HHPL, YATL, AETPL, BKEL and PSTPL, IIFCL replied (April/ May 2020) that in case of SMTL, BPMCPL, SSRPL and NJBTPL, it was not possible to attend few site visits due to paucity of manpower and office exigencies. The Ministry endorsed (June 2020) views of the Management.

Reply is to be viewed against the fact that site visit was one of the elements instituted for effective monitoring of the project, for securing project viability and ensuring quality of loan assets. Hence, required resources should have been put in place in the larger interest of the organisation as well as the projects.

5.1.2.9 Miscellaneous Issues

(i) Sanction and disbursement of loan on the basis of unrealistic projections of traffic/ toll revenue

While availability of RoW is essential for completion/ operational viability of road projects as discussed above, realistic projections of traffic and toll collection also have a bearing on the commercial/ financial viability of the projects. If the project is commercially/ financially unviable, the risk of the Concessionaire not being able to service the loan becomes high.

In case of SMTL (NPA), Audit noticed that the report (November 2011) of the traffic consultant, had ignored the impact of prevailing imposition of restrictions on illegal mining in State of Orissa on the toll revenue. However, in addendum traffic report of September 2012 considering the restriction on illegal mining, number of trucks was considered as 3,600 per day (no. of 2 axle – 1,980 and no. of 3 axle – 1,620) and number of other vehicles remained unchanged as presented in earlier traffic report. IDBI Bank (the lead lender), in its loan appraisal (November 2012) for projected traffic, however, increased the traffic flow exponentially to 29,154 (2 and 3 Axle) trucks with hypothetical assumptions that there would be future increase in demand of iron ore due to proposed Tata Steel plant in Duburi, improvement in the iron ore export by 2016 and improvement in condition of road which would further increase the traffic etc. The project was completed in August 2017. LIE, on the basis of survey conducted in December 2017 over a period of seven days, reported actual average daily traffic of 1,069 (2 and 3 Axle). As the toll revenue was lower than anticipated, the Concessionaire failed to service the loan, leading to turning the IIFCL loan of ₹278.66 crore into NPA on 31 December 2017. Later, the Concessionaire issued notice of termination on 27 March 2019 on the grounds of force-majeure[18] clause.

IIFCL, while accepting the audit observation, replied (April/ May 2020) that the project was found viable based on other factors viz. increase in demand of iron ore in the existing industries in the Kalinga Nagar area and proposed Tata Steel plant in Duburi, improvement in the iron ore exports, expected development in cargo handling capacity in Paradip Port etc.

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[18] *unforeseeable circumstances that prevent someone from fulfilling a contract*

IIFCL added that they followed the lead bank appraisal/ sanction as per SIFTI. The Ministry endorsed (June 2020) views of the Management.

The reply is to be viewed against the fact that IIFCL is mandated to finance viable projects only under SIFTI and the toll revenue, projected and considered at the time of appraisal was not based on realistic traffic.

(ii) Non-cognisance of apparent risk while sanctioning a loan under Takeout finance

In case of Sion-Panvel Tollways Private Limited *(*SPTPL), the Concessioning Authority (PWD, Government of Maharashtra) allowed toll collection from 01 Jnauary 2015 but exempted certain category of local vehicles from payment of toll, even though no such exemption was agreed in the CA. On 30 June 2015, PWD, further exempted light motor vehicles such as car, jeep etc., having capacity of upto 12 passengers, from payment of toll. This affected the toll collection of SPTPL and consequently, the loan of IIFCL in the project amounting to ₹160 crore turned NPA on 30 September 2016. SPTPL issued notice to the Concessioning Authority on 28 November 2017 for termination of the CA and PWD has since taken over the project. The issue of the termination payment under the CA is under arbitration (January 2020).

Audit noticed that IIFCL did not take cognisance of similar risk in another project (MEPIPL) in the same State (Maharashtra), wherein IIFCL sanctioned (February 2016) additional Takeout Finance of ₹269.90 crore for an operational project in Mumbai. Thus, the known risk of exempting the toll collection from certain category of vehicles arbitrarily by Government of Maharashtra was not given due cognisance in this Takeout Finance.

IIFCL replied (January/ April/ May 2020) that Toll notification issued by PWD, Government of Maharashtra is not applicable to MEP infrastructure Private Limited and MEPIPL is collecting the toll to service the debt obligation (interest plus Principal payment) to all the lenders. Hence, the risk to SPTPL is not applicable to MEPIPL. Therefore, the comparison between the two projects is not appropriate. The exemption of vehicles by PWD was a force majeure situation which could not be predicted. The Ministry endorsed (June 2020) views of the Management.

The reply is to be viewed against the fact that the toll exemption was given arbitrarily by Government of Maharashtra without an acceptable compensation to the Concessionaire leading to termination of contract by the Concessionaire. In the instant case, the said risk of Government of Maharashtra exempting certain categories of vehicles from toll collection and its fallouts were already experienced by IIFCL and therefore, the risk should have been considered and mitigated by IIFCL before sanction of the loan under takeout finance.

(iii) Credit rating of the concessionaire

Under the CLA, lenders were mandated to take punitive action if the credit rating[19] is not submitted or is below the prescribed rating.

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[19] ***Credit rating is a warning mechanism on the likelihood of default in servicing of loan asset on the part of the Concessionaire***

In case of BATL, the CLA required that 'the borrower unconditionally agrees and undertakes to get itself rated by credit rating agencies within six months from date of first drawdown notice and thereafter within every 12 months and/ or such other intervals as may be required by the lead lender. In the event, the borrower does not obtain credit rating in time and/ or obtains a credit rating lower than BBB-, the lenders have a right to charge an additional interest of one *per cent* per annum'. First external rating of BATL was done on 03 December 2013 as BB+, which was downgraded as B+ on 06 May 2016.

IIFCL, without ensuring compliance to timely submission of credit rating by the Concessionaire, continuously disbursed the loan without charging additional interest of one *per cent* per annum, resulting in loss of revenue of ₹3.12 crore[20] (up to July 2017).

IIFCL replied (April/ May 2020) that the matter has been taken up with lead bank for charging additional interest. The lead bank has also confirmed (November 2019) that they were not charging additional interest. The matter is being pursued further with borrower and other consortium members. The Ministry endorsed (June 2020) views of the Management.

(iv) Equity infusion and Shareholding Pattern

As per RBI directions (July 2009), the funding agencies should not depend entirely on the Certificates of Chartered Accountants (CA Certificate). Rather, they should strengthen their internal controls and the credit risk management system to enhance the quality of their loan portfolio. One of the measures suggested by RBI in this regard was the periodical scrutiny of borrowers' books of accounts and the 'no-lien' bank accounts.

CLAs required that (i) the promoters shall bring upfront equity in Escrow Account, before the disbursement of loan, and (ii) Management of, and control over, the Concessionaire shall not change, without the prior written consent of the Lenders. The CAs also required that the Concessionaire shall not undertake or permit any change in ownership, except with the prior approval of the Concessioning Authority. Examination of selected cases in Audit revealed the following:

a) In case of CPBSRPL**,** the CLA stipulated that the promoter would bring in equity contribution into an Escrow Account opened with Oriental Bank of Commerce, which was also the lead bank. The promoter made deposits in 16 tranches, each of ₹0.50 crore, during 21 to 30 May 2015, as share application money, in a non-escrow bank account, opened with Allahabad Bank. The funds, so deposited in each tranche, were withdrawn on the same day. In the CA Certificates dated 06 January 2015 and 15 June 2015, attached with the Concessionaire's drawdown notices, the total amount of above 16 tranches of deposit was treated as equity infusion of ₹08.00 crore in the project by the promoter. Considering any deposit made by the promoters in a non-escrow bank account as equity infusion was irregular.

IIFCL replied (April/ May 2020) that as per SIFTI, monitoring is the primary responsibility of the lead bank. The Ministry endorsed (June 2020) views of the Management.

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[20] ***@ one per cent per annum on the amount of loan disbursed during December 2014 to January 2017***

The reply is not acceptable as IIFCL did not apply due diligence in line with RBI guidelines and the provisions of Inter Creditor Agreement which required independent decision making. Further, any deposit, made in a non-escrow account, cannot be treated as equity infusion in the project as certified by CA.

b) As per annual accounts of 2013-14 of CPBSRPL, the shareholding of PATH, one of the two promoters in CPBSRPL, was reduced to 0.02 *per cent* whereas the shareholding of Concast Infrastructure Limited had gone up to 99.98 *per cent,* which remained so till 31 March 2016. Records of IIFCL did not indicate any approval for the change in shareholding pattern by the Concessionaire. Yet, IIFCL disbursed the loan despite the change in shareholding pattern, in contravention of the pre-disbursement condition stipulated in the CLA.

IIFCL replied (April/ May 2020) that in meetings held with the Concessioning Authority, PATH agreed to actively participate in the project. However, PATH did not honour its commitment and the lenders have filed an application against PATH in NCLT. The Ministry endorsed (June 2020) views of the Management.

The reply is not acceptable as records of IIFCL did not indicate that the lenders including IIFCL took any action against the Concessionaire during currency of the CA. Further, the financials of the Concessionaire showed that there was a change in shareholding pattern which was either overlooked or not given due consideration which led to disbursement of the loan despite non-compliance to the pre-disbursement condition stipulated in the CLA.

5.1.3 Conclusion

In road sector, the projects do not have physical assets to provide as security against loan. Viability of the project is the only comfort for securing the quality of loan asset. As such, due diligence on the project before signing of the CLA, compliance to the conditions set in the CLAs before disbursement of loan and monitoring of project work progress for timely corrective action are vital activities to be undertaken by lenders for financing the road projects.

Lenders including IIFCL did not give due cognisance to the risks of RoW availability, the EPC contracts being awarded to promoter company and the restrictions on change in shareholding pattern in concessionaire company. In seven out of nine NPA cases, non-availability of required RoW was the leading factor for non-completion of projects and turning of the loans into NPA. In one NPA case, unrealistic traffic projection affected the project's commercial viability while in another NPA case, low traffic revenue led to unviability of the project.

Vital risks were also not mitigated in many cases by inclusion of suitable pre-disbursement conditions. Although the CLAs contained other valid pre-disbursement conditions for ensuring sustained viability of the project, the loans were disbursed, in many cases including NPA cases, without ensuring the compliance to the conditions relating to environment/ forest/ tree cutting clearances, infusion of required equity through escrow account and funding of cost overrun/ IDC by promoters. This led to delay in work progress, risk of misuse of fund by promoters and avoidable additional loan to badly managed projects.

Monitoring of project progress was weak due to inadequacies in internal control systems established by the lenders, particularly incomplete/ deficient information contained in LIE reports and CA certificates relating to the RoW availability, the equity infusion by promoters, the changes in shareholding pattern, the physical work progress *vis a vis* funds available with the project and the advances released/ unadjusted/ unrecovered. The deficiency in monitoring led to the promoter taking undue benefits out of project fund, at the cost of project work progress.

The CA provided that on termination of CA debt due would be worked out on the basis of lowest project cost which would normally be as mentioned in the CA. However, IIFCL agreed to finance the cost overrun of ₹347.85 crore without seeking approval from the Concessioning Authority for increase in total project cost which was not only irregular but also imprudent, as this encouraged incapable promoters to continue with the project, increased loan exposure to badly managed projects, delayed corrective action and most importantly exposed the lenders to risk of non-recovery of debt given on account of cost overrun/ IDC on termination of CA in view of provisions of CA.

Due to NHAI not making the RoW available and huge loan amount disbursed to the Projects including IIFCL's loan of ₹1,895.50 crore without ensuring availability of RoW and clearances, not only the loan turned NPA, but the country also could not reap the benefit of these road projects due to non-completion of the roads.

5.1.4 Recommendations

Audit suggests the following recommendations in order to address the issues highlighted in this report:

1. Efforts may be made at the level of Ministry of Finance to get the issues related with non-issuance of PCOD Certificates by the Concessioning Authorities despite achievement of progress stipulated in the Concession Agreements, resolved amicably with the Concessioning Authorities/ Ministry of Road Transport and Highways.
2. A separate Tripartite agreement among the Concessioning Authority, the Concessionaire and the consortium of lenders may also be entered into with a view to ensure improved communication in the interest of successful completion of the projects under execution and also to safeguard the financial interest of all the stakeholders including lenders.
3. IIFCL should include loan disbursement conditions in sanction letter/ CLA on availability of RoW to cover the risks flowing out of restrictive clauses like termination payments, conditions in concession agreement or stricter conditions to safeguard its financial interest.
4. A mechanism may be developed to restrict the Concessionaire from allowing any advance, other than mobilisation advance, to the EPC contractor, that too backed by

sufficient encashable security, in the possession of the lenders and such advances should be recovered in a time bound manner.

5. Audit observations are based on selected sample. There is need to get entire population examined to assess the prevalence of the problem and fix the responsibility, wherever required. Cases with indications of mala-fide, if any, may be referred to professional agencies for further examination.

5.2 Avoidable loss due to extension of loan in terminated projects

IIFCL sanctioned and disbursed two loans under Takeout Finance Scheme without ensuring compliance of critical requirement of obtaining 'No Objection Certificate' from Concessionaire Authorities, and without ensuring required debt servicing capacity of the borrowers from their audited annual accounts. Further, in one case, the project had already been terminated before execution of the takeout financing documents between IIFCL and the original lender banks, while in the other case, the notice of termination of project happened before disbursement of loan by IIFCL. Resultantly, the loans of ₹26.20 crore became irrecoverable.

Raipur Waste Management Private Limited (RSWPL) and Bhilai Durg Waste Management Private Limited (BDWPL) were two concessionaire Special Purpose Vehicles (SPVs), for operation of solid waste management projects of Raipur Municipal Corporation (RMC) and Bhilai and Durg Municipal Corporation (BMC), respectively, in the State of Chhattisgarh. The Concession Agreements were signed between RSWPL and RMC on 03 September 2012 and between BDWPL and BMC on 17 July 2012, for a period of 30 years, each. The project viability was fully dependent upon the revenue to be generated/ received by the SPVs from RMC/ BMC under the concession agreements.

IIFCL sanctioned (22 September 2014) two loans of ₹13.71 crore and ₹12.74 crore to RSWPL and BDWPL, respectively, under its 'Takeout Finance Scheme'[21], by partially taking over the outstanding amount of loans, which had been extended to the SPVs by different banks. The loans (₹13.71 crore and ₹12.74 crore) were disbursed on 03 December 2014.

Considering the poor performance of both the concessionaires (RSWPL and BDWPL), the Concessioning Authorities (RMC and BMC) served notices of termination of concession agreement on 24 December 2013 and 21 October 2014. The concession agreements were finally terminated on 25 November 2014 and 24 November 2014, respectively. Resultantly, servicing of the loans was not being done by these SPVs since January 2015. Eventually, both the loans turned into non-performing assets (NPA) as on 30 June 2015 (i.e. within seven months of disbursement) and finally ₹26.20 crore (₹13.59 crore and ₹12.61 crore) due from RSWPL and BDWPL, respectively, were written off (March 2016).

With regard to sanction and disbursement of above loans, Audit observed the following:

- As per Credit Policy (2012) of IIFCL for takeout finance, No Objection Certificate (NOC) from the Concessionaire Authority, lenders and the consortium of lenders was

[21] *Under the takeout financing scheme, loans given by banks to infrastructure projects are taken out of their books by IIFCL. This helps banks in avoiding an asset-liability mismatch and also frees up their funds to be loaned to new projects*

required to be obtained before scheduled date of occurrence of takeout. However, NOC from the Concessionaire Authority was not obtained.

- IIFCL was also required to consider only those proposals, which had Debt Service Coverage Ratio (DSCR) of at least 1:00. However, sufficiency of the stipulated DSCR was also not ensured by IIFCL at the time of sanction of loans.
- In case of RSWPL, notice for termination of concession agreement was served (24 December 2013) before the date of sanction of the loan by IIFCL (22 September 2014), and in case of BDWPL, signing of financing documents by IIFCL took place (27 November 2014), i.e., after termination of the concession agreement (24 November 2014). Moreover, the disbursement of funds in both the cases was done after termination of its concession agreements, which indicates injudicious disbursements of loans to the SPVs.

IIFCL replied (November 2019) that NOCs dated 28 October 2014, 29 October 2014 and 26 November 2014 were obtained from all the lenders before effecting the takeout. It was further replied that the loan was disbursed, based on the DSCR for the period July 2013 to June 2014, certified by a Chartered Accountant.

Replies of the IIFCL is not tenable due to the following:

- NOC, as required to be obtained from the Concessionaire Authority as per the Credit Policy of the Company, was not obtained.
- The legitimacy of three of the four NOCs obtained (dated 28 October 2014 and 29 October 2014) could not be established as these were not dated and contain reference to a future date {i.e., signing date of 'Amended and Restated Facility Agreement' was 27 November 2014}.
- Regarding DSCR, it was seen from the annual accounts of the borrowers for the year 2013-14 that DSCR was only 0.13 for RSWPL and 0.48 for BDWPL i.e. less than the stipulated ratio of 1.
- Further, the fact remained that the disbursement of funds in both the cases were done after termination of its concession agreements.

Thus, due to non-adherence of the provisions of its own Credit Policy, IIFCL extended loan in the projects which had already been terminated and resultantly suffered a loss of ₹26.20 crore (₹13.59 crore plus ₹12.61 crore written off). It is recommended that responsibility may be fixed for the lapses pointed out by Audit.

The para was issued to the Ministry in January 2020; their response was awaited (June 2020).

NABFINS Limited

5.3 Non-Performing Assets

5.3.1 Introduction

NABFINS Limited which was earlier known as NABARD Financial Services Limited (Company) was formed with the objective to provide financial services in the two broad areas of agriculture and micro finance. Its registered office is at Bengaluru. It is a registered Non-Banking Financial Company (NBFC) and conducted its activities in 11 States[22] during the period covered under audit i.e. 2015-16 to 2018-19. As per the regulations of Reserve Bank of India, the Company is a systemically important Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI).

The objectives of the Company are:

- to provide credit and other facilities for promotion, expansion, commercialisation and modernisation of agriculture and allied activities, and
- to provide micro finance services to the needy and disadvantageous sections of the society for securing their prosperity in both rural and urban areas.

5.3.2 Audit objectives

Audit was conducted to assess whether:

- the Company achieved its financial and physical targets;
- there was an effective mechanism for sanction of loans; and
- there was a robust mechanism for collection of dues.

5.3.3 Audit criteria

- Instructions issued by the Reserve Bank of India from time to time,
- Memorandum of Understanding (MoU) entered into with NABARD,
- Provisions of the Operations Manual on Loans of the Company,
- Internal working instructions issued by the Company,
- Agenda and Minutes of Board meetings of the Company, and
- Guidelines for One Time Settlement (OTS) scheme

5.3.4 Audit scope and methodology

An Entry Conference was held with the Company on 05 October 2018 after which the audit was conducted and the draft para was issued to the Management in March 2019. The reply of Management was received in May 2019. An Exit Conference was held with the Management on 13 September 2019 to discuss the audit findings, after which the draft para was issued to the Ministry of Finance (Department of Financial Services) in December 2019. The reply of the Ministry was received in January 2020, which has been duly considered while finalising the draft audit para.

Loan accounts were selected from five States having highest overdues as on 31 March 2018. In the selected States, the district/ branches having highest overdues were selected. The details of the selected branches/ districts are given as under:

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[22] ***Andhra Pradesh, Chhattisgarh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Mizoram, Tamil Nadu, Telangana and Tripura***

Table 5.3.1

State	Districts/ Branches selected
Karnataka	Sirsi, Vijayapura, Tumkur
Tamilnadu	Cuddalore, Dindugul, Madurai, Erode
Maharashtra	Gondia, Yavatmal, Nanded, Amravati
Andhra Pradesh	Chittoor
Telangana	Warangal

Details of the accounts selected are shown in ***Annexure-III***. Audit was conducted for the period 2015-16 to 2017-18 and the audit findings were updated up to 2018-19.

5.3.5 Business models of NABFINS

The Company operates loan disbursements in three major business verticals, viz., Second Level Institutions (SLIs), Business and Development Correspondents (B&DCs) and Direct Lending (DL) to borrowers.

(i) **Second Level Institutions (SLIs):** It is a registered body having a distinct legal identity comprising first level organisations such as Self Help Groups[23] (SHGs), Joint Liability Groups[24] (JLGs) and Farmers' Groups/ Societies. Prospective SLIs are identified by field (Branch/ District) offices of the Company and designated teams from Headquarters (Bangalore) of the Company visit to conduct project assessment[25] and due diligence. The SLIs carry out onward lending to first level organisations out of the loans disbursed by the Company. The SLIs are entitled to the surplus arising out of the interest differential, i.e., the difference between the interest payable by SLIs to the Company and interest receivable from the onward lending activity.

(ii) **Business & Development Correspondents (B&DCs)**: These are intermediaries between the Company and SHGs. They are responsible for identifying SHGs, processing loans, collecting instalments and remitting the same to the Company. For these services, they are entitled to be paid commission at the rate of two *per cent* of the loan disbursed (0.5 *per cent* on the disbursement of loan and 1.5 *per cent* on completion of collection and remittance).

(iii) **Direct Lending (DL):** Under DL, the staff of the Company directly supervises the activities of lending and collection. This business vertical commenced its operations during the year 2016-17 and created a business of ₹88.38 crore and ₹193.35 crore during 2017-18 and 2018-19 respectively.

