Chapter II

2. Performance Audit relating to Statutory Corporation

Andhra Pradesh State Financial Corporation

Executive Summary

Introduction

Andhra Pradesh State Financial Corporation (APSFC) was set up in November 1956 under the State Financial Corporations (SFCs) Act, 1951 for extending financial assistance to Micro, Small and Medium Enterprises (MSME) in the State. The sources of funds for APSFC include the Small Industries Development Bank of India (SIDBI), borrowings from banks and financial institutions etc. In November 2003, APSFC, Government of Andhra Pradesh (GoAP) and SIDBI entered into an MoU for improvement of APSFC's profitability and viability, which was renewed in January 2010 for another five years.

A Performance Audit of the activities of APSFC thus, would not only cover a review of the follow-up action taken on the earlier audit findings and COPU recommendations, but would also provide insight into how successful APSFC was in the medium-to-long term in the implementation of the tripartite MoU and completing its turnaround, besides appraisal of its policies and procedures for appraisal, sanction, disbursement and recovery of loans.

The current Performance Audit covered the activities of APSFC for the period from 2007-08 to 2011-12. Out of 6169 loans sanctioned for ₹ 5699.91 crore during this period, detailed audit scrutiny of loan files covered a stratified sample of 175 loans, constituting about 21 per cent of the total sanctioned amount during 2007-12. In addition, 65 OTS (One Time Settlement) and recovery cases for loans sanctioned during earlier periods were also scrutinised.

The main objectives of the Performance Audit were to assess whether (a) the terms of the tripartite MoU were adhered to; (b) APSFC's policies and procedures for appraisal, sanction and disbursement of loans were effective; and (c) APSFC's processes for timely recovery of loans were adequate and effective.

Our main audit findings and recommendations are summarised below:

Adherence to MoU Terms

- *GoAP's efforts towards strengthening of APSFC's equity base were limited to alienation and allotment of land in a prime area of Rangareddy District. However, since the land is encroached upon by people engaged in illegal quarrying, APSFC has not benefitted from GoAP's equity contribution.*

- *In the tripartite MoU, among APSFC, SIDBI and GoAP, APSFC had assured that it would curtail administrative and establishment expenditure to 10 per cent of total income by 2009. However, from 2007-08 to*

2011-12, such expenditure ranged from 14 to 17 per cent. It was also unable to diversify its product base through non-fund income.

Appraisal, Sanction, Disbursement and Recovery of Loans

- *Contrary to the Know Your Customer (KYC) norms, APSFC did not conduct due diligence in respect of the sources of interest-free advances brought in for a majority of high-value loans sanctioned. It also had no mechanism for updating of customer data on a periodical basis.*
- *Audit scrutiny of test-checked loans sanctioned during 2007-12 revealed several deficiencies/ deviations:*

  With effect from October 2009, interest rate for term loans was based on the credit ratings assigned by APSFC. However, there were several instances of grant of concessional rates of interest in an arbitrary/ non-transparent manner.

  Loans were sanctioned to educational institutions, even though they were not included as eligible activities under the SFC Act.

  Other deviations included improper consideration of the cost of machinery/ improper valuation of existing machinery, sanction for an unapproved purpose, non-obtaining of additional collateral security for a unit which had availed of OTS benefits, sanction to units with accumulated arrears on an earlier loan/ whose sister concerns had already been classified as NPAs.
- *There were several deficiencies/ deviations in disbursement and recovery of test-checked loans:*

  APSFC had been disbursing loan amounts on ad hoc basis in selective basis without verification of proof of expenditure, resulting in large amounts pending adjustment for long periods. Further, APSFC was irregularly treating such ad hoc releases as regular term loan amounts.

  APSFC had substantial NPAs (Non-Performing Assets); there was a jump from ₹233.11 crore in 2007-08 to ₹296.79 crore in 2011-12.

  There were numerous instances of non-compliance/ delays in taking recovery action (issue of recall notices, seizure of assets and sale, action under the Revenue Recovery Act/ SFC Act etc.). Such action was not being initiated in time even in respect of doubtful assets (let alone all sub-standard assets).

