

Chapter-I INTRODUCTION

1.1 Introduction

Rural Electrification Corporation Limited (REC) was incorporated on 25 July 1969 for financing power generation and electrification schemes. REC was declared a Public Financial Institution in 1992 and was registered with Reserve Bank of India (RBI) as a Non-Banking Financial Company (NBFC) in February 1998. REC was accorded 'Mini Ratna' status in 2002 and 'Navratna' status in 2008. RBI classified REC as an Infrastructure Finance Company on 17 September 2010.

Power Finance Corporation Limited (PFC) was incorporated on 16 July 1986 as a dedicated Financial Institution (FI) for the power sector. PFC was declared a Public Financial Institution in 1990 and was registered with RBI as a NBFC in February 1998. PFC was accorded 'Mini Ratna' status in 1998 and 'Navratna' status in 2007. RBI classified PFC as an Infrastructure Finance Company on 28 July 2010.

1.2 Financial and operational highlights

Summary of financial highlights of REC and PFC during the last three years (2013-14 to 2015-16) are at **Table 1.1**.

Table 1.1: Financial highlights of REC and PFC from 2013-14 to 2015-16
(₹ in crore)

Particulars	2013-14		2014-15		2015-16	
	REC	PFC	REC	PFC	REC	PFC
Authorized Capital	1200.00	2000.00	1200.00	2000.00	1200.00	2000.00
Revenue from operations	17120.80	21322.50	20388.05	24862.37	23756.28	27473.65
Profit Before Tax	6531.12	7558.31	7427.04	8378.23	8045.21	9060.66
Profit After Tax	4683.70	5417.75	5259.87	5959.33	5627.66	6113.48

Operational highlights during last three years (2013-14 to 2015-16) are at **Table 1.2**.

Table 1.2: Operational highlights of REC and PFC from 2013-14 to 2015-16
(₹ in crore)

Year	2013-14		2014-15		2015-16	
	Loan Sanctioned	Loan Disbursed	Loan Sanctioned	Loan Disbursed	Loan Sanctioned	Loan Disbursed
REC						
Private Sector	7868.59	6412.70	7348.42	8320.98	2731.13	5298.20
Others	62870.88	23115.81	53525.03	29701.63	62739.97	36807.64
Total	70739.47	29528.51	60873.45	38022.61	65471.10	42105.84
PFC						
Private Sector	13010.00	11259.00	17016.00	9496.00	8403.00	6920.00
Other Sectors	47719.00	35903.00	43768.00	35195.00	56638.00	39667.00
Total	60729.00	47162.00	60784.00	44691.00	65041.00	46587.00

The private sector loan portfolio covers 17.20 per cent and 15.51 per cent of the entire loan portfolio of REC and PFC respectively.

1.3 Quality of assets with REC and PFC in the private sector portfolio

Quality of assets has a considerable impact on the financial statements of REC and PFC as the prudential norms of RBI do not permit recognition of interest till actual realization against loan accounts which have turned Non-Performing Assets (NPA) and requires provisioning against the principal amount of such loans.

Quality of assets is the primary consideration for assessing credit risk. As per RBI norms, a loan asset is categorized depending on servicing of loans by the borrowers. In an NBFC, a loan is considered as 'stressed' when interest or instalment is not paid as per schedule:

- Default up to 30 days are categorized as Special Mention Account (SMA-0) loan accounts
- Default for more than 30 and up to 60 days are categorized as SMA-1 loan accounts
- Default for more than 60 days and above are categorized as SMA-2 loan accounts.

If the period of default is *five* months or more, the loan account becomes a NPA.

Audit noticed that loan accounts of the Independent Power Producers (IPPs) were serviced irregularly and a number of them became 'stressed' (SMA accounts) and subsequently turned NPA. The loan accounts of REC and PFC under SMA categories in respect of IPPs during the period 2014-15 and 2015-16 are at **Table 1.3**.

Table 1.3: Details of SMA-1 and SMA-2 in respect of IPPs

Period	SMA-1				SMA-2			
	REC		PFC		REC		PFC	
	No. of cases	Amount (₹ crore)	No. of cases	Amount (₹ crore)	No. of cases	Amount (₹ crore)	No. of cases	Amount (₹ crore)
2014-15	1	389.45	-	-	7	5510.64	2	628.14
2015-16	1	467.74	-	-	5	5423.21	5	6570.22

A comparative statement showing the year-wise position of NPAs in respect of loans sanctioned to IPPs over 2013-14 to 2015-16 in REC and PFC is at **Table 1.4**.

Table 1.4: Status of NPAs vis-à-vis loans sanctioned

Year	REC			PFC		
	Gross NPA of IPP	Gross NPA to outstanding		Gross NPA of IPP	Gross NPA to outstanding	
		IPP loans	Total loans		IPP loans	Total loans
	(₹ crore)	per cent	per cent	(₹ crore)	per cent	per cent
2013-14	490.40	2.32	0.33	1227.72	4.28	0.65
2014-15	1421.78	5.08	0.74	2363.63	6.49	1.09
2015-16	4243.57	13.90	2.11	7519.04	19.86	3.15

NPAs related to IPP loans, in both companies, increased sharply over the three years period (2013-14 to 2015-16). At the end of 2015-16, a total NPA of ₹11762.61 crore for IPP loans was recognized in the books of accounts of REC and PFC, of which ₹10360.39

crore (86 per cent) were NPAs recognized during 2013-14 to 2015-16. Considering that REC and PFC disbursed ₹47706.88 crore to IPPs during the same period (2013-14 to 2015-16), the NPA generation works out to a significant 21.72 per cent of the amount disbursed during 2013-14 to 2015-16.