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[23] *Self Help Groups are small informal group of 10-20 individuals, who are homogenous with respect to social and economic background and come together voluntarily for promoting savings habit among members and for a common cause to raise and manage resources for the benefit of group members*

[24] *A Joint Liability Group is an informal group comprising of 4-10 individuals coming together for the purpose of availing bank loan on individual basis or through group mechanism against mutual guarantee*

[25] *The Company has to make an assessment of the projects intended to be taken up by the first level institutions out of the loans to be obtained from SLIs*

The outstanding loans and Non-Performing Assets (NPAs) as on 31 March 2019 under the above three major business verticals of the Company were as under:

Table 5.3.2

(₹ in crore)

Particulars	SLIs	B&DCs	DL
Outstanding Loans	141.59	1101.41	196.31
NPAs	3.01	47.45	0.86

Out of the three major business verticals, 95.31 *per cent* of total NPAs as on 31 March 2019 (₹52.94 crore) were accumulated under B&DC and SLIs.

5.3.6 Audit Findings

5.3.6.1 Targets and Achievements

The details of financial and physical targets and achievements of the Company for the years 2015-16 to 2018-19 are shown in ***Annexure-IV***. The Company was able to achieve satisfactory levels of growth in the achievement of financial and physical targets during all the four years. The growth in financial achievement in terms of overall loan disbursement was 56 *per cent* over the four years' period 2015-16 to 2018-19. The growth in physical achievement in terms of number of Self-Help Groups (SHGs), number of States covered, Districts covered and Business & Development Correspondents (B&DCs) covered, increased by 50 *per cent*, 100 *per cent*, 36 *per cent* and 87 *per cent* respectively during the years 2015-16 to 2018-19.

The Company concurred (May 2019) with the facts reported by Audit.

5.3.6.2 Non-Performing Assets

Non-Performing Asset (NPA) is any account, wherein either the principal or the interest or both are due for a period of 90 days or more. The details of NPAs of the Company for the four years ended 31 March 2019 are shown in ***Annexure-V.***

It was observed that:

- NPAs of the Company increased from ₹36.53 crore to ₹85.11 crore (including prudential write-offs[26] made in the years 2016-17 & 2017-18) which recorded a growth of 133.02 *per cent* during the preceeding four years ended 31 March 2019.
- The Company made prudential write-offs of ₹32.17 crore.
- During the period 2015-16 to 2018-19, outstanding loan portfolio was increased by 67.72 *per cent* whereas NPAs recorded a growth of 133.02 *per cent*. NPAs constituted 4.24 *per cent* (2015-16), 6.17 *per cent* (2016-17) and 6.12 *per cent* (2017-18) and 5.89 *per cent* (2018-19) of total outstanding loan portfolio ***(Annexure-VI)***.

[26] ***Prudential write-off is the amount of non-performing loans which are outstanding in the books of the branches, but have been written-off (fully or partially) at Head Office level***

The Company concurred (May 2019) with the facts reported by Audit. The Ministry replied (January 2020) that Management had strengthened their Stressed Assets Management Section in order to follow-up with overdue customers and address the issue of loan becoming NPA. Special Recovery Team (SRT) had been constituted to undertake field visits and recover the overdues. Audit will review the performance of SRTs in subsequent audits.

5.3.6.3 Sanction of loans

i) Sanction of loans through SLIs

There were 36 SLIs covering 39 loan accounts whose NPA stood at ₹3.83 crore as on 31 March 2018. Out of these 36 SLIs, Audit covered 19 SLIs in the selected branches whose NPA stood at ₹2.23 crore. SLIs, by definition, were supposed to extend loans to the first level institutions.

As per para 5.5 of the Operations Manual on Loans (September 2015), an SLI would be eligible for sanction of loans, if it was in existence for a minimum period of one year of operations after registration. The loan eligibility would be the lowest of the following:

- 85 *per cent* of the project outlay excluding cost of land;
- up to debt-equity ratio of 10:1 (10 times of net worth);
- up to 100 *per cent* of the value of collateral security.

Every such loan would have the following securities:

- hypothecation of goods/ assets procured out of loan amount;
- mortgage of land and buildings if purchased out of loan amount;
- collateral by way of mortgage of properties of SLI or its promoters, wherever available; and
- guarantee of promoters or directors, wherever available.

Further, as per para 5.8 of the Operations Manual on Loans, Post Disbursement Visits (PDVs) were to be conducted to ensure proper end-use of loan amount.

Audit, however, observed that the loan eligibility criteria for SLIs and appraisal requirements were not duly followed while sanctioning loans, as discussed in the succeeding paragraphs.

(a) Six SLIs promoted by Pragati Seva Samiti, Warangal

The Company extended (March 2015) loans aggregating to ₹299.80 lakh to six SLIs promoted by Pragati Seva Samiti, Warangal, Telangana. The loan eligibility in terms of the amount of loan to be sanctioned was to be determined on the basis of 10 times of the net worth of SLI *minus* amount of existing debt of the SLI. Audit, however, observed that the loan eligibility was not determined correctly due to errors in calculation, due to which the loans were sanctioned even though the SLIs were either not eligible for it or were eligible for a much lesser amount than was sanctioned, as shown below:

Table 5.3.3

(₹ in lakh)

Sl. No	Name of the SLI	Amount sanctioned	Net worth	Existing Debt	Loan eligiblity	Remarks
1.	Jhansilaxmi Mahila Paraspara Sahayaka Sahakara Parimitha Sangham	50.00	(0.52)	14.78	Nil	Net worth is negative, so not eligible for loan.
2.	Mother Therissa Mahila Paraspara Sahayaka Sahakara Parimitha Sangham	50.00	0.15	20.97	Nil	Existing debt exceeds 10 times of net worth, so not eligible for loan.
3.	Munneru Mutually Aided Cooperative Credit & Marketing Society Limited	50.00	6.15	62.97	Nil	Existing debt exceeds 10 times of net worth, so not eligible for loan.
4.	Priyadarshini Mahila Paraspara Sahayaka Sahakara Parimitha Sangham	49.80	(0.03)	13.95	Nil	Net worth is negative, so not eligible for loan.
5.	Sarojini Naidu Mahila Paraspara Sahayaka Sahakara Parimitha Sangham	50.00	2.30	22.85	0.15	10 times of net worth *minus* existing debt
6.	Swarna Bharati Mahila Paraspara Sahayaka Sahakara Parimitha Sangham	50.00	0.38	22.85	Nil	Existing debt exceeds 10 times of net worth, so not eligible for loan.
	Total	**299.80**			**0.15**	

The primary reason for incorrect determination of loan eligibility was that the Company considered thrift (savings) of members of SLIs as part of their net worth. The thrift of the members was an outstanding liability of the SLIs as this amount was liable to be repaid along with interest upon demand from the members. As such, thrift should have been excluded in calculation of net worth of SLIs. Further, the following deficiencies were noticed in sanction/ appraisal of loans:

- Loans were extended by the SLIs to individuals directly, and not to the first level instititions. Thus, the principle of collective group responsibility was not ensured and the above six borrowers did not meet the definition of SLIs.
- Loans were extended with book debts as only collateral and the list of book debts of the SLIs were not certified by the auditor, as required.
- Loans were sanctioned without considering the existing NPAs of the SLIs.
- Third party guarantee/ personal guarantees of the promotors were not obtained.
- The loan repayments were rescheduled without verifying the intended utilisation of the loans sanctioned.

As on 31 March 2019, the NPAs from these six SLIs stood at ₹62.24 lakh and remained at the same level as on 30 September 2019.

Management replied (May 2019) that the above referred six borrowers can be construed as SLIs. They are registered as Mutually Aided Co-operative Society (MACS) with the Government of Andhra Pradesh and MACS falls under SLI category as per loan policy of the Company. Due to non-payment by borrowing members, the SLIs had prayed for rescheduling of loans and the same was acceded to.

The Ministry replied (January 2020) that these MACS extend loans to SHGs affiliated to them and maintain disaggregate borrower-wise loans outstanding and the same had been submitted in the form of book debts. The accounts were being followed up regularly.

The reply is not acceptable as the lists of book debts of the SLIs contained only individual beneficiaries, instead of groups/ societies. As per clause 5.3 of the Operations Manual on Loans of the Company, an organisation would be called as SLI if it was formed by a group of first level organisations like SHGs, JLGs, farmers/ artisans groups/ society and may include federations. Therefore, these six organisations were only first level institutions but not SLIs. Further, before rescheduling of loans, the Company should have verified and satisfied itself about the purpose of the loan and that there was adequate possiblity of recovery of loans.

(b) Navjeeven Mutually Aided Cooperative Thrift Society, Nellore

Audit observed that loans were extended by the above SLI to individuals directly, instead of to the first level institutions. Thus, the principle of collective group responsibility was not ensured and the borrower did not meet the definition of an SLI. The loan eligibility was enhanced by considering thrift (savings) amount of members as part of net worth. The Company sanctioned loans with only book debts as collateral and it was observed that out of the initial loan of ₹30 lakh disbursed in December 2013, the chances of disbursement of the loan to members of SLI were doubtful since as much as ₹25 lakh was paid to a single person.

Out of another loan amount of ₹50 lakh disbursed in March 2015, an amount of ₹2.42 lakh was transferred to Navjeevan Organisation (NGO of SLI) and an amount of ₹11.25 lakh was paid to the Company towards repayment of its outstanding loan which tantamounted to diversion of sanctioned loan.

In respect of the loan of ₹50 lakh given in March 2015 to SLI, the Company recorded that the outstanding loan amount was "0.00", instead of ₹42.98 lakh as of 1 March 2015 (out of a loan of ₹50 lakh sanctioned in August 2014) and a further loan of ₹50 lakh was sanctioned. Further, it was observed that neither the list of book debts was certified by auditor as required nor any third-party guarantee/ personal guarantee of the promoter was obtained. The outstanding loan amount as on 31 March 2019 was ₹44.81 lakh and the same amount was lying outstanding as on 30 September 2019.

Management accepted (May 2019) that the inclusion of savings of members for arriving at net worth was due to lack of understanding on the part of the loan appraiser and stated that the Company was pursuing the recovery through legal means. It was further stated that

₹25 lakh was drawn by Secretary of the Society for disbursement to its members. In respect of non-certification of book debts, it was stated that it obtained the details of some of the borrowers on a sample basis and disbursements were made.

The reply of Management is not acceptable. There was no recorded evidence available that the said Secretary of SLI had actually disbursed the loan amount to the intended beneficiaries. The Company did not obtain any third-party guarantee/ personal guarantee of the promoters. Further, Management did not respond to the audit observations on diversion of loan funds by the SLI for repayment of earlier loan.

The Ministry replied (January 2020) that the loan was periodically monitored by obtaining book debt statement. Hence, there was no deviation of funds.

The reply is not acceptable as the SLI utilised ₹11.25 lakh for repayment of previous outstanding loan which is nothing but diversion of loan funds.

Similar deficiencies were noticed in sanction of loans by the Company to Sri Soundarya Mahila Mutually Aided Cooperative Thrift Society, Chittoor (Andhra Pradesh) and Kongunadu Vivasaigal Sangam, Erode (Tamil Nadu). These cases have been discussed at ***Annexure-VII.***

ii) Sanction of Loans through B&DCs

As on 31 March 2019, the outstanding amount of loans disbursed through B&DCs was ₹1,101.41 crore. Out of this, there were 53 B&DCs in the branches selected for audit, against whom the NPAs amounted to ₹37.27 crore. A review of business activities of the B&DCs in the selected branches/ districts revealed that:

- As on 31 March 2015, NPAs of B&DCs stood at ₹7.77 crore which increased to ₹40.34 crore by 30 September 2019, recording an increase of more than five times.
- As on 31 March 2019, NPAs of top 10 B&DCs stood at ₹28.23 crore which constituted 76 *per cent* of total NPAs as on 31 March 2019.
- Even though the model agreement with B&DCs provided for investigative audit as per discretion of the Company, no such reports were made available for scrutiny.

Management replied (May 2019) that even though there have been no specific reports of investigation, high NPA cases under B&DC were covered under regular audit and business with such institutions had been put on hold.

(a) Retention of ₹12.10 crore by B&DC, Chittoor

The Company entered into an agreement (March 2013) with a B&DC namely, Society of Noble Oath & Welfare (SNOW), a registered society at Chittoor, Andhra Pradesh. On the recommendations of SNOW, the Company sanctioned loans of ₹19.62 crore in cash to 442 SHGs during 2013-14 to 2015-16. Examination of records revealed the following:

- SNOW operated only in Somala Mandal in Chittoor district and had got sanctioned a maximum loan amount of ₹20.40 lakh for 36 SHGs identified by it during 2006-07 to

2009-10. However, during the three years 2013-14 to 2015-16, a substantial amount of ₹19.62 crore, which was 95 times of the loans that were sanctioned during the previous four years, was sanctioned by the Company to SNOW.

- After the loan of ₹19.62 crore was disbursed, SNOW took back major portion of the loan from the SHGs. The Company was unaware of this activity until the loans became NPA.
- No periodic review was carried out by the Company after disbursement of loans. As a result, an amount of ₹12.10 crore became NPA and the same was yet to be recovered (September 2019).

Management replied (May 2019) that this was a fraud, where the agency had carefully designed a process to defraud the Company and the borrowers. Even though the loans were disbursed to beneficiaries in person, the agency had managed to obtain the loan proceeds (either fully or in part) through deceit. The agency had ensured that the Company could not detect the fraud. Management admitted that the Company should have been more vigilant and stated that the monitoring mechanism with respect to loans given had since been strengthened. The investigation of the three criminal cases filed at Chittoor had been completed by the police and the matter was pending before the Court. In addition to the criminal cases, the Company had filed civil suit against the NGO and its Board of Directors in Bengaluru City Court and civil suit had been filed against three SHGs at Chittoor for recovery. Management further stated that credit was extended from time to time based on previous satisfactory performance of B&DC. It assured that now the Company was not making any cash disbursements and loans were being disbursed through bank accounts of beneficiaries.

Reply of Management is not acceptable in view of the fact that there was a total failure of appraisal systems and other allied internal control systems during sanctioning and disbursement of loans which led to the non-recovery of loans.

The Ministry replied (January 2020) that based on the experience, the Company had put in place a strong monitoring mechanism and periodicity of the audit had been increased to give early warning signals.

5.3.6.4 Inadequate Post Disbursement Visits

Para 3.13.1 of Chapter 3 of Operations Manual on Loans stipulated that Post Disbursement Visits (PDVs) were to be conducted periodically to ensure that the loan was utilised for its intended purpose and the same was not slipping into NPA. However, it was observed that PDVs were conducted only in 35.26 *per cent* of cases during the last four years from 2015-16 to 2018-19 as shown below:

Table 5.3.4

Year	No. of loans sanctioned	No. of PDVs to be conducted as per Operations Manual	No. of PDVs actually conducted	Percentage of actual PDVs conducted w.r.t PDVs to be conducted
2015-16	36,367	1,45,468	41,585	28.58
2016-17	39,633	1,58,532	52,336	33.01
2017-18	41,576	1,66,304	1,31,875	79.29
2018-19	2,26,661	7,52,192	2,05,231	27.28
Total	**3,44,237**	**12,22,496**	**4,31,027**	**35.26**

Source: Data provided by the Company

Management concurred with the audit findings and replied that efforts were being made to increase the quantum of PDVs. It was also stated (September 2019) that 90 *per cent* and 74 *per cent* of PDVs were conducted in I and II quarters of 2019-20 respectively.

Ministry replied (January 2020) that the Company had linked the incentive policy to achievement of threshold limit of conduting PDVs.

5.3.6.5 Loan collection mechanism

In order to ensure timely recovery of outstanding amounts from loan accounts and prevent them from becoming NPAs, the collection mechanism has to be robust and effective. The mechanism should also provide signals for early detection/ identification of probable NPAs so that corrective actions can be taken in time. For this, the Operations Manual on Loans of the Company provided detailed procedure.

(a) Monitoring System for early warnings of Portfolio at Risk

Chapter 9 of the Operations Manual on Loans stipulated that any loan account, overdue for 30 days or more, had to be classified as Portfolio at Risk (PAR). Any loan account entering into PAR category was a warning signal of incipient NPAs. These loan accounts were to be closely monitored and effective steps should be initiated to avoid slippage of any account into NPA category. The details, as provided by the Company, of the number of accounts with overdues less than 30 days, 30-60 days and 60-90 days along with the number of such accounts contacted by the Company are at ***Annexure-VIII***. However, in the absence of any documentary evidence, Audit could not verify the existence of any such mechanism in place.

Management replied (May 2019) that the mechanism of collecting information regarding conduct of visits is carried over telephone on a regular basis by Stressed Assets Team at Head Office.

Ministry replied (January 2020) that the Company had strengthened its Stressed Asset Management Section in order to follow-up with overdue customers and address the issue of loan becoming NPA. Special Recovery Team had been constituted to undertake field visit and recover the dues.

The Company needs to strengthen their monitoring system to take prompt action as and when early warning signals are noticed.

(b) NPA management

Chapter 10 of the Operations Manual on Loans laid down the procedure regarding NPA management. It stipulated, *inter alia*, that:

- Within 30 days from the date of any account becoming NPA, a written demand notice in vernacular language would be sent to borrower groups by the District Office. The notices were to be preferably delivered in person by the District Staff. If there was no response for such notice, a second reminder would be issued by the Head Office, within 60 days of account becoming NPA. In case of no progress in recovery even after these two stages, legal action would be initiated by the Head Office of the Company.
- Detailed investigative audit would be conducted in cases where the number of accounts with outstanding amount more than ₹1,000 per account, reached 20 *per cent* of total accounts linked through a B&DC.

Audit scrutiny, however, revealed that out of 2360 loan accounts with NPAs of ₹33.32 crore as on 31 March 2018 in the selected districts ***(Annexure-IX)***, demand notice (first reminder) was issued by the District Offices in 71 *per cent* cases covering NPA amount of ₹29.20 crore (88 *per cent*). Further, the Company took steps to initiate legal action in respect of 683 loan accounts (29 *per cent*) covering NPA amount of ₹18.09 crore (54 *per cent*) only.

With respect to investigative audits, Management informed (October 2018) during course of audit that they had undertaken field visits of B&DCs where NPA accounts had crossed 20 *per cent* of total accounts, but no specific reports were available on investigative audits. This could, however, not be verified by Audit as no supporting documents were provided.

Management replied (May 2019) that it had not been able to cover all the B&DC cases (where NPA had reached 20 *per cent* limit) under investigative audit. However, investigative audits had been conducted in respect of some important cases such as Society of Noble Oath & Welfare (SNOW), Mahatma Gandhi Trust (MGT), Manuvikasa, and Rural Education & Environmental Development Service (REEDS). Management, however, did not furnish documentary evidence in support of the investigative audits stated to be undertaken.

The Ministry in its reply furnished (January 2020) some of the investigative audit reports. From the investigative audit reports furnished by the Ministry it was observed that (i) maximum loan was availed by a single member, (ii) loans were taken by members beyond their repayment capacity, (iii) loans were sanctioned despite poor grading given by Field Survey Officer, etc. Thus, it is evident that proper due diligence was not made by Management in sanctioning of loans and post sanctioning of loans which led to loan amounts becoming NPAs.

(c) Non-recovery of decreed amount in cases decided by Lok Adalat

In order to expedite recoveries from NPA accounts, the Company evolved a policy to approach the Lok Adalat[27] to amicably settle the outstanding loans with the borrowers. The guidelines of the Company regarding settlement before the Lok Adalat stipulated that:

- The Company was authorised to forego accumulated interest fully or partially based on the NPA amount;
- Managing Director of the Company was authorised to waive upto 50 *per cent* of the total principal outstanding in exceptional cases by recording reasons;
- On receipt of the decree from Lok Adalat, the amount of sacrifice to be made by the Company shall be arrived at and approval of Competent Authority would be obtained; and
- In case repayments were not regularised even after two months, the Stressed Assets Team should initiate legal proceedings and reverse the settlement benefits accorded to the borrower.

Accordingly, the Lok Adalat was approached in 108 cases and settlement was arrived at through decree of Lok Adalat for an amount of ₹1.42 crore as on 30 September 2018. As against this, only ₹0.19 crore was remitted by the borrowers and the balance amount of ₹1.23 crore was yet to be recovered (September 2019).

Management replied (May 2019) that Execution Petitions (EPs) were filed against SHGs on a sample basis. However, it was found that the women borrowers did not own enough physical assets, based on which recovery could be affected, even after EP decision came in favour of the Company. In addition, undertaking such action had a huge reputational risk and political risk for the organisation.

The reply is not acceptable since in the case of judicial decision in the form of a decree, the Company had no legal recourse except filing Execution Petitions for their implementation. Thus, not initiating such action in all the cases on the grounds of reputational/ political risk was not correct and would result in further accumulation of NPAs.

The Ministry replied (January 2020) that against the decreed amount of ₹1.42 crore, the Company recovered an amount of ₹0.26 crore as on 30 December 2019.

However, an amount of ₹1.16 crore was pending for recovery as against the decreed amount of ₹1.42 crore, which needs to be watched.

(d) Non recovery of dues under One-Time Settlement

To expedite recoveries from chronic NPA accounts, the Company decided (September 2018) to initiate One-Time Settlement (OTS) with borrowers. The OTS scheme was valid during the period from 15 December 2015 to 14 June 2016. During this period, the Company

[27] ***Lok Adalat is one of the alternative dispute redressal mechanisms; it is a forum where disputes/ cases pending in the court of law or at pre-litigation stage are settled/ compromised amicably. The award (decision) made by the Lok Adalats is deemed to be a decree of a civil court***

pursued OTS in respect of 938 NPA accounts of SHGs with an outstanding principal amount of ₹10.16 crore, whereby it agreed for waiver of outstanding interest to the extent of ₹1.24 crore.