  There were instances of acceptance of defective securities, without proper verification, as well as irregular/ improper release of collateral security without adequately protecting the financial interests of APSFC (which resulted in accumulation of large outstanding amounts/ arrears).

  APSFC has been operating the OTS Scheme for 15 years continuously without a fixed timeframe, promoting a culture of non-payment amongst its borrowers. There were numerous instances where APSFC settled the loan accounts for amounts less than the collateral security available, deviating from its own OTS guidelines and COPU's directions. Further, OTS benefits were also irregularly extended to wilful defaulters.

2.1 Introduction

2.1.1 Background

Andhra Pradesh State Financial Corporation (APSFC) was set up in November 1956 as a statutory corporation under the State Financial Corporations (SFCs) Act, 1951, with the main objective of extending financial assistance for setting up industrial units in the MSME (Micro, Small and Medium Enterprises) sector in the State. APSFC offers financial assistance for acquiring fixed assets like land, buildings and machinery, and also for working capital. APSFC extends such loan assistance through a variety of schemes (general as well as sector/ activity-specific). For the purpose of providing loan assistance, APSFC raises funds from several sources – SIDBI[16] (primarily through the refinance scheme), borrowings from banks/ financial institutions, issue of bonds, acceptance of fixed deposits etc.

2.1.2 Tripartite MoU

In 2003, GoI unveiled a relief package for SFCs, enabling them to reduce their cost of borrowing, improve profitability and operate competitively in the emerging economic scenario. The relief concessions announced by GoI would be extended to SFCs, provided the concerned State Government and SFC signed a tripartite MoU with SIDBI. APSFC requested (March 2003) GoI and SIDBI to extend the required financial support by way of equity contribution, interest rate concession and relief by way of restructuring of refinance outstanding etc. In a meeting held (March 2003) by GoI with all SFCs, the following was decided:

- A reduction in interest rate by two *per cent* on all existing (31 March 2003) high cost refinance borrowings as well as on all fresh loans for refinance.
- An MoU should be entered into, defining the steps to be taken by each party to bring about the turnaround of the SFC.
- GoAP to provide required resource support for achieving the required capital adequacy, convert all loans in lieu of capital into its equity share capital, and appoint the Managing Director (MD) of APSFC in consultation with SIDBI for a minimum period of three years.
- APSFC to curtail the administrative and establishment expenditure to an agreed level (10 *per cent*) as a percentage of total income; and also devise a suitable strategy for raising resources at competitive cost.

Accordingly, an MoU was entered in November 2003 (under the GoI's relief package) for a five-year term for improvement of APSFC's profitability and viability. The MoU was renewed in January 2010 for another five years.

Consequent to the MoU, APSFC has gradually wiped out its accumulated losses of ₹ 157.95 crore (as in March 2003) by the year 2007-08, and continued to earn profits in succeeding years.

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[16] SIDBI: Small Industries Development Bank of India, the principal financial institution for the promotion, financing and development of the MSME Sector, set up through an Act of Parliament.

2.1.3 Organisational Structure and Processes

The Corporation is managed by an 11-member Board of Directors. It is headed by a Managing Director who is Chief Executive and is assisted by an Executive Director, four Chief General Managers, five General Managers and four Deputy General Managers at its headquarters. In addition, APSFC has four zones (located in the head office itself) and 25 branch offices.

2.1.4 Financial position and working results

A summary of key financial indicators relating to the functioning of APSFC during 2007-12 is depicted below:

Table 2.1- Summary of key financial indicators

(₹ in crore)

Particulars	2007-08	2008-09	2009-10	2010-11	2011-12
Loans and advances	1441.48	1660.50	1851.41	2117.35	2384.39
Capital Employed	1615.93	1728.16	1931.46	2157.55	2425.36
Net worth	266.05	266.59	333.52	377.16	409.14
Gross Income	226.87	237.53	288.17	322.43	368.01
Net Profit	89.51	42.85	67.68	67.33	68.33
Percentage of Return on Capital Employed	12.27	9.74	10.57	9.72	9.61
Percentage of average cost of borrowings	8.19	8.57	8.30	8.38	9.02