It may be noted here that recognition of NPA for IPP loans by PFC (₹7519.04 crore as on March 2016) was not as per the prudential norms notified by RBI¹. RBI norms allowed for a single restructuring before scheduled commissioning; additional restructurings would turn the loan account into NPA. PFC norms, however, provide for two restructurings before commissioning date and one restructuring post commissioning. Further, RBI norms allowed classification of restructured loans as standard if the project achieved the scheduled Date of commencement of Commercial Operations (DCCO). PFC had sought the permission of RBI for following its own prudential norms which has been declined by RBI (11 April 2017). With adoption of RBI norms, in 2016-17, PFC reported a Gross NPA of ₹30702.21 crore (12.50 per cent of the total outstanding loans of PFC as on 31 March 2017) in its books. REC has followed the prudential norms of RBI in recognizing its NPAs since 2014-15.

In view of the worsening position of stressed accounts and NPAs pertaining to loan accounts of IPPs, an examination of the mechanism of sanction, disbursement and restructuring of loans by REC and PFC was carried out in audit.

1.4 Scope of audit

The scope of audit included a review of the procedures adopted by REC and PFC for appraisal of loan proposals, sanction and disbursement of loans. Loans sanctioned/ disbursed to IPPs during 2013-14 to 2015-16 were examined.

1.5 Audit objectives

The objectives of the audit were to examine whether:

- (i) the guidelines/ controls regarding appraisal of loan applications and sanction/ disbursement of loans are sound and adequate and whether these were adhered to by REC and PFC;
- (ii) the restructuring/rescheduling/re negotiating (R/R/R) of loans were carried out in line with applicable rules/guidelines including those issued by RBI; and
- (iii) the applicable norms/directives issued by RBI/Ministry of Power (MoP) relating to NPAs were followed.

¹ Notification No.DNBS.CO.PD.No.367/03.10.01/2013-14 dated 23 January 2014 read with RBI letter dated 11 June 2014

1.6 Audit criteria

Audit criteria were sourced from the following:

- (i) Internal guidelines/policies/procedures relating to appraisal of loan proposals, sanction of loans, disbursement of funds, recovery of dues and monitoring of physical/financial progress of the projects,
- (ii) Delegation of Powers,
- (iii) Directions/Guidelines/Circulars issued by RBI and MoP,
- (iv) Agenda and minutes of meetings of Board of Directors and its various Sub-Committees, and
- (v) Memoranda of Understanding signed by REC and PFC with MoP for 2013-14 to 2015-16.

1.7 Audit sample

The audit sample was selected in the following manner:

- Loan cases were identified under three categories, viz., fresh sanctions, restructured loans and NPA cases.
- Fresh sanction and restructured loan cases were stratified into two segments, - loans with sanctioned amount more than ₹1000 crore and loans with sanctioned amount less than ₹1000 crore.
- For sanctioned loans above ₹1000 crore, 70 per cent cases were selected. For sanctioned loans below ₹1000 crore, 24 per cent cases were selected.
- 100 per cent NPA cases were selected for detailed examination.

The total number of cases under each category and number of loan cases selected from each category are indicated in **Table 1.5** (details of loan are given in Annexure-I).

Table 1.5: Sample selected for audit

Sl. No.	Particulars	Number of loans during 2013-14 to 2015-16		Loans selected			
				Number		%	
		REC	PFC	REC	PFC	REC	PFC
1.	Fresh Sanctions	39	18	14	05	36	28
2.	Restructuring	08	18	05	09	63	50
3.	NPA	08	06*	08	06	100	100
	Total	55	42	27	20	49	48

* This does not include two NPA cases, i.e., (i) M/s Jas Infrastructure and Power Limited and (ii) M/s Swarnajyothi Agrotech and Power Limited (earlier known as M/s Octant Industries Limited), as these loans were covered in earlier audit and observations thereon have been reported in Paragraph 11.2 and 11.3 of Report No.15 of 2016 (Vol. I) of the Comptroller and Auditor General of India.

MoP, in case of PFC, stated (June 2017) that in five cases² the sanction of loans or disbursement or conversion of loan into NPA did not occur during the period 2013-16. However, cost overrun/additional loan in these five cases were sanctioned/disbursed or these loans became NPA during 2013-14 to 2015-16 (as indicated in Annexure I of Report), they were reviewed in Audit.

1.8 Audit methodology

Review of records relating to the selected sample was carried out during August to October 2016 and preliminary observations were issued. Separate draft audit reports were issued to REC and PFC in October 2016. Replies were received from REC in December 2016 and PFC in November 2016. The consolidated draft audit report, duly incorporating the replies of REC and PFC, was issued to MoP in December 2016. MoP furnished replies in respect of REC and PFC in March 2017 and February 2017 respectively. The consolidated draft report was again issued to MoP on 18 April 2017. Replies of MoP were received on 15 June 2017. These replies have been duly considered at the time of finalisation of this Report.

1.9 Audit findings

Audit findings are discussed in the succeeding chapters as mentioned below:

Chapter-II	:	Sanction of Loans
Chapter-III	:	Disbursement of Loans
Chapter-IV	:	Restructuring of Loans
Chapter-V	:	Conclusion and Recommendations

1.10 Acknowledgement

Audit acknowledges the co-operation extended by the managements of REC and PFC and MoP in facilitating the conduct of this audit.

² (i) M/s RKM Powergen Private Limited, (ii) M/s Lanco Amarkantak Power Limited (III&IV), (iii) M/s Krishna Godavari Power Utilities Limited, (iv) M/s Konaseema Gas Power Project Limited and (v) M/s Ind-Barath Energy Utkal Limited