It was observed that the borrowers did not honour the agreed timelines of OTS. There were defaults in remitting the agreed amount as only ₹0.05 crore was remitted by the borrowers. Thus, the remaining amount of ₹10.11 crore remained unrecovered.

Management replied (May 2019) that the OTS agreement or verbal understanding was between the SHGs and the Company. In case the borrowers did not go by the agreement, the Company also did not give any kind of benefit, as had been agreed upon. The legal action initiated did not yield any substantial results in terms of recovery, including cases where Executive Petitions had been filed and upheld. Management further stated that the assets held by the beneficiaries were not worthy of recovering the loans, e.g., cattle and poultry, etc.

Ministry in its reply (January 2020) reiterated views of the Management.

From the above replies, it is evident that the OTS mechanism was ineffective and did not yield the required results.

(e) Non-remittance of amounts collected by B&DCs

Examination of records revealed that during the years 2015-16 to 2017-18, there were 10 cases (other than the SNOW) of fraudulent activities by B&DCs wherein they had collected ₹1.85 crore as monthly instalments from the borrowers but did not remit the same to the Company. The details are given below:

Table 5.3.5

(₹ in lakh)

Sl.No.	State	Name of B&DC	Amount involved
1.	Tamil Nadu	Krupalaya, Villupuram	42.41
2.	Karnataka	Social Education Activity for Rural Child Health Development Society, Bagalkot	37.29
3.	Karnataka	Karnataka Integrated Development Services, Tumkur	26.74
4.	Karnataka	Mahatma Gandhi Trust, Kodagu	19.09
5.	Karnataka	Social Welfare and Rural Development Society, Tumkur	17.64
6.	Karnataka	Abhivruddhi Society for Social Development, Tumkur	14.53
7.	Karnataka	Sneha Sampanmula Samasthe, Kolar	8.41
8.	Karnataka	Sree Soogoreshwar Seva Sangh, Vijayapura	7.59
9.	Maharashtra	Swayam Shasan Bahudeshiya Mahila Sanstha, Washim	6.82
10.	Karnataka	Sadhana Education & Rural Development Society, Mysore	4.87
		Total	**185.39**

Management replied (May 2019) that the Company was continuously pursuing with the B&DCs for recovery of the misappropriated funds to avoid time consuming process of filing fidelity insurance claims. They were able to recover an amount of ₹0.95 crore as of 31 March 2019. However, ₹0.90 crore was yet to be recovered.

The Ministry in its reply (January 2020) reiterated views of the Management.

5.3.7 Conclusion

The Company incorrectly included the thrift of members of SLIs in the calculation of their net worth while determining their loan eligibility. Consequently, loans aggregating to ₹299.80 lakh were sanctioned to six SLIs, even though five of them were not eligible for any loan and one was eligible for a loan of ₹0.15 lakh only against ₹50 lakh sanctioned to it. There were deficiencies in appraisal of loans as the list of book debts provided by the SLIs were not certified by the auditor and the third party guarantees or personal guarantees of promoters were not obtained. The findings of investigative audits of B&DCs were not properly recorded. Post disbursement visits in respect of loans disbursed were not conducted as per the Operations Manual of the Company. The follow-up mechanism in respect of the NPA accounts was weak and needed to be strengthened.

5.3.8 Recommendations

1) The Company may establish a robust appraisal system with the objective of assessing creditworthiness of prospective borrowers, in order to avoid sanctioning of loans to ineligible borrowers and to prevent slippages of loans into NPAs.

2) The Company may evolve an effective system to record the findings of investigative audits and ensure follow-up action thereon.

3) Post Disbursement Visits in respect of all disbursed loans may be conducted to ensure that the loans are utilised for intended purpose.

4) Field operations should concentrate on identifying early warning signals for loans slipping into NPAs and prompt corrective action in such cases should be taken. The information collected during field visits and follow-up with borrowers should be recorded in computerised system to facilitate proper storage, analysis and retrieval.

5) The Company should continuously engage with the NPA accounts in order to effect recoveries promptly.

6) The Company may review the position in all the branches/ district offices in all the States taking into consideration the audit observations and take necessary remedial action.

National Insurance Company Limited

5.4 Review of Underwriting of Group Mediclaim Insurance Policies

5.4.1 Introduction

National Insurance Company Limited (NICL), nationalised in 1972, has been servicing in the general insurance industry. NICL with its Head Office (HO) at Kolkata, operates through 33 Regional Offices (RO), 377 Divisional Offices (DO), 584 Branch Offices (BO) and 740 Business Centers (BC) across the country and provides services to its policyholders in fire, marine, motor, engineering, health and miscellaneous sectors of general insurance.

Health insurance portfolio of NICL is broadly categorised into "Individual Mediclaim" and "Group Mediclaim" policies (GMPs). GMP is further sub-divided into Tailor-made[28] policy and Standard Group Mediclaim[29] Policy. Corporate Entities, Banks, Government and semi-Government organisations accept GMPs for health coverage of their employees, members, customers etc.

Insurance companies undertake risks in consideration of premium to protect the financial loss of the insured by payment of claim subject to fulfilment of agreed policy terms. In the insurance sector, incurred claim ratio (ICR)[30] is an important parameter for evaluating the financial performance of any portfolio, as reduced ICR represents more profitability of the portfolio. Audit observed that during 2014-15 to 2018-19, NICL earned maximum premium income in health insurance business (after motor insurance business) which ranged between ₹3,388.41 crore and ₹3,893.45 crore. However, the performance of health portfolio was adverse with ICR ranging between 104 *per cent* and 128 *per cent* during the same period.

Audit made a comparative analysis of the premium income and ICR of GMPs (excluding government sponsored schemes) of NICL *vis-à-vis* Private Sector Insurance Companies as per IRDA data during the last five years ending 2018-19 as given below:

Table 5.4.1

(Premium in ₹ crore and ICR in percentage)

Years	NICL			Private Insurance Companies		
	Total premium for Health portfolio	Premium and ICR of Group Insurance Schemes excluding Govt. Sponsored Schemes		Total premium for Health portfolio	Premium and ICR of Group Insurance Schemes excluding Govt. Sponsored Schemes	
		Premium	ICR		Premium	ICR
2014-15	3,589.09	1,649.27	128.00	5,485.56	2,123.53	96.12
2015-16	3,893.45	1,680.97	127.50	6,675.20	2,484.25	88.86
2016-17	3,746.73	1,702.40	150.00	8,122.04	3,042.11	87.76
2017-18	3,743.53	1,695.06	125.00	10,401.24	4,053.63	85.39
2018-19	3,388.41	1,704.40	115.00	14,652.10	6,462.81	87.88

Source: IRDA website

***28** A policy where coverage, terms and conditions are customized according to the policyholder's requirements and premium derived accordingly*

***29** A policy where coverage, terms and conditions are fixed and applicable for all policyholders.*

***30** Claims paid plus claims outstanding at the year end minus claims outstanding at the beginning of the year over premium earned*

It is evident from Table 5.4.1 that the share of premium income of GMPs (excluding Govt. sponsored schemes) to total premium income of health portfolio of NICL ranged between 43.17 *per cent* and 50.30 *per cent* during 2014-19. Corresponding ICR was consistently adverse over the years and ranged between 115 *per cent* and 150 *per cent*.

Therefore, a Complianc Audit was undertaken to review the performance of underwriting of GMPs (excluding government sponsored schemes) in NICL during 2014-19.

5.4.2 Audit objectives and scope

The objectives of audit of GMP were to assess whether NICL:

- adopted effective mechanism/ followed IRDA guidelines for pricing of products;
- followed prudent underwriting practices, adhering to relevant rules, regulations and guidelines; and,
- put in place an effective control mechanism for monitoring of underwriting practices of GMPs for sustainability of health portfolio.

Audit test checked the GMPs issued for a period of five years ending 2018-19 at the HO, Kolkata and eight ROs of NICL across the country. ROs were selected for scrutiny based on the maximum number of policies involving premium income of ₹3 crore or more. The sample selection under RO was made based on the premium amount of ₹3 crore or more, more than ₹50 lakh but less than ₹3 crore and less than ₹50 lakh at 100 *per cent*, 10 *per cent* and one *per cent* respectively, adopting Stratified Random Sampling method.

5.4.3 Audit findings

The audit findings are discussed in the subsequent paragraphs.

5.4.3.1 Pricing of product

As per IRDA (Health Insurance) Regulation 2013, all particulars of any product shall, after introduction, be reviewed by the company at least once a year. If the product is found to be financial unviable, or is deficient in any particular aspect, the company may revise the product appropriately.

In the light of high ICR experienced in health portfolio, Audit Committee of NICL instructed (February 2014) its Health Department to prepare a focused action plan for reduction of ICR. The committee took (May 2014 and February 2015) the note of the action plan submitted to it, which *inter alia* included actions initiated to revise prices of all policies, including bank tie-ups, considering the burning cost[31] *plus* other expenses. Audit, however, observed that revision of product pricing was not undertaken despite the ICR of GMPs being consistently adverse from 2014 to 2019.

While accepting the audit observation, Management replied (March 2020) that the revision of GMP was long overdue. They also stated that GMP products would be revised following

[31] ***Estimated cost of claims in the forthcoming insurance period calculated from previous years' experience adjusted for change in the numbers insured, the nature of cover and medical inflation***

IRDA directives on certain modifications and inclusions, and along with such changes, the product price was also proposed to be reviewed and revised.

5.4.3.2 Underwriting

i) Issuance of policies without approval of HO

NICL mandated (February 2013) for approval of HO for all proposals of policy renewal where the claim experience in expiring policy was more than 70 *per cent.* Such policies were to be referred to HO for approval.

Test check of 820 policies revealed that 344 policies (41.95 *per cent*) were renewed by the concerned operating offices without obtaining approval of HO.

Audit also observed that there was no monitoring system available in HO of NICL to identify the policies due for renewal and required approval of HO. Further, there was no control to check whether the operating offices issued the policies as per terms and conditions approved by HO and collected the approved amount of premium.

Management replied (February 2020) that it was time and again emphasised to all ROs that no tailor made GMP be accepted without approval of HO. But due to operational issues, at times ROs failed to refer proposals on time to HO and such non-references were generally procedural lapses on the part of ROs and operating offices. They also claimed that "approval process has been more streamlined now". Entry of HO approval numbers in the system while underwriting tailor made Group Health Policies had been made mandatory, since December 2018. NICL also stated that they have introduced alert mails in their system to monitor underwritten policies without HO approval number.

However, no such documentary evidence in support of the system introduced was made available to audit. NICL also needs to ensure that polices issued by operating offices complied with the rate, terms and conditions as approved by HO.

ii) Under recovery of premium

HO instructed (April 2011) that policies renewed by the operating offices/ ROs without approval of HO, be referred to HO for ratification. In case, the amount of premium collected was found to be inadequate or any deviations were made from the approved terms and conditions of the policy, the offices concerned were to collect the additional premium within a specified time line, failing which the policy was to be cancelled after notification.

Test check of 820 policies in audit revealed that in 111 cases (13.54 *per cent*) the operating offices collected lesser amount of premium than the premium amount approved by HO. These policies were also not cancelled as per the directives. Non-compliance of approved terms resulted in loss of premium amounting to ₹42.35 crore (***Annexure-X***).

Management replied (February/ March 2020) that guidlines of HO were generally followed by the ROs but due to market conditions, ROs were compelled to collect lesser premium in order to retain their renewals. However, the audit observation has been noted and intimated to ROs so that premium would be collected as approved by HO.

iii) Short charging of premium due to non-imposition of desired loading

HO instructed (February 2012) that premium of policies due for renewal involving ILR[32] above 70 *per cent,* need to be computed on outgo basis[33]. Further, for reduction of high ICR in health portfolio, Audit committee of NICL, in the action taken note (May 2014), considered factors like claim outgo, medical inflation, TPA charges, intermediaries commission and management expenses in underwriting of renewals of GMPs. Further Health Insurance Underwriting Policy, 2016 of NICL also stipulated that necessary loading be imposed during renewal of GMPs experiencing adverse claim with the objective of recouping the burning cost. Besides, Ministry of Finance (MoF) directed (June 2017), to take into account likely increase in quantum of claims due to ageing of covered group, increase in size of group and other associated factors in addition to the above during renewals.

Audit test checked 820 policies and observed that in 238 policies (29 *per cent*), desired loading was not imposed during renewal despite having high claim experience in the expiring policies resulting in loss of premium income amounting to ₹372.27 crore (***Annexure-XI***) during 2014-15 to 2018-19.

As per HO instructions (February 2013), the premium was further to be loaded at a fixed percentage for coverage of family floater, pre-existing diseases, maternity benefit, corporate buffer *etc*. Audit however observed that during 2015-16, a new GMP[34] policy was issued without imposing desired loading for additional benefits *viz.* family floater coverage, pre-existing diseases, maternity benefit *etc*., which resulted in loss of premium income amounting to ₹0.68 crore.

While accepting the audit observations, Management replied (February/ March 2020) that they have been taking necessary measure for pricing in most of the policies in the financial year 2019-20 and issued a circular on 21 February 2020 focusing on the importance of keeping the GMP at a sustainable level.

In this context, reference is invited to the C&AG's Report No. 9 (Commercial) of 2017 wherein repeated instances of undercharging of loading and non-collection of additional premium (₹89.29 crore) on account of adverse claim ratio ranging between 181 *per cent* and 398 *per cent* during 2011-12 to 2015-16 in respect of GMPs issued to Kolkata Police were highlighted. Though, NICL discontinued the policy from 2018-19, however, focused action was found lacking in the organisation to streamline the imposition of loading during renewals of GMPs having adverse claim experience, for which NICL is incurring losses over the years.

iv) Avoidable loss due to non-revision of bank tie-up health insurance policies

As per IRDA (Health Insurance) Regulation 2013, all particulars of any product shall, after introduction, be reviewed by the company at least once a year. If the product is found to be financial unviable, or is deficient in any particular aspect, the company may revise the product appropriately.

[32] ***Incurred loss ratio***
[33] ***Projected claim outgo of an expiring policy including claim incurred but not reported (IBNR).***
[34] ***Policy No. 10060046158500000254***

NICL entered into agreements with various leading banks like Bank of Baroda, Bank of India, Nainital Bank, *etc.* and introduced health policies for the account holders and their family members. Premium rates under these policies were fixed for individual account holders and their family members on the basis of sum insured. Loading of 25 *per cent* on premium was, however, applied for the account holders above 65 years of age.

Due to consistent adverse ICR, NICL in the action taken note (May 2014) considered for price correction in all policies including bank tie-ups. Further, in Product Performance Review Meeting, IRDA pointed out (July 2014) that the bank policies were loss making propositions for NICL.

Audit observed that huge loss was incurred by NICL in the tie-up business with banks during the last five years ending 31 March 2019 as detailed below:

Table 5.4.2

(Premium, Incurred Claims and Loss - ₹ in crore/ ICR in percentage)

Year	2014-15	2015-16	2016-17	2017-18	2018-19	Overall
Premium Income (A)	98.83	118.47	130.96	147.28	103.70	**599.24**
Incurred Claims (B)	197.74	246.37	275.40	309.78	397.12	**1426.41**
ICR [(B) / (A) x 100]	200.08	207.96	210.29	210.33	382.95	**238.04**
Loss (C) = (B) - (A)	**98.91**	**127.90**	**144.44**	**162.50**	**293.42**	**827.17**

(The above loss has been computed without considering Management Expenses, Medical Inflation, Commission, etc.)

However, NICL continued the tie-up business for a considerable period without any action for price correction and finally NICL decided (September 2018) to withdraw two tie-up health policies (Baroda Health Policy and Bank of India National Swasthya Bima Policy) with effect from October 2018 citing high incidence of ICR.

Thus, due to non-revision of bank tie-up policies in time and continuing with the same despite having high ICR, NICL sustained loss of ₹827.17 crore during 2014-15 to 2018-19.

Management replied (February 2020) that they were aware of the low rates and losses and therefore discontinued two loss making co-branded health polices with effect from 03 October 2018. NICL had offered alternate products National Parivar Mediclaim Policy (for family) and National Mediclaim Policy (for individual) to the existing customers of both the bank policies and extended continuity benefits to protect the interest of the existing policy holders.

However, the fact remains that due to delay in non-revision/ withdrawal of bank tie-up health policies, NICL had to suffer a loss of ₹827.17 crore.

v) Loss of premium due to imprudent underwriting of policies

Audit observed instances of imprudent practice of underwriting group health polices due to non-adherence to the underwriting guidelines for GMPs as detailed below:

- As per instructions issued (August 2010) by HO, extension of discount for low or young age profile, technical discount, etc. are prohibited.

Test check of 820 policies revealed that in 15 cases (1.8 *per cent*), an amount of ₹7.61 crore was allowed as discount on account of low/ young age profile or as special discount which were not permissible ***(Annexure-XII)***.

- Age of the insured is a vital factor in computing the premium. NICL issued (January 2016) a GMP[35] for covering the risk of the employees and the family members of Kolkata Metropolitan Development Authority (KMDA). Instead of considering the actual age of the insured, NICL calculated the premium considering the average age of 45 years as declared by KMDA. Thus, the consideration of average age of the employee instead of their actual age for computation of premium, resulted in undercharging of premium amounting to ₹0.82 crore.

- Calculation of premium during renewal is computed based on the incurred claim data of expiring policy received from TPA. The process of renewal usually commences 30 days prior to expiry of the policy. In terms of instructions (February 2013) of NICL, the operating offices are required to cross check the information submitted by TPA within 30 days of expiry of the current policy. Thus, consequent to reconciliation of TPA data with actual incurred claim data, if computed premium is found less, the balance premium is to be collected in a given timeline.

  Test check of 820 policies revealed that in 10 cases (1.2 *per cent*) the incurred claim data submitted by TPA before expiry of the policies were not reconciled by the operating offices within the period of 30 days of expiry of the policies, which resulted in under recovery of premium income amounting to ₹21.95 crore ***(Annexure-XIII)***. No action was taken to collect the differential premium.

While accepting the audit observations, Management in their replies assured to adhere to the instructions related to prudent underwriting practice and issued a circular on 21 February 2020 in this regard.

vi) Excess payment of brokerage and commission

Brokerage and commission are paid to the intermediaries like brokers, agents for procuring business for the insurance companies. NICL fixed the percentage of agency commission and brokerage payable under health business. Further, as per IRDA (Payment of Commission or Remuneration or Reward to Insurance Agents and Insurance Intermediaries) Regulations, 2016, no commission or remuneration is payable either to insurance agents or intermediaries in case the policies are procured directly.

Test check of 820 cases in audit revealed that in 10 cases (1.2 *per cent*) NICL procured the business directly from the Government organisations. Notwithstanding this, ₹0.27 crore was paid towards commission or remuneration to the agents in contravention of the guidelines ***(Annexure-XIV)***.

Further, in 14 cases (1.7 *per cent*), excess payment of ₹2.37 crore towards brokerage/ commission was made disregarding NICL guidelines ***(Annexure-XV)***.

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[35] ***Policy No. 103000/46/15/850000170***

Management (March 2020) replied that in their circular dated 21 February 2020, they have instructed in detail about the payment of brokerage/ commission in the light of audit observation. Management also stated that it would ensure that all offices strictly adhere to HO guidelines and instructions.

vii) Control and Monitoring

a) Non-compliance of directives, regulations and guidelines

For controlling and monitoring activities of the insurance companies, Department of Financial Service (DFS), MoF and HO of NICL issued directives, regulations, circulars *etc*. from time to time. Audit observed the following deficiencies in the compliance of the above directives:

- DFS, MoF directed (September 2012) that full details of all the Group Health Insurance Policies (whether standalone or part of the overall insurance portfolio of any company/ corporate with other profitable segments of business) needs to be brought to the notice of the Board of Directors of the Company every quarter without fail and the matter be reviewed periodically.
- The Health Insurance Underwriting Policy (HIUP) 2016 and 2017 of NICL stipulated that there should be an Underwriting Procedural Manual.

Audit observed that the above directions/ stipulations were not adhered to.

Management replied (March 2020) that NICL submitted all the information as and when required by the Board of Directors and there was no recent requirement from the Board to provide policy wise details. Further, NICL issued internal circulars for underwriting of group health policies from time to time.

The reply of Management is not acceptable in view of the fact that non-submission of full details of group health policies on quarterly basis before Board and its non-review tantamount to deficient adherence of Ministry's instructions. Further, in the context of high ICR of GMPs, non-existence of underwriting procedural manual vitiates seamless adherence of good underwriting practices of health policies and instructions of HO by all the operating offices.

b) Non-implementation of Action Plan

Due to consistent adverse performance of health insurance portfolio over the years, an action plan was placed before the Audit Committee (May 2014/ February 2015) highlighting measures for reduction of ICR which include tuning up of underwriting practices through centralised approval at HO, consideration of factors like claim outgo, medical inflation, intermediary and management expenses, monthly review of the performance of ROs with high ICR and adoption of remedial measures, price corrections of all policies including bank tie-up policies *etc.*

Audit noticed deficiencies in implementation of the plan. Instances were noticed of non-revision of prices of products, renewal of policies having high ICR without having approval of HO, short charging of premium which have been highlighted in the preceding paragraphs. The action plans were formulated to bring down the overall loss ratio in health portfolio, however, the benefits as envisaged in the action plan did not fructify.

Management replied (March 2020) that over the years NICL had given considerable attention to the loss-making segment and company level strategies were evolved. All endeavors were made to arrest high ICR and to make the health portfolio sustainable. Loss control measures helped to achieve a progressive decline in net ICR in the group segment from 2016-17 to 2018-19.