Details of the financial position and working results of APSFC for the period 2007-12 as indicated in **Annexure-2.1** revealed that during the review period, APSFC's net worth increased from ₹ 266.05 crore (2007-08) to ₹ 409.14 crore (2011-12) and APSFC created reserves and surplus amounting to ₹ 211.40 crore to the end of March 2012. APSFC's borrowings stood at ₹ 2229.90 crore as at 31 March 2012. The percentage of return on capital employed decreased from 12.27 (2007-08) to 9.61 (2011-12) due to increase in cost of borrowings [from ₹ 108.81 crore (2007-08) to ₹ 164.78 crore (2011-12)] and administrative expenditure [from ₹ 29.46 crore (2007-08) to ₹ 51.38 crore (2011-12)].

2.2 Audit Approach

2.2.1 Past Audits

The activities of APSFC were scrutinized and reported through the CAG's Audit Reports (Commercial) on several occasions in the past:

- A review of internal control system in State Financial Sector Undertakings (covering both APSFC and the Andhra Pradesh Industrial Development Corporation) was reported vide paragraph 2.4 of the CAG's Audit Report (Commercial) for the year ended 31 March 2006. This has not yet been discussed by the Committee on Public Undertakings (COPU).
- A topical review of the One Time Settlement (OTS) scheme was reported vide Chapter III of the CAG's Audit Report (Commercial) for the year ended 31 March 2003. COPU recommended (March 2006) that strict guidelines for OTS and for deviations therefrom, APSFC should approach GoAP for approval; discretion at the individual level should be curtailed;

the OTS scheme should be operated within a fixed time frame in future; and a detailed database in respect of promoters /guarantors should be maintained and updated. However, the Action Taken Report (ATR) on the COPU recommendations (27 November 2006) has not been taken up for discussion by the COPU.

- A review of financial companies (including APSFC) was reported vide Chapter 3 C of the CAG's Audit Report (Commercial) for the year ended 31 March 1998. This has not been discussed by the COPU.
- A comprehensive review on the activities of APSFC was reported vide Chapter 3B of the CAG's Audit Report (Commercial) for the year ended 31 March 1992. The review was discussed by the COPU and recommendations were issued by COPU. However, ATR from APSFC was not received.

2.2.2 Present Performance Audit

We felt that a Performance Audit of the activities of APSFC at this time would not only cover a review of the follow-up action taken on the earlier audit findings and COPU recommendations, but would also provide insight into how successful APSFC was in the medium-to-long term in the implementation of the tripartite MoU and completing its turnaround, besides APSFC's policies and procedures for appraisal, sanction, disbursement and recovery of loans would be reviewed.

The present Performance Audit covered the activities of APSFC for the period 2007-08 to 2011-12. Out of 6169 loans sanctioned for ₹ 5699.91 crore during this period, detailed audit scrutiny of loan files covered a stratified sample of 175 loans (the top 25 loans for ₹ 415.42 crore sanctioned across the State, and other 150 loans[17] involving ₹ 773.07 crore in 10 branch offices[18]) which constituted about 21 *per cent* of the total sanctioned amount during 2007-12. In addition, 65 OTS (One Time Settlement) and recovery cases for loans sanctioned during earlier periods were also scrutinised.

2.2.3 Audit Objectives

The main objectives of the performance audit were to assess whether:

- The terms of the tripartite MoU were adhered to;
- APSFC's policies and procedures for appraisal, sanction and disbursement of loans were effective; and
- APSFC's processes for timely recovery of loans were adequate and effective.

2.2.4 Source of Audit Criteria

The main sources of criteria for the Performance Audit were the SFCs Act, 1951; the guidelines and circulars issued by SIDBI and RBI; and APSFC's

[17] 55 loans of more than ₹ 5 crore; 25 loans of ₹ 3-5 crore; 40 loans of ₹ 60 lakh – 3 crore; 20 loans of ₹ 30-60 lakh, and 10 loans of less than ₹ 30 lakh.

[18] 4 branches in and around Hyderabad and 6 other branches (Medak, Eluru, Kurnool, Anantapur, Vijayawada and Rajahmundry).

policies, procedures, circulars and other instructions.

2.2.5 Audit Methodology

An Entry Conference was held with APSFC in May 2012, wherein the scope, objectives and approach of the performance audit were discussed. Field audit, involving scrutiny of APSFC's records (both at the Headquarters as well as the selected branch offices), was conducted between May and July 2012. The audit findings were reported to APSFC and GoAP in November 2012; despite issue of a reminder (December 2012), for furnishing of replies and conducting of Exit Conference, their response is yet to be received (December 2012).

2.2.6 Acknowledgement

The co-operation and assistance extended by APSFC and its officials during the conduct of this performance audit is acknowledged.

2.3 Audit Findings

Our main audit findings are described below:

2.3.1 Adherence to MoU terms

Audit scrutiny revealed the following deficiencies in compliance with the terms of the tripartite MoU among APSFC, SIDBI and GoAP:

- **GoAP's equity contribution through land allotment**- In order to provide resource support to APSFC to strengthen their equity base for facilitating higher levels of borrowing and to achieve and maintain the required capital adequacy and net worth (as stipulated in the MoU), GoAP alienated (August 2007) 33.11 acres land and allotted (August 2007) 238.28 acres on a 99 year lease basis to APSFC, and demarcated and handed over possession of 32 acres and 164.23 acres respectively to APSFC. This was treated (February 2008) by APSFC as GoAP's equity contribution of ₹ 78.63 crore for demarcated land, and ₹ 30.16 crore as share application money for non-demarcated land (total equity contribution of ₹ 108.79 crore).

  Audit scrutiny, however, revealed that:

  - ❖ With regard to the 33.11 acres land, APSFC's request for exemption of land conversion charges[19] had been referred by HMDA[20] (July 2011) to GoAP; the land had not yet been converted (July 2012) for industrial purpose.
  - ❖ With regard to the 238.28 acres land, there were ten unauthorised quarries at the time of allotment, which continue illegal quarrying activities in 100 acres of APSFC's land, and APSFC was unable to secure the land through construction of a compound wall indicated that there was no specific demarcation between the Government land and the private land at the time of handing over; this stand is clearly detrimental to the interests of APSFC. Thus, the APSFC has not been

[19] For change of land use from residential to industrial.

[20] Hyderabad Metropolitan Development Authority.

benefitted from GoAP's equity contribution of ₹ 108.79 crore by way of land due to encroachment.

- **Curtailing administrative and establishment expenditure** - As per the MoU of 2003, APSFC had agreed to curtail administrative and establishment expenditure in a phased manner, so as not to exceed 10 *per cent* of total income; in the renewed MoU (2010), APSFC agreed to consistently bring down such expenditure, without mentioning a specific target.

  Audit scrutiny revealed that APSFC never brought down administrative expenditure to the stipulated 10 *per cent* during 2004-05 to 2011-12 (as per the 2003/2010 MoU); during the review period 2007-08 to 2011-12, the percentage of administrative expenditure to total income ranged between 14 and 17 *per cent*.

- **Appointment of Managing Director** - Contrary to the MoU's stipulation of appointment of a Managing Director, in prior consultation with SIDBI, for a minimum period of three years, the tenure of the two Managing Directors was only two years one month and one year 11 months respectively. Further, audit could not obtain documentary evidence of prior consultation by GoAP with SIDBI for appointment of Managing Director.

- **Product diversification** - As per the MoU of 2010, APSFC agreed to take steps to diversify product-based activities and explore new business avenues. However, during 2010-12, APSFC earned just ₹ 0.93 crore towards insurance commission alone and no income was generated in respect of other non-fund based revenue streams.

- **Credit Appraisal and Rating Tool** - APSFC did not implement the Credit Appraisal and Rating Tool (CART) for loans up to ₹ one crore, so as to ensure uniformity in loan appraisal and sanction as required by MoU.

- **Joint review of performance** - Although the MoU stipulated a joint review of APSFC's performance by SIDBI, APSFC and GoAP every year (or such intervals as fixed by SIDBI, APSFC and GoAP), no such reviews were conducted so far (November 2012). Further, the absence of such reviews also made it difficult to ascertain the extent of funds required to be provided by GoAP in the event of slippages in meeting standards (also stipulated under the MoU).