The reply of Management is not acceptable as there was consistent adverse performance of group health insurance policies over the years. The ICR still remained 115 *per cent* in 2018-19 which calls for strict adherence to the action plan for achieving the breakeven.

5.4.4 Conclusion

Despite growth in the volume of business of health portfolio, consistent adverse performance has been noticed under the health portfolio over the years. Instances were noticed having issuance of policies without approval of HO, non-revision of prices of its products, short charging of premium, excess payment of brokerage/ commission and non-adherence to the circulars of IRDA and its own laid down norms and guidelines, which indicate deficiencies in the monitoring and control in the organisation.

5.4.5 Recommenations

NICL needs to:

1. ensure compliance of regulatory stipulations in relation to product pricing, underwriting of policies and review the adequacy of pricing of product to achieve break-even in the GMPs;
2. take necessary steps to build health insurance database for improving underwriting of policies;
3. develop a robust system for monitoring of underwriting performance of GMPs by various operating offices of NICL, and
4. review all the cases of GMPs taking into consideration the audit observations and fix the responsibility for lapses, wherever required.

The para was issued to the Ministry in April 2020; their response was awaited (June 2020).

5.5 Avoidable expenditure on rent due to delay in relocation of offices

Despite taking possession of office premises which was purchased in Scope Minar Building, Delhi in July 2016, National Insurance Company Limited failed to relocate its offices till March 2019. Delay in relocation of its offices from rental premises to the purchased premises resulted in avoidable rental outgo of ₹8.53 crore.

In order to minimise higher rental outgo of its offices located in Delhi, National Insurance Company Limited (NICL), acquired (June 2016) office premises, having super built area of 24,576 sq.ft.[36], in Scope Minar Delhi from Tourism Finance Corporation of India Limited at a cost of ₹31.50 crore. The possession was obtained by NICL in July 2016. NICL envisaged relocation of its three offices located in Delhi *viz*., Delhi Regional Office-III (DRO-III), OD Claim Hubs (ODCH) and National Legal Vertical (NLV) at vacant premises in the Scope Minar. It was also decided to shift Delhi Regional Office-I (DRO-I) to the premises of DRO-III (having lesser rent), once vacated. NICL estimated that the above relocation would entail an annual savings of ₹5.87 crore towards rental outgo.

To undertake interior furnishing work at the purchased premises, NICL constituted a Committee in December 2016, after five months of possession. The committee proposed (February 2017) to utilise the services of NBCC (India) Limited (NBCC), as Project Management Consultant to carry out the entire process of interior furnishing. Approval of the Board was accorded in July 2017. A MoU was executed in August 2017 between NICL and NBCC, which provided that the work was to be completed in all respects within a period of six months (including two months for engagement of contractor by NBCC).

In November 2017, it was noticed that area of the vacant space was insufficient to accommodate all the three offices as envisaged in its original plan and accordingly it was decided to shift only two offices, *i.e*. NLV along with DRO-III in December 2017. However, in December 2018, NICL changed the decision and decided to relocate ODCH in place of NLV along with DRO-III. Thus, NBCC had to execute necessary changes due to modification in the relocation plan. NICL finally shifted its offices (i.e. DRO-III and ODCH) to Scope Minar in April 2019.

Audit observed that despite having possession in July 2016, NICL failed to shift their offices from the rented premises to the Scope Minar till March 2019. Audit noticed lack of planning, indecisiveness and delays in decision making, grant of administrative approval, formation of committee to oversee the tasks, firming up of the consultant and subsequent approvals of the Board.

As per the negotiations, NBCC was required to complete the work in all respects within a period of six months. Thus, even on conservative basis, after allowing additional six months to complete the work, NICL should have completed relocation of offices by July 2017 i.e. within one year from obtaining the possession of the purchased premises.

Management in its reply (November 2019) stated that NICL did not have any experience of handling work relating to interior furnishing and agreed that better planning could have been

[36] ***Including 10,800 sq.ft. already occupied by Delhi Regional Office-II of NICL on rental basis***

made in this regard. It further assured that adequate care would be taken in all future exercises.

Thus, lack of planning in relocation of offices and delay in decision making resulted in avoidable payment of rent amounting to ₹8.53 crore[37] for the period from August 2017 to March 2019.

The para was issued to the Ministry in November 2019; their response was awaited (June 2020).

5.6 Failure to collect motor insurance premium from discontinued dealer outlets resulted in loss

Despite having specific provision in the tie up agreement, for daily collection of motor insurance premium from the dealer outlets of Hero Corporate Service Private Limited, National Insurance Company Limited failed to collect the premium in time. This resulted in a loss of ₹16.58 crore which was recoverable from the dealer outlets which had discontinued business dealings with NICL.

National Insurance Company Limited (NICL), in pursuit of business expansion through partnership agreement with automobile manufacturers, executed (January 2004) a Service Level Agreement (agreement) for granting corporate agency to Hero Corporate Service Private Limited (HCSPL) under pan India auto tie-up business. The agreement was entered into initially for three years which was subsequently renewed from time to time.

The agreement, *inter alia*, provided for the following:

- HCSPL was to act as a corporate agent of NICL to promote, sell and distribute insurance policies being marketed by NICL from outlets and/ or such other places as mutually agreed upon.
- In consideration for the business generated by HCSPL, NICL was to pay to HCSPL, commission at such rates as may be mutually agreed from time to time, on monthly basis.
- NICL was to implement appropriate technology so as to issue policy online at HCSPL specified outlets and handover the completed policy to the customer instantly upon receipt of premium and necessary documents.
- NICL was to arrange collection of all the documents and instruments of payments pertaining to the business from specified HCSPL outlets on each working day.

Audit observed that by virtue of the agreement, designated dealer outlets of HCSPL issued insurance policies on behalf of NICL from time to time and collected the policy premium from the customers. However, the premium received by the dealer outlets from the customers, on sale of insurance policies, was not collected by NICL on daily basis as

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[37] ***Annual rental outgo of DRO-III (₹1,61,36,784) + ODCH (₹19,05,000) + ₹3,31,63,216 being the difference in annual rental outgo of DRO-I (₹4,93,00,000) and DRO-III (₹1,61,36,784) for shifting of DRO-I to the vacant premises of DRO-III = ₹5,12,05,000. Rental outgo for 20 months (August 2017 to March 2019) = ₹5,12,05,000/ 12 X 20 = ₹8,53,41,667***

provided in the agreement. Consequently, amount of premium outstanding towards the dealer outlets accumulated to ₹131.94 crore as on March 2019. Audit further observed that the amount of ₹32.95 crore[38] which was outstanding upto March 2018, included ₹17.10 crore, recoverable from the dealer outlets who had discontinued business dealings with NICL. NICL, however, recovered only ₹0.52 crore during the first quarter of 2019-20, leaving an amount of ₹16.58 crore pending for recovery (August 2019).

Lack of internal control is evident from the fact that there was no provision in the agreement for obtaining security deposit/ bank guarantee from the dealers to protect the financial interest of NICL. Audit also noticed that to ensure the realisation of premium, the Board of NICL approved (September 2012) opening of Escrow accounts for collection of advance premium under tie-up business, so as to enable them to issue policies only to the extent of advance payments available in the escrow account. However, NICL initiated action to open Escrow account only in October 2018. The system was not implemented till August 2019.

Management replied (September 2019) that:

- The dealer outlets of HCSPL were spread across the length and breadth of the country and due to lack of infrastructure to implement the system in a foolproof manner, collection of premium could not be ensured.
- Out of ₹17.10 crore receivable as pointed out by Audit, ₹7.64 crore was receivable from dealer outlets which were still working in the tie-up but were not placing business with NICL and that NICL was pursuing for recovery of amount from these dealer outlets.
- An amount of ₹15.16 crore existed in form of cash deposit (₹2.37 crore) and unidentified credits (₹12.79 crore) in respect of those dealer outlets which could be utilised for the purpose of adjusting the amount receivables and that remained unadjusted for want of bifurcation of amounts in pay-in slip and reconciliation respectively. Management further stated that NICL implemented the system of premium payment by the dealer outlets through electronic mode from June 2019 so as to eliminate outstanding receivables from the dealer outlets in future.

Management's reply is not acceptable as the issue of large network of dealers as stated in the reply was already factored in while fixing the periodicity of collection of premium from dealer outlets, *i.e.* on daily basis. Further, claim of Management regarding the amount receivable from dealer outlets which were still working in the tie-up is also not acceptable as the dealer outlets were not patronising NICL in their business dealings and are not placing any business with NICL. With regard to the amount lying in cash deposit and unidentified credits, the reply is not acceptable as NICL is having a total outstanding of ₹131.94 crore from the dealers outlets as on March 2019 and Management has failed to reconcile the amount lying in cash deposit and unidentified credits even after considerable period of time (August 2019).

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[38] ***Since year 2012-13 onwards till March 2018***

Thus, NICL suffered a loss of ₹16.58 crore due to absence of provisions to secure its financial interests in the agreement, non-collection of premium in time and weak internal controls.

The para was issued to the Ministry in November 2019; their response was awaited (June 2020).

The Oriental Insurance Company Limited

5.7 Imprudent underwriting and arrangement of injudicious reinsurance cover leading to loss

The Oriental Insurance Company Limited accepted co-insurance share without having net retention capacity and further availed reinsurance cover on Excess of Loss basis which resulted into a net loss of ₹6.60 crore.

As per Reinsurance (RI) Programme of The Oriental Insurance Company Limited (OICL) for the year 2017-18, after placing obligatory cession of five *per cent*, the maximum net retention capacity for event insurance (sports) was ₹15 crore and beyond this it was required to arrange Facultative Reinsurance[39] arrangement. The Company issued (June 2017) four Policies No.111700/ 48/ 2018/ 238 to 241 to M/s Oppo Mobiles India Private Limited (Oppo) for the period from 7 June 2017 to 6 June 2018 covering the risk of loss of sponsorship revenue due to event cancellation for 51 matches. The total loss limit under these policies was ₹50 crore and after retaining ₹15 crore in net capacity of OICL, remaining ₹35 crore was placed with reinsurance arrangement.

Another insurance company, The New India Assurance Company Limited (NIACL) issued in favour of M/s Star India Private Limited (September 2017) a Special Contingency Policy covering risk of loss of broadcasting revenue due to event cancellation of cricket match series for a period from 29 September 2017 to 28 September 2018 with sum insured of ₹543.52 crore. The policy covered three cricket match series having 23 Matches of T-20/ One Day/ Test to be played in different cities in India between India-Australia, India-New Zealand and India-Sri Lanka. The same matches were already covered under policy issued to Oppo as stated above.

Further, NIACL offered ₹138.68 crore of sum insured with a premium of ₹6.10 crore to OICL under a co-insurance arrangement. Maximum limit of liability under the policy was ₹45 crore per match (OICL share being ₹12 crore @ 26.67 *per cent*) and policy loss limit was ₹150 crore (OICL share being ₹40 crore). Since the net retention capacity of OICL had already been exhausted in June 2017 on issuance of policies to Oppo, it invited quotes for proportionate facultative[40] re-insurance arrangement from General Insurance Corporation (GIC) and JLT broker (i.e. a Private Firm). GIC refused to quote and JLT broker demanded a premium at the rate of six *per cent* of proportionate sum insured to be ceded. Considering the

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[39] ***A reinsurance contract under which the ceding insurer has the option to cede and the reinsurer has the option to accept a specific risk of a specific insured.***

[40] ***A type of Reinsurance Cover wherein claim loss is shared between insurer and reinsurer within predetermined proportion without any initial layer of loss***

rate of premium of 4.4 *per cent*[41] offered by NIACL under co-insurance arrangement, the offer of JLT was not found viable. Therefore, the company approached (September 2017) GIC to provide support on Excess of Loss (XOL)[42] basis for co-insurance share of ₹40 crore. However, GIC agreed to provide cover up to ₹30 crore in excess of ₹10 crore for a premium of ₹2.6 crore. With the approval of the Chairman of the Company, the offer of GIC was accepted. Accordingly, the Company accepted the offer of NIACL and issued (September 2017) a policy no.530000/ 48/ 2018/ 256 in favour of M/s Star India Private Limited for a period from 29 September 2017 to 28 September 2018 at a premium of ₹6.10 crore.

In the instant policy, five claims amounting to ₹10.32 crore (₹10.02 crore paid and ₹0.30 crore outstanding) have been reported and after recovery from GIC against five *per cent* obligatory cession (i.e.₹0.52 crore), net claim was left at ₹9.80 crore (total claim of ₹10.32 crore minus obligatory recoverable of ₹0.52 crore) which was below ₹10 crore. The entire net claim of ₹9.80 crore was borne by the company. As the Company has earned a net premium of ₹3.20 crore[43] after five *per cent* obligatory cession and RI facultative cover on XOL basis, it incurred a net loss of ₹6.60 crore. (Net claim borne by the company of ₹9.80 crore minus ₹3.20 crore being net premium earned).

Audit observed the following:

- By accepting the offer of NIACL, risk against 23 matches was got covered twice as those 23 matches were already covered in the policy issued to M/s Oppo Mobiles Private Limited. Further, the company had underwritten the policy beyond its net retention capacity.
- By reinsuring risk on XOL basis, the Company increased its net retention by ₹10 crore, thereby increasing the exposure of losses. Further all the claims were borne by OICL which could have been shared with reinsurer in case of proportionate facultative cover. It is worth mentioning that the availability of adequate Reinsurance cover is an essential prerequisite for underwriting any risk and if the company does not get a suitable and safeguarding reinsurance cover, it is implicitly prudent not to accept such risks so that the commercial interests of the company could be protected. Thus, in the absence of proportionate facultative cover, the company should not have ventured to underwrite the risk in case of M/s Star India Private Limited on XOL basis.

Management replied (December 2019) that the acceptance of risk was based on merits, prudent underwriting practices and a commercial decision to bring overall growth to the sports portfolio with profitability. Further, the proposal was referred for proportional support from the reinsurers and international reinsurers which considering their own experience were

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[41] ***6.10/138.68*100 = 4.4 per cent***

[42] ***A type of Reinsurance Cover wherein Reinsurer agree to share claim losses incurred beyond a predetermined limit up to a specified maximum last limit e.g. in this case XOL cover of ₹30 crore in excess of ₹10 crore means that Reinsurer will bear claim liability only in excess of ₹10 crore and up to ₹30 crore maximum***

[43] ***Net Premium ₹3.20 crore =Gross Premium of ₹6.10 crore minus ₹0.30 crore ceded to GIC towards 5 per cet obligatory cession minus ₹2.60 crore premium ceded to GIC RI facultative cover on XOL basis***

able to rate it, though they were high as submitted by JLT broker, evidently establishing that proposal is doable and merited in the terms provided by insured. Management further added that its experience under the policy for the year 2016-17 was profitable and as a measure of abundant caution that additional loss beyond ₹10 crore could be protected, excess of loss arrangement was considered.

Management reply is not acceptable as the fact that facultative rates quoted by JLT broker for proportionate cover were high and GIC refused to quote on proportional basis substantiates the audit contention that the risk was higher under the instant case and it was not a prudent business decision to reinsure it through facultative cover on XOL basis. It is also pertinent to mention that it is a case of double insurance viz. coverage of sponsorship as well as broadcasting risks for the same events. It would have been prudent to reinsure the risk on proportional basis so that the commercial interest of the Company could be protected.

Thus underwriting the risk without having net retention capacity and reinsuring the risk on XOL basis was an imprudent decision which caused avoidable net loss of ₹6.60 crore.

The para was issued to the Ministry in January 2020; their response was awaited (June 2020).

SBI Global Factors Limited

5.8 Non-liquidation of factoring facility to a client despite clear signs of incipient sickness leading to non-recovery

SBI Global Factors Limited sanctioned a factoring facility of ₹35 crore to a client and did not take timely action to reduce and liquidate the facility despite early warning signals of stress in the asset, leading to non-recovery of ₹28.37 crore.

SBI Global Factors Limited (Company), sanctioned (March 2014) Domestic Factoring Facility[44] to M/s. Fabtech Projects & Engineers Limited (FPEL) with the maximum Funds in Use (FIU)[45] limit of ₹15 crore. The FIU limit was increased (October 2014) to ₹35 crore for six approved debtors[46], which are companies in the energy sector. The performance of FPEL under the facility deteriorated from August 2015 onwards and the Company reduced the FIU limit to ₹30 crore in September 2017 and ₹25 crore in January 2018. The Company, however, continued the factoring of invoices and the amount of ₹25 crore turned into a Non-Performing Asset (NPA) in the books of the Company as on 31 March 2019. The total amount due from FPEL as of August 2019 was ₹28.37 crore (Principal - ₹25 crore and Interest - ₹3.37 crore). The Company has claimed (October 2019) the amount of ₹28.37 crore in proceedings before National Company Law Tribunal (NCLT) and a decision

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[44] *Domestic Factoring Facility is a financial service whereby the client gets orders from domestic buyers located within India, raises invoices for goods supplied/ works executed, assigns the invoice to the Company and receives prepayment up to 80-90 per cent (or as approved by the appropriate authority) of the invoice value immediately. At the end of the credit period (60 days) offered by the client to the buyer, the Company collects payment for the full value of the invoice from the domestic buyer (referred to as 'debtor')*

[45] *The amount of funds disbursed by the Factor to the Client against bills factored at any point of time is called Funds in Use (FIU)*

[46] *Approved Debtor means any debtor who is indebted in respect of receivables to the Client for supply contract(s)/ Purchase Order(s)*

is awaited. The post-dated cheques obtained by the Company from FPEL bounced (April 2019) and a case in this regard is pending in the High Court of Mumbai.

The compliance audit of SBI Global Factors Limited was conducted during February – March 2019. Audit noticed that the Credit Manual of the Company prescribed 'Early Warning signals' for detecting stressed assets and when such signals appear, the Company was required to put in place a gradual reduction-cum-liquidation plan for the asset. The early warning signals include 'direct payments' (wherein the client first gets payment from the Company by factoring the invoices and later collects payments from the debtors also and eventually pays back the Company through direct payments called 'seller cash'), downgrading of credit rating, delays in payment, adverse remarks in Auditor's report etc. The early warning signals started appearing in this case from August 2015 onwards but the first reduction (by ₹5 crore) in the asset happened only in September 2017 i.e. after more than two years and all along the factoring of invoices continued up to the ceiling amount, as tabled below:

Table 5.8.1

Nature of warning signal (As per extant- Credit Manual)	Earliest date noticed	Invoices factored after this date (till December 2018)		Violation of extant Credit Manual		
		No.	Amount (₹ in crore)	Chapter No.	Para No.	Clause No.
Direct Payments/ Seller Cash	03.08. 2015	656	436.91	6	1	2nd bullet
				12	-	-
Delays in payment						
by 31 to 60 days	15.08. 2016	423	276.25	8	C	a & e
by 61 to 180 days	12.02.2017	326	224.90	8	C	a & e
Forged signatures on invoices submitted by client	11.05.2017	241	166.14	12	1	1
Adverse remarks in Statutory Auditor's Report/ Downgrading of external credit rating of client to 'C Negative'	06.02.2018	112	73.18	12	Table 1	5

Further analysis by Audit revealed that Management failed to reduce and liquidate the asset and there were non-compliances, as discussed below:

- The Conduct Report (July 2016) of the Debt Management Team of the Company on FPEL brought out instances of payments through seller's cash amounting to ₹24.79 crore for the past one year, delay in receipt of payment by 15-25 days for the last six months and non-response on follow up for payment of overdue invoices. However, instead of implementing a reduction cum liquidation plan, the Corporate Credit Committee (CCC) of the Company allowed (December 2016) temporary enhancement in the limit from ₹25 crore to ₹30 crore, for one of the debtors (BPCL) valid till 31 March 2017, citing cash crunch faced by FPEL. The Company, thus unduly favoured FPEL by factoring the additional invoices beyond the limit of ₹25 crore, applicable for the debtor and released ₹3.50 crore by way of funding against invoices and balance amount by way of non-factored cash.

- Earlier also, the Company offered relaxations to FPEL – when the FIU limit was increased from ₹15 crore to ₹35 crore in October 2014, instead of obtaining additional security, the prevalent security was diluted from second charge on fixed assets to residual charge. Also, by the time FPEL executed the Deed of Charge on 21 August 2015 (though it was due by December 2014), the early warning signal of direct payments had started (3 August 2015).

- The Direct Payments/ Sellers Cash during the period from August 2015 to December 2018 in respect of the six debtors is given below:

Table 5.8.2

(₹ in crore)

Name of debtor	Invoices factored		Direct payments		Percentage	
	No.	Amount	No.	Amount	No.	Amount
BPCL	283	193.99	80	66.10	28.27	34.07
Cairn India Limited	1	0.52	0	0.00	0.00	0.00
IOCL	94	45.40	71	35.34	75.53	77.84
NPCL	5	0.99	5	0.99	100.00	100.00
Numaligarh Refinery Limited	42	18.74	15	9.74	35.71	51.97
Oil India Limited	231	177.27	54	66.70	23.38	37.63
Total	**656**	**436.91**	**225**	**178.87**	**34.30**	**40.94**

The high level of direct payments by more than 50 *per cent* in the case of three debtors indicates that the facility was becoming more of a lending business than a factoring facility. This was because the debtors were required to make payment to the Company and in case they fail to do so, the Company can collect payment from the client as a recourse or a fall back option. But the Company had to resort to the recourse option more often than not.

- The client was required to get the invoices certified by the debtors for claiming payment from the Company. One of the debtors (IOCL), informed (May 2017) the Company that the signatures on the invoices were not of their Engineer-in-charge and are forged signatures. The Company responded by terminating the sanctions of the concerned three locations and discontinuing factoring in the IOCL's Debtor Account. The Company neither corresponded with other debtors to ascertain the authenticity of their invoices nor took any penal action against the client, indicating a muted response to a grave transgression by the client.

- The Company allowed concession/ discounts by way of deferment of levies/ charges amounting to ₹2.63 crore[47] to FPEL despite their poor performance under the facility.

- Due cognisance was not given to the early warning signals at the time of annual renewal of the facility and the ceiling amount was retained till Spetember 2017.

- All payments under the facility were required to be routed through an Escrow Account opened for the purpose. The Escrow Agent (State Bank of India, Parent of the

[47] *Discount Charges (₹1.50 crore), Factoring Charges (₹0.80 crore) and Facility Continuation Fee (₹0.33 crore)*

Company) suo motu diverted funds of ₹1.90 crore from the Escrow Account during September to October 2017 to another account of FPEL being maintained by them. The Company took up (November 2017) the matter with the Escrow Agent but the diversion continued and an amount of ₹19.39 crore was diverted from the escrow account during April to December 2018, for reducing the irregularities in the other account of FPEL i.e. for reducing the bad debts of the Parent Bank. Thus, the escrow mechanism also failed to protect the interests of the Company.

- The Executive Committee of the Board of Directors (ECB) in their Meeting (March 2018) had approved for filing of Arbitration, Civil Suit (s), NCLT and any other legal proceedings against FPEL for recovery of outstanding dues to the Company. However, the Company did not initiate any legal action against FPEL and instead continued the factoring of invoices till December 2018. It was also known to the Company that the debtors released the payments for invoices directly to FPEL/ its vendors but FPEL was not making payment to the Company, citing cash crunch. The Company directed (February and March 2019) FPEL to clear its dues through Seller's Cash in a bid to prevent the asset becoming an NPA. Nevertheless, the asset became an NPA with effect from 31 March 2019 and only after the post-dated cheques of FPEL bounced, legal action was initiated by the Company. Thus, too much leverage was given to the client by the Company, disregarding its own interest.

It is evident from the above that the Company failed to insulate its financial resources and is now dependent on legal remedies to recover its dues, the possibility of which appears grim.

Management stated (June, November & December 2019 and June 2020) that they took steps/ initiatives to exit from the account and were able to successfully reduce the FIU limit to ₹24.27 crore in January 2018 from ₹35 crore sanctioned in October 2014. Management added that they planned to implement further downward capping to ₹20 crore, but it did not materialise since FPEL failed to submit plan for reduction due to their working capital constraints. Management contended that had they stopped the factoring of invoices in the early stages, the entire amount of ₹35 crore would have become NPA and added that the main focus of the Company was to recover maximum assets in a gradual way. Management expressed the hope that they would recover the dues through legal remedies which are underway.

The reply is to be viewed against the fact that the Company failed to take affirmative action to exit from the facility when the early warning signals appeared in August 2015. Though eventually the Company could achieve a reduction of ₹10 crore, the bulk of the amount i.e. ₹25 crore along with interest of ₹3.37 crore became NPA in March 2019. The fact that the client was facing liquidity issues was well known and under the circumstances, it was not realistic on the part of the Company to expect that the client would submit the reduction plan. Rather, the FIU ceiling should have been curtailed at least during the annual renewals, if not earlier, leading to liquidation within a definite time frame and adequate and effective collateral securities should have been obtained for the exposure until then.

Thus, despite being aware of the incipient sickness of FPEL right from August 2015 onwards, the delay in taking timely action by the Company in managing the factoring facility led to avoidable litigation and the possibility of recoverability of the dues is also remote as it is an unsecured creditor in the legal process.

The para was issued to the Ministry in November 2019; their response was awaited (June 2020).

United India Insurance Company Limited

5.9 Loss due to less charging of premium

United India Insurance Company Limited (UIICL) did not adhere to the guidelines issued by the Ministry of Finance for pricing and while underwriting the group health insurance policies. Consequently, the Company suffered a loss of ₹112.28 crore due to less charging of premium during 2016-17 to 2018-19.

In view of continued losses suffered by Public Sector General Insurance Companies (PSGICs) in the group health insurance portfolio, Department of Financial Services, Ministry of Finance (MOF), Government of India (GoI) issued guidelines (July-2012/ September 2012) for pricing of health insurance policies. As per the guidelines, the Group Health Insurance Policies (GHIPs) should be appropriately priced, duly considering the burning cost[48], Management Expenses (ME), Medical Inflation (MI) etc. to ensure that the Combined Ratio (CR)[49] should be less than 95 *per cent* of the premium charged. Policies not conforming to this ratio should not be renewed. It was also emphatically laid down in the aforesaid guidelines (July 2012/ September 2012) that no discount would be given in the Standalone GHIPs where the CR was more than 100 *per cent* and these guidelines were mandatory and no discretion in this regard was available to the PSGICs.

The MoF, GoI, citing the reference to the violations of aforesaid directions, reiterated (June 2017) and stressed the need for strict observance to the aforementioned directions in order to appropriately price the GHIPs and to avoid uneconomical and unviable discounts causing unnecessary strain on financial health of the PSGICs.

In pursuance of the aforesaid guidelines (July 2012/ September 2012) of the MoF, the Corporate Office of the United India Insurance Company Limited (UIICL) had also issued a Circular on 24 July 2012 (subsequently modified on 26 October 2012) for underwriting of the Health Insurance Policies which stipulates that the pricing of “Standalone” GHIPs should be such that the combined ratio i.e. the expected claim outgo, the acquisition cost, the TPA charges and Management expenses to the premium is below 95 *per cent*.

Audit reviewed Standalone GHIPs having premium of ₹50 lakh and above underwritten or renewed by Delhi Regional Office (DRO)-I, Delhi Regional Office (DRO)-II, and Large Corporate Branch Office (LCBO), New Delhi of the UIICL pertaining to the period from 2016-17 to 2018-19.

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48 *Estimated cost of claims in the forthcoming insurance period calculated from previous years' experience adjusted for change in the numbers insured, the nature of cover and medical inflation*

49 *The Combined Ratio (CR) is the sum of annualised claim outgo (i.e. incurred claim) adjusted with proposed number of lives, TPA charges, commission/ brokerage, medical inflation and management expenses divided by the premium charged in the previous year*

Audit observed that in case of 61 GHIPs, where claim ratio incurred was higher than 100 *per cent* ***(Annexure-XVI)***, premium was not worked out to ensure that the CR was within 95 *per cent*. The Company considered only the previous year's annualised claim outgo, adjusted with the proposed numbers of lives to be covered, TPA charges and brokerage but did not consider ME and MI which stood at 4.57 *per cent* (2016-17), 4.37 *per cent* (2017-18) and 7.14 *per cent* (2018-19) as per the consumer price index reports of the Ministry of Statistics and Programme Implementation (MOSPI), GoI.

While arriving at appropriate pricing of the GHIPs proposals, audit has considered all the pricing factors as per the aforesaid guidelines of the MoF and the UIICL except ME in the absence of any benchmark and compared with the actual premium collected for the GHIPs under audit review. The minimum premium thus worked out by Audit comes to ₹527.80 crore in respect of total 61 GHIPs ***(Annexure-XVII)*** considering the annualised claim outgo adjusted with the proposed lives, TPA charges, Brokerage/ Commission and MI[50] only without considering ME (as there was no benchmark available). Against this, the DRO-I, DRO-II and LCBO of UIICL charged premium of ₹415.52 crore only by violating the specific guidelines of the MoF/ UIICL, which led to loss of the revenue due to less charging of premium of ₹112.28 crore.

Management replied (December 2019) that premium cannot be charged based on a fixed rate/ formula and various factors including the market conditions and other premiums from the same source have to be taken into account. That audit has not taken into reckoning such factors in arriving at the 'Minimum premium to be charged' and hence the perceived loss of premium of ₹112.28 crore reported is not real. The premium has been charged in accordance with the company's health underwriting policy which has been framed taking into account all factors including the guidelines of the MoF. Further, out of the 61 accounts cited by audit only 24 are currently on their books and remaining 37 have not been renewed.

Management's reply that premium cannot be charged based on a fixed rate/ formula is not acceptable as the Guidelines issued (July 2012/ September 2012) by the MoF for pricing of health insurance policies provide for the underwriting methodology and stipulates that such guidelines are mandatory and no discretion is available to the company. Moreover, management's reply that the premium has been charged in accordance with the company's health underwriting policy which was framed taking into account the guidelines of the MoF, is also not acceptable as the company charged the premium in violation of its own health underwriting policy in all 61 GHIPs as pointed out by the audit. In fact, the figure of loss would have been higher if ME were also factored in. Further, management's reply that other premium from the same sources have to be taken into account while underwriting the GHIPs, is also not acceptable as the cases pointed out by audit are standalone cases wherein premium for health segment only, was collected by the company. Management's submission that out of 61 cases as pointed by audit, 37 accounts have not been renewed by the company, is in line with and validates the audit contention.

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[50] ***As per the consumer price index report of the Ministry of Statistics and Programme Implementation (MOSPI), Government of India***

The para was issued to the Ministry in January 2020; their response was awaited (June 2020).

IFCI Factors Limited

5.10 Factoring and Loan Services by IFCI Factors Limited

5.10.1 Introduction

IFCI Factors Limited (IFL) is registered as a NBFC-Factor with Reserve Bank of India (RBI) and is primarily engaged in the business of factoring[51] and short-term corporate loans. It is a subsidiary of IFCI Limited.

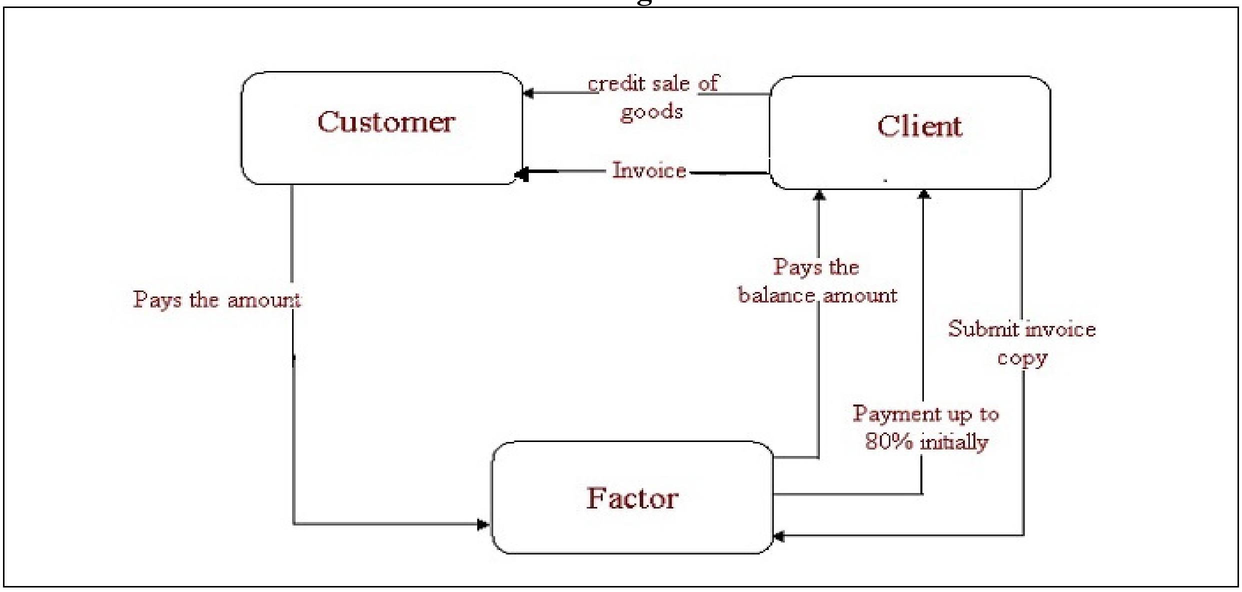
Factoring is a continuing financing arrangement where a business concern (client) assigns its accounts receivable (debtor) to a third party called a "Factor" at an agreed discount rate and factoring/ service fee, which provides immediate liquidity to finance the operations of the business concern. An entity requiring working capital finance in relation to a transaction involving receivables may avail of factoring.

There are generally three parties involved in a factoring arrangement: -

- the client, who is originally entitled to the accounts receivables and requires immediate working capital;
- the debtor, who is obliged towards such accounts receivable to the client; and
- the factor, who agrees to liquidate the accounts receivable towards the client.

Chart No.5.10.1

Factoring Mechanism



[51] *As per Factoring Regulation Act, 2011, Factoring Business is defined as "the business of acquisition of receivables of assignor by accepting assignment of such receivables or financing, whether by way of making loans or advances or in any other manner against the security interest over any receivables"*

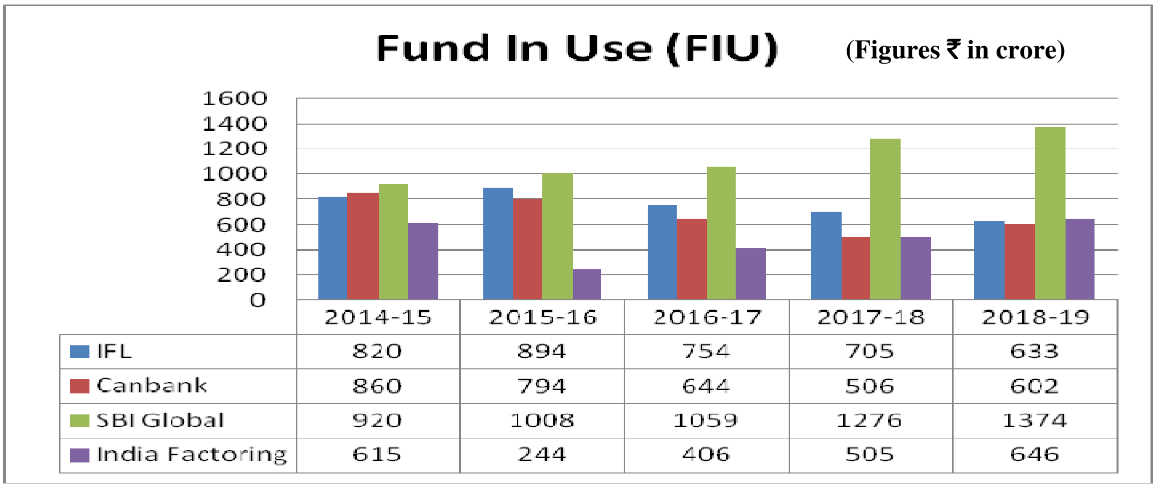
5.10.2 Financial Performance of the Company vis-à-vis other factoring companies in India

Fund in Use

Fund in Use (FIU) is the amount of facility utilised by the client, out of the total sanctioned limit. It includes both principal and interest. In the IT system[52] of the Company, the interest is charged at the end of the month (like banks).

Audit selected two Government owned/ controlled entities viz. SBI Global Factors Ltd and CanBank Factors Limited and one private entity viz India Factoring and Finance Solution Private Limited for comparison of performance of IFL and comparative position of FIU in these companies is shown in Chart given below:

Chart No.5.10.2



	2014-15	2015-16	2016-17	2017-18	2018-19
IFL	820	894	754	705	633
Canbank	860	794	644	506	602
SBI Global	920	1008	1059	1276	1374
India Factoring	615	244	406	505	646

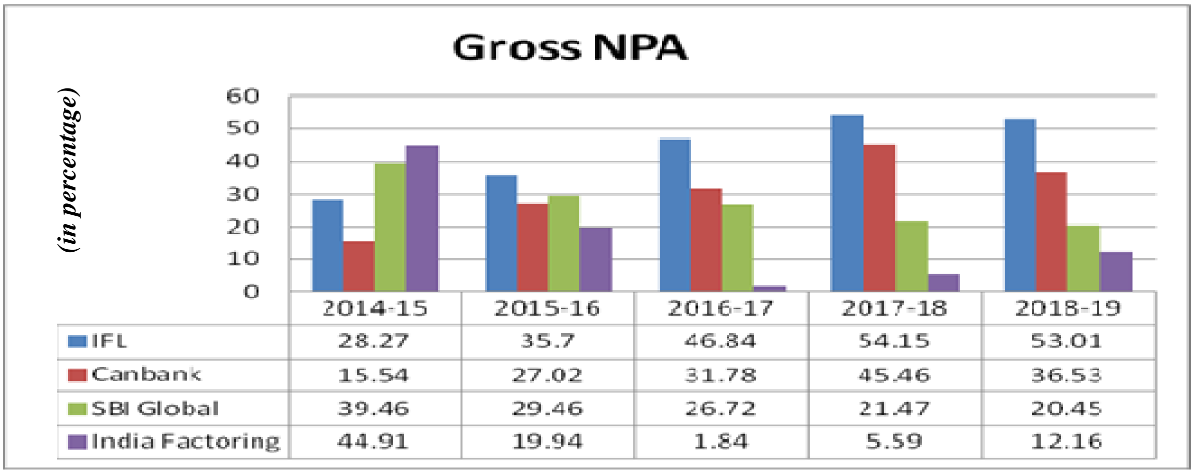
Source of data: Annual reports of respective companies

FIU of the Company decreased over the last three years ending 2018-19. FIU of CanBank has also decreased during the period from 2014-15 to 2017-18 but increased in 2018-19, whereas FIU of SBI Global has increased during last five years ending 2018-19. FIU of India Factoring (private company) decreased in 2015-16 but has increased during the last three years ending 2018-19.

It was observed that the asset quality of the Company has deteriorated over last five years as the gross NPA ratio has increased continuously for four years with slight decrease in 2018-19. Similarly, in case of CanBank the gross NPA ratio has increased continuously for four years with decrease in 2018-19. However, the gross NPA ratio of SBI Global has continuously declined during the last five years ending 2018-19. In India Factoring the gross NPA ratio has declined during the period from 2014-15 to 2016-17 but has increased in 2017-18 and 2018-19 as shown in the Chart given below:

[52] *Named IFL Trade Free System*

Chart No.5.10.3



5.10.3 Audit scope, objectives and criteria

Audit inspected records at the Head Office/ Corporate Office of the Company (Delhi) and two regional Marketing offices (Chennai and Kolkata) for the period of five years i.e. 2014-15 to 2018-19 wherein cases of sanctions and disbursements of Factoring and Loans services, the Non Performing Asset (NPA) and written off cases were scrutinised with the following audit objectives to:

- examine compliance with the annual credit policy and business plan of the Company,
- review the credit appraisal mechanism and examine whether due diligence has been exercised in sanction and disbursement of loans, and
- examine the efficiency of credit monitoring mechanism.

The audit criteria included Business Plan of the Company, Credit Policy of the Company, Field Audit Survey Reports, internal Risk Rating Model of the Company, agreements entered into with the client and RBI prudential norms for provisioning in respect of NBFCs.

5.10.4 Sampling Method

Audit reviewed the cases of sanctions and disbursements of factoring and loan services approved during 2014-15 to 2018-19, written off cases during 2014-15 to 2018-19 and the NPA cases (as on 31 March 2019). The sample selection has been done on the basis of stratified random sampling as under:

Table 5.10.1

Particulars	Total Population	Sample Selected
Sanction & Disbursements	49	26(53 *per cent*)
NPA Cases	44	23(52 *per cent*)
Write Off Cases	21	11 (52 *per cent*)
Total	**114**	**60[53]**

[53] *Out of total 60 cases, nine NPA/ write off cases were declared NPA prior to April 2014 and are not included in the Report*

5.10.5 Compliance with the annual Credit Policy and business plan of the Company

5.10.5.1 Business plan

The Company prepares an annual business plan specifying the targets for sanctions, disbursement, recovery etc. for the ensuing year, which is then approved by the Board of Directors. The plan also describes the actual performance of the Company against the targets set for the previous year and discusses the variances and reasons thereof.

5.10.5.2 Targets and Achievements

The targets and achievements of the Company during the last five years with regard to FIU and recovery are given as under:

Table 5.10.2

(₹ in crore)

Particulars	2014-15	2015-16	2016-17	2017-18	2018-19
Target and Achievement for FIU					
Target	850	1150	1000	1100	865
Achievement	820	893.76	754.93	705.41	632.95
Shortfall	(-) 30	(-) 256.24	(-) 245.07	(-) 394.59	(-) 232.05
Variation in *per cent*	-3.53	-22.28	-24.50	-35.87	-26.83
Recovery target and achievement thereof					
Target	25	62	30	32	50
Achievement	11.01	58.57	27	41.25	39.11
Shortfall	-13.99	-3.43	-3	9.25	-10.89
Variation in *per cent*	-55.96	-5.53	-10	28.90	-21.78

As can be seen from the above, the Company could not achieve the targets fixed for FIU during the period 2014-15 to 2018-19. In 2014-15, the shortfall was 3.53 *per cent*, which further increased from 22.28 *per cent* to 35.87 *per cent* during 2015-16 to 2017-18 and decreased to 26.83 *per cent* in 2018-19. Similarly, the Company also could not achieve the recovery targets during 2014-15, 2015-16, 2016-17 and 2018-19. The target fixed for the year 2017-18 was achieved by the company, however, it was seen that targets of recovery were lower in 2016-17, 2017-18 and 2018-19 as compared to 2015-16 despite NPA being higher[54].