- **Relevance and long-term viability** - In terms of the MoU, GoAP had to initiate steps to study the relevance and long-term viability of APSFC. However, such impact assessment to assess the relevance of APSFC in the field of industrial financing sector in the State was not conducted.

2.4 Appraisal, Sanction, Disbursement and Recovery of Loans

2.4.1 Background

2.4.1.1 Lending Norms and Policy

- As per the SFC Act, 1951, APSFC can grant financial assistance to industrial concern (with aggregate paid up capital and free reserves less than ₹ 30 crore) upto ₹ 5 crore to a company or co-operative society and upto ₹ 2 crore to other entities; this limit can be increased four times with the prior approval of SIDBI.

- Every year, APSFC formulates its annual "Lending Policy", based on the performance of units in various lines of activities, feedback from branches, default ratio, NPAs, market outlook, Government policy etc. Lines of activities are classified as "**encouraged"** or **"not to be encouraged"**, with assistance to "not to be encouraged" activities requiring approval at the Head Office. Minimum Collateral Security requirements are also prescribed for each line of activity which ranged between 25 *per cent* and 150 *per cent* depending upon the line of activities as well as risk involved.
- Those who have availed of OTS are ineligible for future loan sanctions; however, if the OTS was due to failure of the unit for reason beyond control, APSFC could consider loan sanctions after five years from the date of closure under OTS, but with 50 *per cent* additional collateral security.

2.4.1.2 Appraisal, sanction and disbursement

- Upon receipt of loan enquiry and application along with DPR and sources of finance, the branch office conducts due diligence (including pre-sanction site inspection) for proposal to meet the KYC (Know Your Customer) norms[21], as well as to facilitate project appraisal and credit rating. The pre-sanction inspection report is forwarded to the Head Office with the recommendations of the Branch Manager.
- Proposals in the form of enquiries/ applications are screened by the Project Screening Committee (PSC), which decides in principle whether to finance the project and may also impose restrictions, based on risks associated with the proposal/ promoter.
- Detailed project appraisal comprises of promoters', technical appraisal, financial appraisal, market appraisal, and risk evaluation (involving due diligence from branches and credit rating from a third party agency[22] from new customers for loans of more than ₹ 5 crore). The viability of the project would be appraised, and the repayment track record for loans availed from APSFC and other financial institutions, if any, would also be considered.
- APSFC's lending policy stipulates that its term loans as well as working capital loan shall invariably be secured by primary security/ collateral security for which valuation of security will be carried out by APSFC.
- Sanction of loans is carried out at various levels, depending on the delegation of powers – Board (₹ five crore and above), Executive Committee (₹ three to five crore), Head Office Sanction Committee (₹ 60 lakh to ₹ 3 crore), Operational Zonal Screening-cum Sanction

[21] In August 2002, RBI issued KYC (Know Your Customer) norms and Anti Money Laundering (AML) standards for commercial banks. SIDBI/ RBI felt (August 2007) that these norms shall also be applicable to SFCs.

[22] ONICRA.

Committee (₹ 30 to ₹ 60 lakh), and Branch Sanction Committees (up to ₹ 30 lakh).

- APSFC introduced (September 2005) credit risk rating models for rating of loan proposals above ₹ one crore, which was subsequently extended (July/ August 2009) to loans above ₹ 30 lakh. Proposals receiving credit ratings ranging from CR-1 (Excellent Safety) to CR-4 (Ordinary Safety) are to be considered for extending financial assistance. With effect from October 2009, interest rates for term loans are also fixed based on the credit rating.
- Disbursement of sanctioned loans takes place after compliance with the terms and conditions stipulated in the sanction, e.g. furnishing of collateral securities, personal guarantees etc.