5.10.6 Audit findings

5.10.6.1 Compliance with the annual Credit Policy of the Company

Board of Directors of the Company approves the credit policy for each year based on which the facility is sanctioned to the borrowers. Before sanctioning of facility, proposal is reviewed by the credit team and the same is put up to the competent authority for approval. All the

[54] ***NPAs during 2014-15 to 2018-19 were ₹219.25 crore, ₹319.08 crore, ₹353.59 crore, ₹381.96 crore and ₹335.51 crore respectively***

cases upto ₹5 crore would be considered for approval by the Credit Committee[55] (CC) and exceeding ₹5 crore would be put forth to Committee of Directors[56] (CoD), duly recommended by the CC. CC is also empowered to approve modifications in proposals sanctioned by CoD except for modifications relating to pricing and security (Credit Policy 2018-19).

Audit reviewed 26 out of 49 cases of sanctioning and disbursement approved during 2014-15 to 2018-19. Out of 26 approved cases, 20 proposals ***(Annexure XVIII)*** i.e 77 *per cent* of proposals were approved with one to seven deviations and in 10 cases monitoring as per credit policy was not adhered to. Although the competent authority (Managing Director/ CC/ CoD/ BoD) is empowered to approve the deviation but it should be approved in exceptional circumstances. Further, the credit policy is silent regarding number of deviations and degree of deviation, which can be approved by the competent authority. Four[57] cases out of 26 cases selected for review turned into NPA.

5.10.6.2 Sanction of corporate loan to an ineligible client

As per the credit policy credit risk rating should be done before the proposal is placed before CC/ COD. The Company assigns the final risk score on the basis of a model provided (December 2014) by ICRA Management Consulting Services Limited (IMaCS) for the various factoring loans such as domestic sales bill factoring (DSBF)[58], export bill factoring (EBF), reverse factoring[59] (RF) and Advance against Future Receivables (AFR)[60]. The same model was used for credit rating for providing corporate loans also. IFL uses the AFR option to arrive at the final rating in case of sanction of corporate loans. The minimum final risk grade for a credit proposal to be eligible for sanction is stipulated as IFL5 which signifies moderate safety. In case of internal risk rating for AFR facility, the client rating is calculated and then the notch up/ upgrade based on comfort for security is given to arrive at final account rating. At the time of introduction (December 2014) of this rating model provision of security was not a necessary eligibility criteria for sanction of AFR facility. However from the year 2015-16 onwards, provision of security was made a necessary eligibility criteria for

55 ***The Credit Committee (CC) consists of Managing Director (MD), Heads of Marketing/ Operations/ Risk/ Credit departments and one nominee of IFCI Limited. The MD is the head of CC***

56 ***The Committee of Directors (CoD) consists of four members of the Board of Directors of IFL including MD. The Chairman of the Committee would be any Board member present in the meeting other than MD***

57 ***VNR Infrastrucuture Limited, Trend Flooring Private Limited, GHV India Private Limited and Navrang Roadlines Private Limited***

58 ***This is a credit facility whereby the client invoices the goods to a domestic buyer located within India, assigns the invoice to Company and receives prepayment up to 80-90 per cent (or as approved by appropriate authority) of the invoice value immediately. The DSBF is offered either as disclosed or as silent/ non disclosed facility***

59 ***This is a credit facility provided to the client wherein the purchases of raw materials etc. made by the client are financed by IFL thereby facilitating payment directly to the suppliers for purchases made locally. This facility is intended only for top rated clients and backed by tangible collaterals and generally not extended on a standalone basis i.e. generally accompanied with sale bill factoring facility***

60 ***Credit facility/ Advance extended to a client repayable in monthly/ quarterly installments through cash flows emanating from identifiable future receivables of the client backed by Notice of Assignment or Debtor's confirmation to pay to the designated escrow account or under silent factoring***

sanction of AFR facility. In case of sanction of corporate loan, provision of security has always been a necessary eligibility criteria since its introduction (July 2010) as a credit product. In essence, Company necessarily obtained collateral security for sanction of corporate loans.

Audit observed that while sanctioning the loan in eight cases ***(Annexure XIX)*** the Company unduly upgraded/ notched up the rating of the clients by two points (from IFL7 signifying 'inadequate safety' to IFL 5 signifying 'moderate safety' in seven cases and from IFL 8 signifying 'risk prone' to IFL 6 signifying 'inadequate safety' in one case). This notching up/ upgradation was done on the basis of comfort of security (collateral security mortgaged) despite collateral security for an amount of at least twice the amount of loan, based on distress sale value of the property being basic and essential eligibility criteria for sanction of Corporate Loans. Even the credit policy of the Company did not provide for sanction of Corporate Loan without obtaining adequate security cover. Thus notch up/ upgrade based on comfort of collateral security in the process of sanction of corporate loan was improper as it was neither in line with the provisions of credit policy nor the risk rating model.

Management replied (December 2019) that the Risk Model will be revisited and updated with the help of IMaCS to validate the products of corporate loan and advance against Future Receivables along with the factoring. Further, the rating model primarily caters to factoring facilities, where security is not mandatory. Notching up of rating in case of security is a provision in the risk model, be it Domestic Factoring, AFR or Corporate Loan.

Management further stated (January 2020) that risk rating model was developed for capturing various structures with primary focus on DSBF. In case of AFR and corporate loan, provision of notching up was understood and agreed upon during the development of the model. It may be noted that notching up happens based on strength of security (in case of AFR and CL/ TL) as such provision has been allowed in the system. Sanction with deviations is a part of commercial decision making. A client fulfilling all the eligibility criteria is an ideal situation. But, considering the cost of fund of IFL, it has to make a trade-off between an ideal client and a doable client with appropriate risk mitigation measures. In this process, some of the decisions go wrong, sometimes because of wrong judgment and sometimes because of the external environment for a particular industry/ economy.

Management accepted to revisit and update with the help of IMaCS to validate on the products of Corporate Loan. Reply of Management regarding upgrading of rating needs to be viewed in light of the fact that as per the credit policy from 2015-16 onwards submission of security was a basic and necessary eligibility criteria for sanction of AFR and therefore upgrading the rating considering the security offered was not in line with credit policy. Further, sanctioning of loan deviating the eligibility criteria may be the conscious business decision without compromising the financial interest of the Company but determining the credit rating should be as per the credit policy of the Company and therefore upgrading the rating considering security offered was not justified.

A review of the 26 sample cases revealed that the criteria for sanctioning of credit facility were deviated/ relaxed and not timely monitored. Few illustrative cases of major relaxations/ deviations from eligibility criteria, poor monitoring and operation are discussed below:

(i) M/s VNR Infrastructures Limited (VNRIL)

The Company sanctioned (December 2014) a corporate loan of ₹18 crore to M/s VNR Infrastructures Limited (VNRIL- the client) which was secured by equitable mortgage of two parcels of land in Telangana and performance guarantee (PG) of two promoters/ director. The loan was repayable in eight equal quarterly instalments (30 April 2016 to 31 January 2018). The client paid the interest only for the period from January 2015 to August 2015 and defaulted in repayment of all the principal instalments. The account was classified as NPA in March 2016. The total outstanding as on 31 March 2019 was ₹33.85 crore (principal outstanding of ₹18 crore and interest of ₹15.85 crore). Complaint has been filed by Company u/s 138 to 141 of Negotiable Instruments Act (February 2016). Proceedings for liquidation of client was going on in NCLT, Hyderabad and claim of the Company was admitted before liquidator provisionally (November 2017). IFCI, the parent Company, has lodged a complaint against client before CBI, Banglore including claim of the Company.

Audit observed that the credit rating of the client was CARE A3[61] which was lower than the stipulated credit rating of CRISIL P2[62]. As per the credit policy, the minimum final risk grade for a proposal to be eligible for sanction is stipulated as IFL5 (moderate safety). In the instant case the client rating was LC07 (it is same as IFL 7 and indicates inadequate safety) which was unduly upgraded by two rating grades to IFL5 (moderate safety) based on comfort of collateral security mortgaged despite the fact that requirement of mortgage of property providing security cover of two times was one of the basic and necessary eligibility criteria for a proposal to be eligible for corporate loan.

As per the initial valuation report (January 2015) the Fair Market Value (FMV) of the two collateral properties was ₹52.92 crore (₹33.77 crore and ₹19.15 crore respectively) which was arrived at by considering the per sq yard value of ₹2,750 and ₹2,500 respectively. The Distressed Sale Value (DSV) was considered as ₹38.23 crore. This valuation was accepted by the Company despite the fact that the Government value of land of these properties was ₹300 per sq yard only. Accordingly, the total value of mortgaged property considering the Government rate was ₹5.97 crore as against the accepted DSV of ₹38.23 crore.

In view of default, the Company initiated (August 2016) action under the Securitisation and Reconstruction of Financial Assests and Enforcement of Security Interest (SARFAESI) Act, 2002. A fresh valuation (March 2017) was carried out by the company and FMV was assessed as ₹21.08 crore and the DSV was assessed as ₹18.02 crore. Thus, the fresh valuation was 60.16 *per cent* and 52.86 *per cent* lower than the valuation at the time of sanction respectively. In order to recover the outstanding dues both the properties were put

61 Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligations

62 Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligations. Such instruments carry low credit risk

up for sale twice in October 2017 and March 2019. However, the auction for the mortgaged property was not successful despite reduction in the reserve price and thus Company could not manage to recover its outstanding dues amounting to ₹33.85 crore.

Management replied (December 2019) that the long-term debt rating of the client at the time of sanction was 'BBB+', which is investment grade. The rating notch up is given for tangible security in case of AFR and in a similar way notch up for tangible security is given for Corporate Loans.

Management further stated (January 2020) that the stipulated rating as per the prevailing credit policy was CRISIL equivalent minimum BBB and P3 (short term). Accordingly, there was no deviation as long term/ short term rating of the client was 'BBB^{+}/ $A3^{+}$'. The rating model of IFL is conservative as prudence demands that, and therefore it is a normal phenomenon of rating upgrade with the consideration of collateral in many other similar sanctions. IFL fully depends on valuers' report as it has no expertise to carry out valuation and the entire valuation exercise was carried out by APITCO (IFCI empaneled valuer). IFL had taken up the matter of value climb-down with M/s APITCO in a very stringent manner and IFCI Limited has blacklisted and de-empaneled it. IFL is still upbeat of getting a favorable response in the near future with some uptake in market sentiment in the real estate sector for recovery through SARFAESI. Also, there is a government initiated project, wherein land parcel is being acquired covering one of our mortgaged land also, which is underway.

The reply of Management is not acceptable as the minimum short-term credit rating of P2 was stipulated in the credit policy (2014-15) and not P3 as claimed by Company. The notch up on the basis of tangible security for sanction of corporate loan was improper because the credit policy clearly mentioned that tangible security is a pre-requisite for a proposal to be eligible for sanction of corporate loan. The Company should have deliberated on the huge difference between Government rate of land and that considered by the valuer and given proper justification for accepting the higher rate suggested by the valuer at the time of credit appraisal.

(ii) M/s Trend Flooring Private Limited

The Company sanctioned (December 2017) Domestic Sales Bill Factoring (DSBF) facility of ₹1 crore to a trader viz M/s Trend Flooring Private Limited, (client) on the security of receivables, Notice of Assignment (NOA) accepted by its debtor viz. Vasisht Agencies Pvt Limited (debtor) and PG of two directors. The Company appraised (Dec. 2017) and assessed the various criteria (minimum net worth, net sales, profit making for last two years, credit rating etc.) stipulated in the credit policy for the debtor based on financial statements of the debtor for the year 2014-15. The debtor did not fulfil the eligibility criteria as its networth was ₹1.82 crore and net revenue was ₹6 crore against the required net worth of ₹2 crore and revenue of ₹25 crore as per the credit policy of the Company. Further, the debtor was also a trader and unrated against the requirement of CRISIL equivalent investment credit rating of minimum BBB and short-term rating of minimum A2. The prepayment limit of the client was capped at ₹0.50 crore. The client made partial payment till December 2018 with delay.

IFL reassigned[63] (December 2018) the overdue invoices by accepting the general reasons (GST related issue and other industry related reasons) given by client for non-payment against overdue invoices. Despite reassignment the outstanding amount was not received and the account was finally classified as NPA on 30 June 2019. As on 31 March 2019, the outstanding dues were ₹48.08 lakh (Principal ₹45.55 lakh and interest ₹2.53 lakh).

Audit observed that instead of insisting for the latest financial statements for last two years i.e. 2015-16 and 2016-17, the credit appraisal was made on the basis of Financials of 2014-15. Further, tangible security required to be taken in case of an unrated debtor as per the credit policy was not obtained. The facility was sanctioned/ disbursed despite several adverse remarks[64] in the Field Survey Report (FSR) (1 November 2017) of the client. In the FSR, the debtor was assigned rating score of 4 and it was categorically stated to reject debtors where the score is above 3. The Company ignored the concerns raised by its risk department pertaining to client's significant dependency on sales to the debtor (being 57.7 *per cent* of total sales) indicating high concentration risk and client's low Debt Service Coverage Ratio (DSCR) of 0.75. Also, Company did not obtain debtor's latest audited financials (FY 2015-16 and 2016-17) and status of filing of same with Registrar of Companies (ROC) before disbursement as strictly advised by its risk department. Reassignment of invoices was intended towards ever greening of the sales ledger/ financial statements to avoid the classification of account as NPA.

Management replied (December 2019) that the financials for 2014-15 were available on the Ministry of Corporate Affairs (MCA) website, so the available financials were considered for analysis. All the deviations including the debtor being an unrated one were approved by the CC. The invoices were reassigned as balance payment was expected in coming days and the facility was allowed against new set of invoices due to health issues of the promoter. Management further stated (7 January 2020) that the deviations are allowed and mentioned in the Credit Policy itself. The facility was sanctioned looking at the long business association between the client and the debtor and the strength of the transaction being backed by debtor's Post-dated Cheques (PDCs). The assigned score of 4 to debtor Vashisht Agencies Private Limited as mentioned in the FSR is a reflection of the deviation from the standard practices but does not mean negative about the client debtor relationship. The lesser score of 4 as against acceptable score of 3 was due to the reason of the specific trade between client and debtor. Things went in the wrong direction only when health of the promoter deteriorated, which ended with his disability post brain haemorrhage.

Management reply needs to be viewed against the fact that the credit policy states that *"to assess the bankability of the proposal, the credit proposal should conform to credit policy guidelines. The proposal which does not fulfil the criteria would be summarily rejected*

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[63] ***When payment against factored invoices is not received from the client/ debtor, the client offers new/ fresh set of invoices against the old invoices already factored. This does not lead to fresh factoring but alters the due date of payment of old invoices and is known as Reassignment of invoices***

[64] ***No fixed credit terms between client and debtor, the aging of debtors as provided by the client did not match with the ledger balance of the buyer and there was huge deviation as per aging and ledger balance.No purchase order, invoice copy, detailed trial balance, top suppliers ledger and related details were provided to the surveyor***

giving specific reasons". In the meeting of the Board of Directors of IFL (30 April 2015), it was categorically stated that Company has learned from its past experience that major problems have been experienced in case of factoring facilities sanctioned to purely trading Companies. Despite this learning, the facility was sanctioned though the client and debtor were both trading Companies. The financials of the debtor for the last two years should have been insisted for at the time of credit appraisal to ascertain current financial health of the debtor, who was to make payments to the Company. Obtaining PDCs from the debtor was not a valid and safe recourse in view of the policy, which stipulated taking tangible security where debtors are unrated. The Field Survey was done by an empaneled external agency who categorically stated to reject the debtor, which was finally approved. The reassignment was improper as it was done after a gap of almost five months from the due date of payment without assigning any specific reasons for the same.

5.10.6.3 Examination of efficiency of credit monitoring mechanism

Credit policy of the company approved by the Board envisages a broad procedure for monitoring of credit portfolio which includes aggressive use of field audits, random verification of invoice and debtors account balance through periodic interaction with debtors, unscheduled/ scheduled visit to clients as well as to the debtors (at least once in a year) and visit to the client to be made at least once in every half year in case of sanction limits of ₹10 crore and above, periodical verification of Notice of Assignment/ Escrow acceptance letter (at least once in a half year) etc.

Audit reviewed 25 cases (17 NPA and 8 write off cases) and observed non- compliance of credit policy in 21 cases **(*Annexure-XX*)** with respect to sanctioning and monitoring of the facility which led to account turning into NPA/ write off. Some issues observed by Audit are discussed in detail below:

(i) Debit note funding

The IT system put in place by the Company for disbursement of funds against the invoices received from the client allows disbursement of funds till the invoices do not go into recourse[65] (30 days after due date of payment) and/ or the client has not availed the full prepayment limit sanctioned. When the invoices already factored become recoursed or the client utilises full prepayment limit, no further factoring/ disbursement against invoices can be done through the IT system without special approval of MD.

Audit observed that the Company continued to fund the clients despite invoices being in recourse, by way of debit note funding with the approval of the Competent Authority (MD). In this practice of debit note funding, the client first makes partial payment to the Company against overdue invoices and also submits fresh invoices for further funding. This payment received from client is returned to the client in a short period (0 days to 6 days) after deduction of a certain percentage from the amount received from the client. This practice

[65] ***In a DSBF facility if payment of an invoice is not received within prescribed period (due date plus 30 days) from debtors the further recovery action shifts on client instead of debtor and invoice is said to have gone into recourse***

leads to knocking off/ settling of the old overdue/ recoursed invoices and allows funding against the new invoices received. Thus, this practice leads to rotation of money between client and the Company and in essence delays the classification of an account as NPA thereby ever greening the accounts. The Company generally takes legal action after the account is declared as NPA. Since NPA recognition is delayed it leads to delay in initiation of legal action. During audit it was noticed that IFL resorted to funding through operation of debit note in 13 cases (***Annexure XXI***).

(ii) Non-compliance with RBI Guidelines on NPA classification

As per the RBI guidelines for an NBFC-Factor, a receivable acquired under factoring which is not paid within six months of due date as applicable, shall be treated as NPA. Further RBI circular stipulates that *"In respect of accounts where there are potential threats to recovery on account of erosion in the value of security and existence of other factors, such as frauds committed by borrowers, such accounts should be straight away classified as doubtful asset or loss asset, as appropriate, irrespective of the period for which it has remained as NPA".*

Audit observed that the Company did not classify the account as NPA in 16 cases (***Annexure XXII***) where the overdue were more than six months. Further, Account of M/s Navrang Roadlines Private Limited was not declared NPA even after it was established (July 2019) that a fraud had been committed by the client.

Management replied that it follows the practice of recognising an account as NPA at the end of accounting period (quarterly). However, as per advice of RBI, Company is now classifying an account as NPA on the date when it crosses 180 days, but if the same is regularised before the closure of books, the account would be treated as standard asset.

The reply of management is not acceptable as the RBI Master Directions (September 2016 as updated from time to time) for an NBFC-Factor, clearly states that a receivable acquired under factoring which is not paid within six months of due date as applicable, shall be treated as NPA; and once an account is declared as NPA, it can be treated standard only after a period of one year from the commencement of the first payment of interest or principal, whichever is later.

5.10.6.4 Fraud cases resulting in loss/ doubtful recovery

Out of 51 sample cases (after excluding nine cases where facility was declared NPA before March 2014), in four cases company reported a fraud committed by the client/ debtors whereby company had to incur a loss (doubtful recovery) of ₹50.33[66] crore. The major lapses on part of the company which resulted in fraud are: -

- Sanctioning the credit facility to the client who did not meet the eligibility criteria as laid down in the credit policy for the client and the debtors.
- Lack of due diligence at the time of sanctioning and addition of new debtor.

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[66] ***(i) M/s Navrang Roadlines Private Limited- ₹9.11 (ii) M/s Leeway Logistics ltd – ₹21.61 crore (iii) M/s Kalyani Engineering Works–₹6.73 crore and (iv) M/s Accurate Transformers Limited-₹12.88 crore***

- Non-monitoring of the account as per the procedure laid down in the credit policy.
- Delay in declaration of the account as NPA by reassignment of invoices and debit note funding.
- Non-compliance with the terms of sanction as per sanction letter, disbursement condition and waiver of crucial pre-disbursement condition.

Three cases where major shortcomings were noticed on the part of management allowing the clients to commit fraud are discussed below and one such case is included in ***Annexure XXIII.***

(i) M/s Leeway Logistics Limited

The Company sanctioned (January 2011) DSBF facility to Leeway Logistics Limited (LLL-the client) of ₹5 crore, which was enhanced (May 2013) upto ₹18 crore in relaxation to the eligibility criteria. The Total Outstanding Liabilities/ Total Net Worth (TOL/ TNW) ratio was 9.33:1 instead of maximum TOL/ TNW ratio of 6:1, and existence of the client was only one year instead of required minimum three years and profit making for last two years. As per sanction letters, notice of assignment of debt (NOA), duly accepted by approved debtors was submitted by LLL wherein it was agreed that debtors were required to make all payments against the invoice raised by LLL in favor of the Company. The conduct of account initially remained satisfactory. However, when the factored invoice remained unpaid beyond the stipulated credit period and the account became NPA in September 2016, the client and the debtors were approached several times for payment of the outstanding amount, but no payment was received. Company took legal action against client and debtors by filing a case with Delhi Police under Negotiable Instruments Act and invoking arbitration clause.

When the Company approached the debtors for payment of outstanding dues, all the debtors alleged that the outstanding invoices were fake, forged and fabricated. One of the debtors *i.e.* M/s Berger Paints India Limited replied that all the outstanding invoices demanded have never been raised on them, the stamps and signature used in invoices had never been used by them, billing address shown in bill was the office which had been closed in 2012. Further, the LLL has changed its corporate office address on 30 December 2013 but the address mentioned in the invoices was of old address of the company till 2016.

Scrutiny of realisation statement further revealed that payments were received from the debtors either within the credit period or with delay from January 2011 to May 2013 but after May 2013 most of the payments were received from client which is against the practice followed in factoring facility (DSBF) and which shows that either the debtor was making payment to client directly in violation of NOA or forged invoices were factored by the Company. It is evident that random verification of invoices, personal visit to debtors/ client and monitoring as per credit policy was not done which led to fraud of ₹21.61 crore (principal ₹12.85 crore and interest ₹8.76 crore).

Management replied (7 January 2020) that deviations were approved looking at the business model, management capability, strength of the transactions between LLL and the debtors which were A rated companies and MNC's, having long standing in the market. As deviations were allowed in the Credit Policy by respective sanctioning authority, this was not a violation of Credit Policy. Periodic visit to the debtors were not stipulated in the policy. In case of subject client, since payments were coming from the debtors in the escrow account as seen from escrow statement, periodic physical verification of debtors was not done. The client visit could not be undertaken due to the overdue position and focus to reduce the overall exposure in the account. The escrow statement shows regular payments from the debtors in FY 2016 as well.

Management reply is to be seen in light of the fact that deviations from the Credit Policy should have been resorted to in exceptional cases, but it was done as a routine as most of the cases selected were sanctioned in deviation of credit policy. Further, periodic visits of debtors/ clients were required to be made as per credit policy. Non-visit to the client/ debtors indicates lackadaisical approach by company in monitoring of factoring account. As per realisation statement made available to audit, most[67] of the payments were made by the client and not the debtor in the year 2016.

(ii) M/s Navrang Roadlines Private Limited

Company sanctioned (January 2013) DSBF facility of ₹1.5 crore to Navrang Roadlines Private Limited (NRPL- client) which was enhanced (November 2017) to ₹9 crore. As per sanction letter, an escrow agreement was entered into amongst the client, the Company and HDFC Bank Limited, whereby it was agreed that all the receivables accruing from the sales to approved debtors or any other debtors by the client shall be deposited in the Escrow Account only and the company was the sole beneficiary of the said escrow account. In pursuance thereof, escrow letters duly accepted by all approved debtors were submitted by the client to the company. The client was making payment till December 2018 against the factored invoices, but after that no further payment was received against the invoices of ₹9.11 crore factored during January-March 2019. When the company enquired/ contacted the debtors regarding payment of pending invoices, the debtors informed that the pending invoices were fake and forged and never raised on them. The company filed (July 2019) a police complaint regarding cheating and forgery against the client and its directors. Proceedings in NCLT have also been started against the client wherein IFL has also filed its claim (March 2020).

Audit observed that at the time of enhancement of credit limit to ₹9 crore the external rating of the client was not available and the internal rating of the client was IFL 7 which was not acceptable as per credit policy, however, internal rating of IFL 4 was assigned on the basis of credit rating of client and approved debtors. Moreover, the rating of debtors was considered without proper verification of their actual business with the client e.g. in case of Fine Tech Corporation Limited, credit rating of Reliance Industries Limited was considered.

[67] ***Out of a total of 252 invoices for which payment was received during 2016, payment for only 9 invoices was made by the debtors***

It was also observed that the monitoring as per credit policy was not adhered to as two debtors[68] denied that they ever signed the NOA/ Escrow Account. Further, no periodical visit was made to debtors and no field audit conducted during the period of 2014 to 2019. As per the records of M/s Carrier Air Conditioning and Refrigeration limited only ₹7 lakh was due to the client against ₹2.94 crore outstanding as per the company.

Further, the company did not (30 September 2019) declare this account as NPA in violation of RBI's guidelines although it had the replies of debtors dated 2 May 2019 and 17 June 2019 in which they had denied the acceptance of invoice and Escrow letter.

Management replied (December 2019) that verification of Escrow Acceptance letter was done through e-mail and mobile from the person who had signed the letter. There was some connivance between the borrower and the debtors, which was difficult to trace out especially when the borrower had a relationship with IFCI for more than six years with impeccable track record of making timely payment. Learning lessons from this fraud, IFL has made its debtor verification system more robust. The client was doing business since 2013 and never observed any misconduct in their account. Payments of factored invoices from debtors were being received well within time limit. FCL being a RIL group company, rating of the same was thought to be significant as there was strong parentage by way of RIL. In July 2019, it was conclusively established that the client had committed fraud. Accordingly, in terms of RBI guidelines, the entire outstanding principal is being provided for in four equal quarterly instalments, the first of which (₹2.25 crore) has been done in September 2019 quarter and the remaining will be done in December 2019, March 2020 and June 2020 quarters.

Management further stated (January 2020) that after detection of this fraud, IFL has made changes to the Credit Policy and made physical verification of Escrow Letter with the person who has signed the same at their office/ plant compulsory, by company's RM/ Credit Manager, before the first client disbursement. Verification of Escrow Acceptance Letters was always conducted through Email and Mobile phone, from the person who had signed the letter, as per the guidelines of the prevalent credit policy.

Management reply needs to be seen in light of the fact that even if the verification was done through e-mail, the genuineness of the e-mail ID should have been verified before accepting the escrow letter. Though, management has accepted to make changes in its credit policy, the same has not been done yet. Further, as per RBI circular in the case of fraud entire amount should be straight away classified as NPA.

(iii) M/s Kalyani Engineering Works

The Company sanctioned (August 2012) DSBF facility of ₹5 crore (enhanced to ₹7.50 crore in February 2013) to M/s Kalyani Engineering Works (KEW – the client) despite the fact that the client did not meet eligibility criteria pertaining to TOL/ TNW ratio in terms of credit policy (2012-13). The TOL/ TNW ratio was 4.59:1 as against the stipulated maximum of

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[68] ***(1) M/s TVS logistic Services Limited (o/s ₹3.46 crore) informed (2 May 2019) that the person who signed the Escrow letter is not an employee of company (2) M/s Carrier Air conditioning Refrigeration limited (o/s ₹2.94 crore) informed (17 June 2019) that no one from Carrier office had signed and stamped on Escrow account***

4:1. The facility was for factoring of invoices drawn on Bharat Heavy Electricals Limited (BHEL) at Haridwar and Bhopal.

As per the sanction letter dated 30 August 2012, each factoring transaction was to be supported by the following documents.

- Notice for transfer of Receivables (NTR)
- Copy of purchase order
- Certified true copy of invoice duly acknowledged by the debtor.
- A copy of lorry receipts/ delivery challan/ gate pass
- Inspection and dispatch certificate by BHEL appointed third party or BHEL
- Material receipt duly acknowledged by the debtor to be submitted within 25 days of the invoice date.

The transaction structure between the client and BHEL was such that once the final product is manufactured as per the buyer's specifications, buyer's engineers or a third party appointed by the buyer would visit for Pre-delivery Inspection (PDI) and clear the goods for delivery. Once inspection report is obtained, client delivers the goods to the prescribed location of the debtor along with relevant invoice by road mostly through buyer's approved transporter. Before the facility could take off, the Company waived the condition of *"Inspection and dispatch certificate by BHEL appointed third party or BHEL"* citing the reason that it was not possible for the client to provide inspection report with each set of invoices and revised it with material receipt duly acknowledged by the debtor to be submitted within 45 days of the invoice date (snapshot of the online BHEL portal duly evidencing as due for payment/ material receipt for the invoices provided for factoring was to be treated as material receipt).

The Company factored 32 invoices amounting to ₹6.73 crore (20 invoices amounting to ₹4.09 crore raised on BHEL, Bhopal from 22 October 2013 to 20 June 2014, and 12 invoices, amounting to ₹2.64 crore, raised on BHEL, Haridwar from 1 November 2013 to 9 January 2014) without complying with even the revised factoring conditions. Out of the 20 invoices submitted by the client, the material against six invoices were rejected and 12 invoices were not received by BHEL Bhopal. Though payment against two invoices was stated to have been made by BHEL but it was not received by the Company. Similarly, 12 invoices made on BHEL Haridwar were not received and accordingly, no payment was due against these invoices.

Audit observed that non-compliance with the revised terms of sanction letter resulted in avoidable fraud by the client which led to a loss of ₹6.73 crore as the account was declared NPA in September 2014. Complaint u/s 138 to 141 of Negotiable Instruments Act was filed by Company (October 2015). A case on alleged cheating and forgery was also filed (August 2017) by the Company before CBI, New Delhi for registration of FIR. Response was not received from CBI.

Management accepted (January 2020) the audit observation of non-compliance of eligibility criteria regarding TOL/ TNW ratio. Further, the disbursement against invoices was made upon approval of the competent authority. The fact of non-receipt of invoices, material rejection against invoices etc. from BHEL was subsequently brought out when IFL took up the matter with BHEL pertaining to non-receipt of payments.

The reply of Management needs to be seen against the fact that the Company factored and financed invoices of the client raised on BHEL, Bhopal and Haridwar without even receiving acknowledgment from the debtor or snapshot of the online portal duly evidencing as due for payment/ material receipt for the invoices provided for factoring as per revised factoring condition.

5.10.6.5 Deviations and relaxation in monitoring and operation (NPA/ write off cases)

A review of the sample cases of NPA/ write off revealed that the criteria were deviated from/ relaxed and monitoring/ operation as per the policy was not adhered to. Out of 25 cases (sample), audit observed deviations in 15 cases out of which nine cases of major relaxations/ deviations from eligibility criteria, monitoring and operation are discussed below and remaining six cases are included in the ***Annexure XXIV***. Recovery of ₹212.31 crore was doubtful in these 15 cases.

i) M/s Archon Engicon Private Limited

The Company sanctioned (April 2011) DSBF facility of ₹7.50 crore to M/s Archon Engicon Private Limited (AEPL – the client) which was increased (December 2013) upto ₹17.50 crore. Facility was secured by NOA duly accepted by the approved debtors and PDCs for the facility along with PG of promoters. The client account was in stress since May 2014. Due to non-receipt of payment from debtors, Company inquired (March 2015) about the balance payment of invoices of ₹13.01 crore from a debtor (M/s Diamond Power Infrastructure Limited), who stated that the entire lot was rejected and returned to client long time back and the same was intimated to the Company. Audit observed that initially payments were received from the debtor (M/s Diamond Power Infrastructure Limited) but during May 2014 to September 2015 most of the payments were received from the client. However, no efforts were made to know the reasons of non-receipt of payments from debtors directly.

Audit further observed that instead of taking action against the client or said debtor (M/s Diamond Power Infrastructure Limited), the Company modified (June 2015) the facility wherein the facility was reduced from ₹17.50 crore to ₹15 crore and also included AFR (as sublimit) of ₹12.50 crore. Security against the said facility was equitable mortgage of land (valuing ₹81.48 lakh) and PG of promoters.

Moreover, payment against AFR and DSBF from another approved debtor i.e. GETCO was not received since November 2015. Accordingly, the facility was declared as NPA in March 2016 and company filed a case under section 138 r/w 141 of Negotiable Instrument Act.

Audit observed that the credit policy of the Company stipulates that in the case of AFR facility the security coverage should be 1.5 times of the sanctioned facility and the same should be in the form of immovable property or pledge of listed shares. However, Company collected security of land of ₹81.48 lakh only. Had the company collected the stipulated security against the AFR facility of ₹12.50 crore, the outstanding amount could have been recovered by sale/ disposal of that security.

Audit further observed that payment against invoices of ₹31.72 crore of GETCO are overdue since November 2015 despite having POA (Power of Attorney) issued to GETCO by the client which stipulates that 80 *per cent* payment against the invoices shall be made to the Company and rest 20 *per cent* payment will be made to client if the request is not routed through the Company. Further, Company did not raise the issue with GETCO to recover the outstanding dues of ₹24.88 crore (principal ₹13.12 crore and interest ₹11.76 crore) as on 31 March 2019 despite a lapse of more than four years.

Management replied (January 2020) that periodical visits to the client and debtors were made for the purpose of client plant/ office visit, invoice ledger verification with debtors etc. Company was following up with both the client and the debtors. POA was the arrangement for the AFR facility from GETCO and Company officials followed up the matter with GETCO by visiting personally and through other communications.

Management reply needs to be viewed against the fact that records related to visits and invoice ledger verification with debtors were not made available to audit. The Company never enquired about the reason for non-receipt of the payment from debtors. POA cannot be treated as collateral security as the policy requires tangible security/ listed shares. No correspondence/ records were made available to audit which shows that efforts were made to realise the dues from GETCO.

ii) M/s Elder Pharmaceuticals Limited

The Company sanctioned (August 2010) factoring facility of ₹15 crore (₹15 crore DSBF facility and ₹5 crore PBF) to M/s Elder Pharmaceutical Limited (EPL-the client) subject to satisfactory field audit. The factoring facility was to be secured by security cheques, PG of Directors, NOA and transaction backed PDCs. Initially 10 debtors were approved (including four unrated debtors). In September 2010, conditions of the facility were modified wherein DSBF facility changed to silent basis and field audit was also waived off. The Company approved (February 2011) addition of new debtor M/s Kash Medicare Private Limited with credit line of ₹5 crore which was enhanced up to ₹15 crore during February 2012 to September 2012. The client became irregular in making payments from March 2013 onwards. The total overdue was ₹16.48 crore in April 2013. The client agreed to convert silent factoring into disclosed DSBF facility (April 2013). The Company facilitated the client through debit note funding during July 2013 to August 2016. The Company renewed the facility in August 2013 for further one year. The account was declared NPA on 30 September 2016. The total outstanding as on 31 March 2019 was ₹25.61 crore (principal ₹15 crore and interest ₹10.61 crore).

Audit observed that the Company approved PBF facility without obtaining collateral tangible security in contravention of credit policy. Further M/s Kash Medicare Private Limited who was an unrated debtor (distributor and trader of pharmaceuticals) was added as debtor in contravention of credit policy which stipulates that DSBF (silent basis) deals pertaining to well accredited clients where the debtors being Government entities/ large corporates do not acknowledge Notice of Assignment or Escrow arrangement and the collection of debts is done directly by the client.

Further, the Company renewed the account of the client without proper monitoring even though the client account was in stress since March 2013. In August 2013, it was decided to monitor the account closely and efforts to be made to reduce the exposure with better transaction structure. However, instead of reducing exposure in the stressed account, the Company continued to fund it through Debit Note Funding.

Management replied (January 2020) that Credit Policy prevalent then, permitted silent factoring and unrated debtors on the basis of the financial strength of the client; which was fairly good. It was purely a business decision to improve the topline of IFL with adequate risk mitigations. We have since made our policy more stringent and as of today, we do not accept debtors below 'BBB+' rating. The RMs and Credit Department used to regularly and closely monitor all client accounts and its debtors, as per policy, usually over phone and emails. The Company aimed to continuously reduce the overall FIU and exposure and recover as much money from the client between 2013 and 2016, as was practically possible.

Management reply needs to be seen in light of the fact that as per credit policy the field audit is required for DSBF and PBF and may be waived off in the case of BG backed DSBF only. Though Management made its policy more stringent the fact remains that the company did not comply its own credit policy regarding criteria relating to financial strength of M/s Kash Medicare Private Limited which led to non-recovery of ₹25.61 crore.

iii) M/s Era Infra Engineering Limited

The Company sanctioned (15 February 2010) DSBF facility of ₹7.5 crore on silent basis to M/s Era Infra Engineering Limited (EIEL-the client) which was enhanced (June 2011) to ₹15 crore. The account became irregular (May 2013) and outstanding overdues was in the range of 40-69 days. The company renewed (July 2013) the facility for another 12 months, despite the conduct of account not being satisfactory. Further, the company continued the facility despite the fact that the rating of the client was downgraded (October 2013) from CARE BB+/ A4 to CARE D (Instruments with this rating are in default or are expected to be in default soon).

The renewal of facility was till 30 June 2014 and funding was done through operation of Debit Note from December 2012 to January 2016 and the account was classified as NPA in March 2016. The company waived off the penal interest amounting to ₹1.36 crore (31 December 2014) and ₹0.29 crore (28 September 2015). The complaint u/s 138 to 141 of Negotiable Instruments Act was filed by the Company in February 2016.

The Company wrote to NTPC (approved debtor) (eight invoices of ₹13.15 crore) and Bhartiya Rail Bijlee Company Limited (approved debtor) (BRBCL) (five invoices of ₹12.63 crore) in March 2016 for confirmation of status of the payment(s) due against the invoices raised by EIEL. In response to these letters, NTPC Moudha and BRBCL replied that mentioned invoices are settled and no further payment is to be made. The client was under corporate insolvency resolution process w.e.f. 8 May 2018. The claim of the company amounting to ₹22.58 crore was admitted by the Interim Resolution Professional against the dues of ₹25.47 crore as on March 2019. The insolvency process was under way (December 2019).

Audit observed that field audit was not conducted in this case on the ground that EIEL was an existing client having satisfactory financials and whose conduct was satisfactory.

Management replied (January 2020) that the field survey was waived, since it had an existing relationship (purchase bill discounting) with IFL, having satisfactory track record. Levying of penal charges for a stressed account is primarily to discourage any default and for the purpose of adherence to the sanctioned term and conditions and the penal interest was waived off to keep the account standard while ensuring timely servicing of interest and repayment of principal. The renewals were done despite irregular conduct & stress, to keep the account regular with a hope to salvage the account. The funding through debit note was not to delay the reporting of account as NPA, rather to support the company/ client in its tough times.

The reply of Management needs to be viewed against the fact that existing relationship cannot be the ground for waiver of field survey, more so when the new facility (DSBF) was different from the existing facility. Further, as the account was already in stress and payment was not coming from the client, waiver of penal interest was not justified and even after waiver the account was not regularised. As per the conditions of sanction, in the event of default by the client on the payment of the outstanding dues or payment of interest on the due dates, the company shall have an unqualified right to disclose the name of the client and its directors as defaulters to the RBI/ CIBIL and take necessary action to recover the outstanding dues. However, the company did not comply with the conditions of sanction but renewed the facility despite irregular conduct & stress in the account.

iv) Concast Steel and Power Limited (CSPL) and Concast Exim Limited (CEL)

The Company sanctioned (August 2011) DSBF facilities of ₹15 crore to CSPL (a subsidiary of Concast Group). The factoring facility was to be secured by PDCs, PG of promoters and NoA duly accepted by debtors. The facility was renewed by the Company from time to time. The payments were received from debtor/ client regularly till October 2014 thereafter the payments were delayed by the debtors.

Similarly, DSBF facility of ₹10 crore sanctioned (January 2012) to CEL (a subsidiary of Concast Group). This client account became irregular/ stressed after December 2014.

Subsidiary companies of Concast Group were amalgamated with Concast Steel and Power Limited under the scheme of amalgamation in December 2015. After September 2017, no further payment was received against the factored invoices, therefore, the client account was declared NPA in December 2017. The total outstanding amount as on 31 March 2019 was ₹32.23 crore[69].

Audit observed that the Company continued the facility till September 2017 despite irregular/ part payment received, NPA declared (March 2016) by the parent company (IFCI Limited) and information received (September 2014) from other lenders about the default of the client. Review of accounts of the client also revealed that Company made two payments (₹67 lakh and ₹60 lakh) to the IFCI Venture Capital Limited directly on the request (June 2016) of client.

Further, the Company released capping of ₹4 crore (July 2015) on the request of CSPL and continued facility even though the client suffered loss during 2013-14 and 2014-15. Union Bank of India (UBI) also furnished (Nov 2015) the credit status of CSPL wherein overall assessment of the client was shown as below par. UBI also informed that the client has not served interest since July 2015 and the promoter of Borrower Company was charge sheeted by CBI.

On merger of subsidiary companies under Concast group, the Company's exposure ranged between 17.83 *per cent* to 57.62 *per cent* of its Net Owned Fund (NOF)[70] against the exposure norms of 15 *per cent* fixed by RBI/ Company. It was further revealed from records that the client was not able to serve principal and interest timely against the factored invoices, therefore, company facilitated the client funds through debit note from December 2015 to September 2017.

Management replied that (January 2020) post-merger of both the companies, the exposure on combined entity went more than the sanctioned/ prescribed exposure. Also by that time the company was in stress, it became difficult to immediately call off the facility as the company was facing difficulties in its operations. The company was not in a position to close the account immediately, so efforts were made to reduce the exposure. Payments to IFCI Limited and IFCI Venture Capital Funds Limited were done at the request of the client. IFL made all efforts for regularisation of the account, since during the period mentioned in observation client had paid more than ₹3 crore towards discount and factoring charges. Facility sanctioned by IFL is nowhere related to facility sanctioned by IFCI Limited. Both the companies are different and so are their facilities. The facility was subsequently partly secured to protect the interest of IFL. No undue favour was given to the client by funding through debit note. In many instances, IFL has been able to reduce the exposure in the stress clients and in fact closed some accounts through debit note transactions.