2.4.2 Profile of sanctions, disbursements and recovery

A summary of loans sanctioned, disbursed and recovered by APSFC during the five year period 2007-12, along with the corresponding targets, is given below:

Table 2.2 – Sanctions, Disbursements and Recovery during 2007-12 (Targets vs. Achievements)

(₹ in crore)

Particulars	2007-08	2008-09	2009-10	2010-11	2011-12
Sanctions					
Targets	900.00	1250.00	1050.00	1452.00	1600.00
Achievements	1006.66	885.67	1052.38	1386.38	1368.82
Disbursements					
Targets	648.00	870.21	700.02	939.55	1120.00
Achievements	662.89	685.70	707.99	904.35	936.90
Recovery –Principal					
Targets	400.78	445.12	463.67	561.95	591.17
Achievements	421.72	449.25	528.04	614.48	636.14
Recovery - Interest					
Targets	190.34	226.65	263.53	289.41	327.41
Achievements	177.51	224.95	252.85	283.90	324.54
Recovery - Principal and Interest					
Targets	591.12	671.77	727.20	851.36	918.58
Achievements	599.23	674.20	780.89	898.38	960.68

- As can be seen from the above, there is a wide gap between sanctions and disbursements, resulting in cancellation of sanctioned loans; this was largely due to non-compliance by the borrowers with the stipulated collateral security conditions and also due to APSFC's charging higher rates of interest than banks. Actual disbursements were also consistently lower than targets (except in 2007-08 and 2009-10) due to premature closure of accounts and partial disbursement where required Collateral securities were not provided. The basis for fixing of targets for recovery was not documented. Normally, targets for recovery of principal and interest should have been based on the instalments of principal and interest falling due (e.g. *95 per cent* of instalments falling due). This was clearly not the case, since the achievements for principal recovery were higher than the targeted principal recovery in all five years.

2.4.3 Audit Findings – Appraisal and Sanction

The main audit findings relating to appraisals and sanction are indicated below:

2.4.3.1 Know Your Customer (KYC)

SIDBI stipulated (August 2007) compliance by the State Financial Institutions with the guidelines issued by the Reserve Bank of India on Know Your Customer (KYC) norms and Anti Money Laundering (AML) standards to banks and financial institutions, so as to understand their customers and their financial dealings better, which would, in turn, help the lending institutions to manage their risks prudently. However, audit scrutiny revealed certain deficiencies in APSFC's compliance with these norms:

- **Sources of funds (interest-free advances) not scrutinised** - KYC norms caution against use of funds invested by relatives/ third parties (other than the promoters) as money mules[23] and possible complicity with criminal entities. Audit scrutiny revealed that out of the top 25 loans sanctioned by APSFC during 2007-12, 16 units involved funds totalling ₹ 45.16 crore being brought in the form of interest-free advances. Except for stipulating non-withdrawal of these amounts during the loan period, APSFC did not conduct due diligence or verification of the provenance of the sources of these funds. Further, the due diligence reports of APSFC's branches and the project reports submitted by the promoters did not cover this important aspect.
- **Non-updation of customer data** - Audit scrutiny revealed that while the branches of APSFC were submitting due diligence reports (duly verifying the particulars of the promoters) at the time of loan sanctions, there was no mechanism for updating of customer data (promoters, guarantors and investors with address proof, latest photographs and commercial activities) on a periodical basis. The recommendation of the COPU in their 11th Report (March 2006) on OTS Topical Review reported through CAG's Audit Report (Commercial) for the year ended March 2003 that databank in respect of promoters and guarantors should be maintained and updated from time to time was also not being followed.
- **Lack of mechanism for watching utilisation of working capital loans** – Once the loan has been disbursed, it needs to be ensured by the Corporation whether the loan has actually been utilised and for the purpose for which it was sanctioned. Audit scrutiny of seven test-checked working capital term loans and marketing assistance loans for ₹ 60.40 crore indicated that APSFC was disbursing such loans, without insisting on evidence of utilisation (stock statements, cash flow statements etc.), nor was there any mechanism for verifying such utilisation post-disbursement.

[23] Money mules can be used by criminals to launder the proceeds of fraud schemes eg. phishing and identity theft.

2.4.3.2 Credit Rating and Use of CIBIL Reports

The Credit Information Bureau of India Ltd (CIBIL) acts as a repository of information regarding borrowers pooled in by its members (lending institutions operating in India), and provides a complete picture of the payment history of a credit applicant to its members.