Management reply needs to be viewed against the fact that as the account was in stress the company should have made efforts to reduce the exposure to comply with the RBI guidelines and therefore, the request of the client to make payment to IFCI Venture Capital Funds Limited should not have been accepted. The value of security (land) obtained being ₹6.7 crore against the facility of ₹25 crore was not sufficient. Further, instead of taking

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[69] ***(₹19.34 crore (CPSL) and ₹12.89 crore (CEL))***

[70] ***Net Worth plus Perpetual Debt minus Intangibles***

action to disclose the name of the company/ client and its directors as defaulters to the RBI/ CIBIL and stop further funding, the company continued funding.

v) M/s Arch Pharma Labs Limited

The Company sanctioned (May 2011) DSBF facility of ₹10 crore and PBF facility of ₹6 crore to Arch Pharma Labs Limited (APLL - the client). The factoring facility was to be secured by PDCs, PG of promoters and NOA duly accepted by proposed debtors. The account was in stress since May 2012. The client was not in a position to serve principal and interest timely against the factored invoices, but the Company continued the facility through debit note funding from December 2012 onwards. The client informed (July 2013) that it had applied for Corporate Debt Restructuring (CDR) and requested Company's support for the same. The Company (September 2013) accepted the CDR proposal. As per CDR proposal, total outstanding including interest was to be converted as Working Capital term Loan (WCTL) and Funded interest term Loan (FITL) against which a security in the form of first *pari passu* charge on current Assets (CA) and second *pari passu* charge on Fixed Assets (FA) was to be obtained. Meanwhile, the account was declared as NPA in September 2013. A master restructuring agreement was executed in December 2013. The client again defaulted in payments, therefore, Company declared the account as NPA in September 2015. The total outstanding was ₹19.05 crore as on 30 September 2016. Against which JMFARC[71] offered total consideration of ₹3.13 crore which includes cash contribution of ₹0.47 crore and ₹2.66 crore as Security Receipts. The proposal of sale of NPA to JMFARC was approved by the Board of Directors of the Company in December 2016.

Audit observed that facility of ₹6 crore was approved for PBF without obtaining any tangible security as required under credit policy of the Company. Credit policy of the company also envisaged a broad procedure of monitoring of client account. However, no such monitoring was done by the Company as it became evident from the fact that when the company enquired about the balance payment of invoices from the debtor (Dr. Datsons Labs Limited) (May 2014), it was intimated that the material sent through mentioned invoices were returned due to quality issue and thereafter fresh supplies never came to them. It was further observed that before sale of account to JMFARC, Company did not explore other legal options to recover the maximum outstanding dues.

Management replied (January 2020) that the facility of PBF was not on a standalone basis but was in addition to the ₹10 crore of DSBF. As the client was one of significant pharmaceutical companies of India, being assigned the highest credit quality, call was taken to waive security requirement. Problems started mainly after the renewal with liquidity issues affecting both the client as well as the approved debtor (Aanjaneya Lifecare Limited) resulting in stress and overdues. The liquidity crunch forced the company/ client Arch Pharma to approach its lenders for being considered for CDR. The duly debtor acknowledged LR from client was received with all other supporting documents based on which fund was released to client. Later, as the material was found not as per the quality standard, debtor 'Datsons Labs Limited' had sent the material back to client. The incident was neither

[71] ***J M Financial Asset Reconstruction Company***

informed by client nor the debtor. The matter came to light during overdue invoice payment follow up with the debtor. Immediately, the client was contacted for the same, when the client refused the blame of quality issue imposed by debtors. The company was already facing a plethora of other liquidation issues through its other lenders, which would have made recoveries a very bleak prospect, had IFL not gone the ARC mode.

Management reply needs to be viewed against the fact that Credit policy of the company (2011-12) stipulated that the PBF was intended only for top rated clients and should be backed by tangible collaterals. The invoices against which there were quality issues pertained to August 2012, whereas it was noticed by Management in May 2014, which indicates poor monitoring. Further, the fact remains that no alternative option was explored except sale of account to JMFARC.

vi) M/s Ind-Swift Limited

The Company sanctioned (July 2011) DSBF facility of ₹10 crore on silent basis to Ind- Swift Limited (ISL- the client) which was secured by PG of two promoter directors and PDCs of ₹10 crore. The factorable debtors included eight rated debtors and 10 unrated debtors having total credit line of ₹7.75 crore and ₹13 crore respectively. The client serviced its account as per the terms of sanction from July 2011 to June 2012 after which the account became irregular due to default by client. The account was classified as NPA on 30 June 2016. Against outstanding dues (31 March 2018) of ₹15.48 crore (principal- ₹10.50 crore and unrealised interest/ other charges- ₹4.98 crore) which was entirely on part of unrated debtors, Company entered (13 April 2018) into One Time Settlement (OTS) with the client for ₹6 crore.

Audit observed that company credit policy (2011-12) states that silent factoring means DSBF pertaining to well accredited clients where the debtors would generally be listed Companies, blue chip Companies, PSUs, Central/ State Government entities and MNCs which should be profit making in last two years and should be in existence for minimum three years.

However, the 10 unrated debtors approved by Company did not fall in any of the above listed parameters as they were mainly C&F agents/ distributors of the client who were partnership/ proprietorship concerns whose details/ financials were not readily available. Despite field audit/ examination being vital aid in pre sanction appraisals, it was not conducted on the ground that the client had satisfactory financials and a group Company of the client was an existing client whose conduct was satisfactory.

The prepayment limit was initially capped (8 June 2012) at ₹9 crore and subsequently reduced to ₹8 crore (29 June 2012). Due to liquidity issues faced by the client, the Company decided (July 2012) to reduce the exposure to the client gradually by deducting 20 *per cent* from each payment till the facility is fully repaid which was reduced (Nov 2012) to 10 *per cent*. However, capping on prepayment limit was lifted and limit was increased (3 July 2013) to ₹8.50 crore and subsequently (27 February 2015) to ₹10 crore after which an *ad hoc* limit of ₹1 crore was also sanctioned (26 May 2016) on the request of the client. The capping on limit was removed and *ad hoc* limit sanctioned despite the fact that the account had become highly irregular (since July 2012) and the conduct of account was not satisfactory due to which the Company decided to reduce the exposure. Further, the client had already undergone restructuring of its debts under the CDR mechanism (December 2012), had incurred net losses during 2011-12 to 2014-15/ 2015-16 and was referred (August 2015) to BIFR under provisions of Sick Industrial Companies (Special Provisions) Act 1985. As a result of removal of capping on sanction limit the FIU which was ₹8 crore in June 2012 eventually increased to ₹11.32 crore in June 2016 when the account turned NPA.

The client availed factoring of invoices raised on six debtors which included five unrated debtors and only one rated debtor though there were eight approved rated debtors. The invoice value of six debtors which were factored from July 2011 to November 2012 (before start of debit note funding in December 2012[72]) amounted to ₹53.04 crore of which invoices of rated debtor amounted to ₹1.65 crore only which was 3.11 *per cent* of the total invoice value factored till November 2012.

The Company charges penal discount charges at the rate of four *per cent* over the sanctioned discount charges in case of delay in payments. Accordingly, the Company levied (1 April 2013 to 1 March 2015) penal charges amounting to ₹45.81 lakh out of which an amount of ₹34.36 lakhs was waived (May 2015) which was against the terms of sanction.

Company increased the credit limit of one unrated debtor (Justin Pharmaceuticals) periodically from ₹1.5 crore (4 July 2011) to ₹4.5 crore (29 August 2011) and then from ₹6.5 crore to ₹10 crore (December 2012) in absence of laid down norms/ parameters for the same. The payments from this debtor were not realised later.

Company resorted to debit note funding for a period of more than 41 months (13 December 2012 to 27 May 2016) despite the invoices being overdue and lack of timely payment by the client after which it was finally classified as NPA.

While considering and approving the proposal for OTS, Company neither considered nor put on record the personal net worth of the promoter directors to assess the repayment capacity of the promoter directors as it was a security offered at the time of sanction of facility. Further, OTS was done without initiating legal action though the approval note stated that *"recovery suit against Company and guarantors has to be filed before Delhi High Court"*. The Company only filed (September 2016) a case under section 138 and 141 of the Negotiable Instrument Act, 1881 which was withdrawn (15 April 2019) after the completion of OTS.

The credit policy of the Company did not have any clause/ provision which sets out the criteria for fixation of prepayment limits of the client and the credit line extended to the debtors. Company neither adhered to the monitoring criteria and its timeline mentioned in the prevalent credit policy, nor took updated net worth statements of the promoter Directors at the time of annual renewal.

Management replied (7 January 2020) that at the time of sanction, Ind Swift Limited was a corporate of decent size and good business standing. Looking at the client's strong profile

[72] ***The payments released at the time of debit note funding are not assigned to a specific invoice number but are factored on any invoices present in the sales ledger***

and satisfactory payment track record, the facility was sanctioned. Satisfactory conduct of account of group company and its conduct of account with IFCI Limited was considered while sanctioning of facility with waiver of field survey. The limits were capped at ₹8 crore in the year 2012 due to delays in payments from the debtors as the company had met with a fire incident in its manufacturing facility during that time and the whole pharma industry was going through a bad phase. On the basis of past relationship, support from IFL was provided so that the company may come out of its tough phase during that time and the limits were uncapped to support the company towards its revival as it had inherent strengths in terms of brands and manufacturing facilities. The waiver provided to the client and funding was allowed as the client was showing its intention to maintain the account and its closure in future. During the time between year 2012 and 2016, it was a management decision to continue with the funding through debit note and IFL recovered around ₹6.25 crore (approx.) during that period by way of interest and factoring charges. It was a management call (with the ultimate objective of recovery of money) that went wrong in case of Ind Swift Limited and that is going right in case of Ind Swift Laboratories Limited. Before OTS was approved, the promoters' PG was invoked and cases were going on in the court of law. All the bankers had also explored the personal guarantee option and had finally assigned their debt to ARC at 20 – 35 *per cent* of the total debt. In fact, the OTS done by IFL was at a higher amount as compared to clients OTS/ Assignment done with other bankers.

Management reply needs to be viewed against the fact that credit policy clearly stipulated separate selection criteria for client and debtor. Sanction of facility solely on basis of client strength was in deviation from credit policy. The waiver of field audit on the basis of satisfactory conduct of group company and its conduct with IFCI Limited did not serve its stipulated purpose. The uncapping of limit and sanction of ad hoc limit was not in best interest of Company as client was going through stress, referred to BIFR and it was already decided to reduce the exposure. Funding by way of debit note for more than 41 months indicates the inability of the client to honor the outstanding payments. Recovery of interest and factoring charges to the extent of ₹6.25 crore in effect led to waiver of huge unrealised amount at the time of OTS due to practice of DNF. IFL itself never filed a suit against the promoters invoking their personal guarantee though personal guarantee had been provided.

vii) M/s Critical Mass Multilink Pvt Limited

The Company sanctioned (September 2015) Advance against Future Receivables (AFR) facility of ₹7.50 crore to Critical Mass Multilink Limited (CMML- the client) which was secured by equitable mortgage of one industrial and two residential properties situated in Kutch, Gujarat; pledge of 69.46 lakh shares of Gujarat NRE Coke Limited (listed Company); pledge of 5 crore equity shares of Gujarat NRE Mineral Resources Limited (unlisted Company). The factorable debtors in this facility were M/s Bajrang Bali Coke Industries Limited and M/s NRE Metcoke Limited. The client and both the debtors were part of the same group whose flagship Company was Gujarat NRE Coke Limited (GNCL). The tenure of facility was three years and repayment were to be done from 30 June 2017 to 30 September 2018. Due to short payment received against the first instalment of principal repayment, the account was classified as NPA in September 2017. As on 31 March 2019, the total outstanding amount was ₹4.84 crore (including principal and interest).

Audit observed that the Company considered provisional figures instead of audited figures for the year 2014-15 at the time of credit appraisal (September 2015). As against the stipulated minimum net worth of ₹25 crore, the Company considered net worth of the client as ₹356.95 crore without considering the adjusted tangible net worth (ATNW)[73] which was negative (₹31.95 crore). Even during the years 2011-12 to 2013-14, ATNW of the client was ₹0.29 crore, ₹0.31 crore and ₹0.17 crore respectively. As against the clients stipulated minimum turnover of ₹50 crore, the actual turnover was ₹0.48 crore (provisional figures of 2014-15). Further, during 2011-12 and 2012-13 turnover was ₹1.22 crore and ₹1.36 crore respectively and there was no revenue from operations during 2013-14. As against the requirement of client having past track record of minimum two years with the debtors or should have provided such service to other customers with regular track record of payments, the relationship between client and debtor was new relationship and there was no track record of payments received by client on providing such service to other customers. As against the stipulation that debtor should be profit making for last two years, both the debtors were loss making. As against the stipulated minimum internal rating of IFL5, the proposal was sanctioned even though the internal rating was IFL 6 which meant inadequate safety. This rating was arrived at after giving two notches up based on strength of collateral property even though the mortgage of property was a basic and necessary criterion for sanction of AFR facility.

This sanction was accorded (September 2015) on the basis of service agreements (2010) between the client and debtors (related parties) according to which client was nominated as technical consultant by both the debtors and in consideration thereof it was to receive ₹1 crore per quarter as royalty, payments for which were to start from 1 January 2015. This date was mutually extended by client and debtors to 1 April 2016. However, the Company did not ascertain the quantum of work that had already been executed and did not place on record the detailed works schedule or the nature of work which was further required to be performed by the client under the general service agreements signed five years back. No royalty payments were received thus indicating that the agreements were on paper only considering the fact that both the debtors were shareholders of the client and both client and debtor were part of the same group.

The Company did not take into account the fact that both the debtors were in the process of amalgamation (30 March 2015) with the flagship Company (GNCL) even before sanction (September 2015) of AFR facility which in turn meant that the client was to ultimately receive the cash flows under the service agreements from GNCL which had already undergone CDR in March 2014 due to deteriorating cash flow position and ultimately the credit facilities of GNCL had turned NPA. Company was aware of the NPA status of GNCL account and it still accepted pledge of equity shares of GNCL as one of the securities despite

[73] ***the networth of a Company reduced by the investments/ loans to subsidiary/ affiliate Companies***

the fact that the share price of GNCL had consistently and steeply fallen during the period 2009 to 2015 from high of ₹79.9 per share in 2009 to ₹3.04 in 2015.

As CMML could not fully repay (30 June 2017) the first principal instalment, the account of CMML was classified (30 September 2017) as NPA after which the facility was rescheduled/ restructured (November 2017) considering the projected cash flows of the client (September 2017 to September 2019) by way of advance from group Companies/ sale of investments. However, these cash flows did not emanate from identifiable future receivables on the basis of which an AFR facility is sanctioned. The agreements entered into by the client for these cash flows were not found on record. The reschedulement was in deviation from the credit policy (2017-18) as the maximum tenor of AFR facility was in any case not to exceed three years but the Company extended the same to four years.

One of the pre disbursement conditions in the present AFR facility was creation of security to the satisfaction of Company. However, disbursement of ₹7.50 crore was made without execution of mortgages of properties as the documents of properties/ securities which were to be mortgaged/ pledged with the Company for this AFR facility were in the custody of IFCI Limited. Thus even though the AFR was sanctioned to CMML to whom the amount should have been disbursed, the Company disbursed the sanctioned amount of ₹7.50 crore directly to the loan account of GNMRL with IFCI Limited. In this regard the Statutory Auditor in its report (FY 2016-17) stated that it is apparent that *"this has been done to accommodate/ save the NPA of group Companies of the borrowers"* in the books of IFCI Limited. Thus, this sanction of AFR was meant for ever greening the accounts of IFCI Limited.

The client did not fully honor the repayments even as per the terms of reschedulement according to which the principal repayment was to be done from 30 June 2017 to 30 September 2019. The instalments of ₹1.25 crore each due in March/ June/ September 2019 has not been received till date. There was lack of timely action in selling the pledged shares at the time of default in repayment (June 2017). Instead it resorted to reschedulement (November 2017) after which the shares of GNCL were suspended (February 2018) from being traded on the stock exchanges. Company did not initiate any action under SARFAESI Act in respect of mortgaged properties though it got coverage under SARFAESI Act from August 2016[74].

Management replied (7 January 2020) that provisional financials of FY 2014–15 were considered as audited financials were not available then as last date of filing audited Balance Sheet was 30 September 2015. Details of debtors were mentioned in the credit proposal, out of last two years there was profit in one year hence it was not continuous loss. Moreover, in last FY mentioned in the proposal turnover of debtors were much better than previous year, which was more than three times. The Internal Risk rating of the client was done as per the Board Approved Risk Rating Model. The proposal was rated as IFL 6 by the Risk Department and was sanctioned by the COD on the basis of the justifications mentioned in

[74] ***SARFAESI Act was extended to certain NBFCs, including IFL, vide Ministry of Finance notification no. 6/1/2014- Recovery dated 5 August 2016***

the proposal. The notch up by two grades on the basis of the tangible security was as per the AFR structure and not a wrong practice. Here it is observed that agreement between client and buyers was made five years back for payment of royalty hence it may be difficult to judge that these agreements were made for the sake of taking loan only five years before taking the facility from IFL. The fact that both the buyers were from same group was mentioned in the proposal and it might be difficult to judge the court's final order before hand as order of amalgamation came in the year of 2016 although sanction was made in 2015. All the facts and figures *w.r.t.* client and debtors (being group companies and possible merger) were mentioned in the proposal.

The reply of Management needs to be viewed in light of the fact that credit policy does not mention that provisional figures can be taken where audited figures were not available on date of sanction. The various parameters for client and debtor selection did not meet those specified in the credit policy. The notch up on basis of tangible security was improper as credit policy mentioned that tangible security was basic requirement of sanction of AFR. Internal rating of IFL6 indicated inadequate safety and was below the minimum rating for sanction of proposal. Credit policy states that in AFR, the payments are made from cash flows emanating from identifiable future receivables which in the instant case were not identified as even after lapse of five years the quantum of work done to enable receipt of royalty payments was not put on record. The Board of the GNCL had approved the merger of debtors with itself in March 2015 i.e. before the sanctioning of the facility. The fact regarding possible merger of debtors with flagship Company was not stated in the sanction proposal and was thus overlooked.

viii) M/s Jakhau Salt Company Private Limited

The Company sanctioned (October 2009) DSBF facility of ₹5 crore to M/s Jakhau Salt Company Private Limited (JSCPL - the client). The approved debtor under the facility was Travancore Cochin Chemicals Limited. Besides, the company approved (23 March 2011) the PBF facility of ₹5 crore with credit period of 120 days within the existing approved prepayment limit of ₹5 crore. The company enhanced (03 August 2011) the prepayment limit in case of DSBF facility (Silent Basis) from ₹5 crore to ₹10 crore on the approved debtors (as previously approved) including PBF sub limit of ₹5 crore. Similarly, maximum prepayment limit on the PBF facility was also enhanced (February 2012) from ₹5 crore to ₹10 crore, with full interchangeability between DSBF and PBF without obtaining any collateral security as required under credit policy of the company which states that the PBF is intended only for top rated clients and backed by tangible collaterals.

The account was serviced regularly by the client till June 2013; thereafter defaulted in payment of principal and interest. The company resorted to debit note funding from December 2013 to August 2017 and the account was declared NPA in September 2017. The company approved (10 July 2018) OTS for a total value of ₹4.25 crore as against the outstanding amount of ₹7.20 crore (principal: ₹7.09 crore and interest: ₹ 0.11 crore) thereby waiving off ₹2.95 crore (principal ₹2.84 crore and interest ₹0.11 crore) on the plea that

JSCPL was sanctioned the facility without any collateral security. The client made full and final payment on 29 September 2018 to honour the OTS agreement.

Audit observed that field audit was not conducted in this case citing the reasons of satisfactory credentials/ financial of the client and proposed debtor. The company extended PBF (Reverse Factoring) facility to the client on the purchases made by it from its group company (Bharat Salt Refineries Limited) which was not in the best interest of the company and lacked due diligence on part of the company.

Management replied that facility was sanctioned on the basis of satisfactory credit conduct with IFCI Limited and approval of competent authority. Since the conduct of the account with IFCI Limited and with Company was satisfactory, the PBF facility was sanctioned by the competent authority, without obtaining any collateral security.

The reply needs to be viewed against the fact that satisfactory credit conduct with IFCI Limited can neither be the ground for waiver of field audit which is stipulated in the BoD approved credit policy nor for waiver of such a crucial condition of obtaining collateral security for purchase bill factoring facility, which is stipulated in the BoD approved credit policy.

5.10.7 Conclusion

As the Company is a Non Banking Finance Company – Factor (NBFC- Factor) registered with RBI, it is essential that rigorous standards of appraisal, diligence and monitoring are followed and due consideration is given to its own financial/ commercial interest during the process of appraisal and extension of Factoring/ Loan facilities.

The review of sanctioning, disbursement and monitoring of Factoring/ Loan facility extended by company to several borrowers revealed that the company did not observe the highest standards of due diligence in credit appraisal while sanctioning, disbursing and monitoring accounts. It did not adhere to its own Credit Policy in several instances and relaxed various stipulated eligibility criteria pertaining to minimum security cover, financial ratios, stipulated credit rating etc. Audit observed that there was delay in enforcement of security and there were instances of non-enforcement of security. Audit also observed violation of Guidelines of RBI on declaring the account as NPA.

5.10.8 Recommendations

1. The credit appraisal mechanism should be strengthened.
2. The Company should strictly adhere to its Credit Policy and should not take recourse to deviations as a matter of routine.
3. The Company should assess the financial position of the borrower company and the debtors from time to time.
4. Company may put in place a mechanism/ policy/ procedure in place to ensure that intimation about rejection of material or non-acceptance of any invoice due to any other reason by debtors is given to Company in case of disclosed factoring.

5. Parameters to be considered for fixation of prepayment limit of the client and credit limit of debtors should be clearly laid down.
6. Adequate security should be collected to safeguard the interest of company.
7. Extensive monitoring should be done to avoid fraud or loss to the company.
8. The Company should strictly comply with the RBI guidelines applicable to Non-Banking Financial Companies.
9. Audit findings reported in the para are based on selected sample, but Ministry/ Management is requested to get entire population examined/ investigated to assess the prevalence of the problem and fix the responsibility, wherever required. Cases with indications of mala-fide, if any, may be referred to professional agencies for further examination.

The para was issued to the Ministry in January 2020; their response was awaited (June 2020).