Although APSFC joined CIBIL as a regular member in August 2008, audit scrutiny of one selected Branch[24] revealed that Credit Information Reports (CIRs) were not obtained in respect of two out of 13 test-checked loan cases. Further, APSFC was not uploading the defaulters list in respect of sanction of loans below ₹ 60 lakh, nor had it identified any defaulter as wilful defaulter[25] in data uploaded to CIBIL, although nine cases of wilful defaulters had been identified by audit as per OTS guidelines.

2.4.3.3 Deviations with regard to grant of interest concession

With effect from October 2009, the interest rate for term loans was based on the credit ratings assigned by APSFC. Audit scrutiny revealed the following instances of deviations and arbitrary/ non-transparent grant of interest concessions.

- At the time of loan appraisal of Kandhari Hotels (P) Ltd. Vijayawada, the project was rated as CR-3, and term loan of ₹ 10.50 crore was sanctioned by the Board of Directors in September 2011. However, within just one month, the credit rating was revised (October 2011) by the MD to CR-2, on the grounds of expected occupancy of 90 *per cent* against the projected occupancy of 50 *per cent* in the first year of provision. This arbitrary change resulted in the unit being eligible for interest concession of two *per cent*.

- Lohia Edible Oils Pvt. Ltd. was sanctioned (January 2011) an additional term loan of ₹ 18 crore with credit rating of CR-3 and applicable interest of 13.5 *per cent*. However, in the same month (January 2011), at the request of the promoter, APSFC decided to extend interest concession of one *per cent* stating that the unit falls under the Good Entrepreneur Scheme (GES), *i,e,* the unit should earn net profit for one year and cash profit for two years preceding the year of sanction. However, while the unit earned profits of ₹ 0.28 crore for 2007-08 and 2009-10, in 2008-09, it suffered a loss of ₹ 0.32 crore (more than the depreciation of ₹ 0.28 crore), and that too without providing for deferred tax liability of ₹ 0.25 crore. Thus, undue interest concession for the loan period amounted to ₹ 0.63 crore.

- A term loan of ₹ 14.45 crore was sanctioned (August 2009) to GV Estates and Hotels Pvt. Ltd for taking over an existing term loan from SBI. Despite being a loss making unit operating from December 2007 with losses of ₹ 6.56 crore (during 2007-09) and occupancy of just 40 *per cent*, an interest rate of 13 *per cent* with a concession of one *per cent* under

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[24] Rajahmundry Branch.

[25] Wilful defaulter is defined as one who defaults in meeting repayment obligations to lenders though he has the capacity to honour the said obligation; or who has diverted funds; or the default is intentional, deliberate and calculated.

Senior Successful Entrepreneur Scheme (SSES) was extended; this was irregular, since the SSES stipulation of earning of net profit for one year and cash profits for two years prior to the year of approval, was not complied with.

At the request of the promoter, the interest rate was arbitrarily reduced (February 2011) further to 12.5 *per cent* retrospectively from the date of drawl. Undue interest concession for the loan period amounted to ₹ 0.96 crore.

- APSFC sanctioned (July 2010) two term loans (including a medium term loan for working capital requirements) of ₹ 10 crore to NCS Industries[26]. With credit rating of CR-3, the interest rates were fixed at 14 and 14.5 *per cent*. However, the MD, APSFC gave a special interest concession of one *per cent* in respect of both loans, treating the promoters as good/ existing borrowers, although they had availed of OTS earlier.

2.4.3.4 Sanction of Term Loans to Educational Institutions

Although educational institutions are not included under eligible activities as defined in the SFC Act, APSFC has been extending loans/ financial assistance to educational institutions. Despite APSFC taking up the matter (December 2009) with SIDBI for enlarging the definition of 'industrial concern', SIDBI did not agree with APSFC's interpretation. Such loans have also been objected to in the past audits, both due to non-eligibility and also the difficulty in seizing assets of educational institutions in cases of default. Out of ₹ 48.32 crore sanctioned to 12 educational institutions during January 2010 to March 2011, the outstanding amounts as of March 2012 was ₹ 34.22 crore inclusive of overdue amount of ₹ 2.02 crore.

Audit scrutiny also revealed that:

- Superwhizz Professionals Pvt. Ltd, a coaching institute not recognized as an educational institution by GoAP, was irregularly sanctioned (August 2010) a term loan of ₹ 4.19 crore. Lending to a coaching institute is *ultra vires* / beyond the scope of APSFC.
- APSFC decided (March 2012) to seize the assets of Ravi Rishi Education Society against the outstanding amount of ₹ 4.35 crore, and noted that it was difficult to seize the educational unit with more than 1000 students.

2.4.3.5 Other Deviations

Audit scrutiny also revealed other deviations:

- While sanctioning a term loan of ₹ 19.17 crore (September 2010) to MLR Auto Ltd. and disbursing ₹ 12.93 crore (November 2010 to June 2012), APSFC irregularly considered 75 *per cent* of the cost of the machinery for loan (instead of the stipulated 50 *per cent* of the cost of machinery more than 18 months ago) and disbursed ₹ 4.88 crore instead of the eligible amount of ₹ 3.25 crore.
- APSFC sanctioned (June 2011) a term loan of ₹ 16.88 crore to Srivalli Shipping and Transport Pvt. Ltd., Visakhapatnam for construction of

[26] Other deviations with regard to the sanctions for NCS Industries are covered subsequently.

warehouses at Autonagar, Visakhapatnam and APIIC Industrial Park, Vakalapudi, Kakinada. However, APIIC had allotted land of 7.82 acres at Kakinada for repairing and servicing of handling and other transport equipment, and not for a warehouse. Further APIIC clearly mentioned in its land allotment letter to the unit that the unit should utilize the land for the purpose for which it is allotted; if any of the terms and conditions stipulated in the allotment letter were not complied with, all the amounts paid by the allottee would be forfeited. Hence, APIIC could, at any time, revoke the allotment of land, thus jeopardizing the status of loan extended by APSFC. The loan had thus been sanctioned for an unapproved purpose.

- APSFC sanctioned (July 2010) two term loans (one term loan for expansion of existing oil refinery and oil storage tank unit and a medium term loan for working capital requirements under MSME-MTL scheme) of ₹ 10 crore each to NCS Industries. The promoters of the unit had availed of OTS in March 2001, and APSFC's recovery policy stipulated additional collateral security of 50 *per cent* for future sanctions, depending on project viability. However, additional collateral security (amounting to ₹ 6.75 crore) was not obtained. Further, the two loans were appraised as one loan, although they had to be appraised under two different models. Also, under the MSME-MTL Scheme, the unit should have earned net profits for two years and cash profit for one year (out of the last three years). However, the unit earned net profits for two years and incurred cash loss for one year i.e. 2008-09.

- While sanctioning (February 2009) a Working Capital Term Loan of ₹ 1.10 crore to Padmasree Steels Pvt. Ltd, existing machinery was valued at 100 *per cent* (instead of the stipulated 50 *per cent*) at the request of the company, arriving at an Asset Coverage Ratio (ACR) of 135 *per cent*. Had the machinery been valued as per guidelines, the ACR would have been 100 *per cent*, below the limit of 135 *per cent* stipulated by the PSC for being eligible for loan, and the unit would have been ineligible for the loan. Though the unit did not fit into the terms of working capital term loans, the Corporation sanctioned loan.

- A term loan of ₹ 30 lakh was sanctioned (October 2011) to Madhavi Nursing Home, Rajahmundry for purchase of additional medical equipment for the existing nursing home under 'Financial Assistance to Practising Doctors' scheme. However, the loan amount was disbursed (January 2012) for purchase of land for establishing a new hospital without any details regarding project cost, implementation etc. As per the terms of scheme, land cost should not be considered for sanction of loan.

- After having rejected an earlier proposal for ₹ 1.13 crore in January 2000 on account of poor financial conditions, APSFC sanctioned (November 2003) an additional term loan of ₹ 2.71 crore to Sanghi Zip Fasteners Pvt. Ltd., despite it being pointed out that credit by banks and financial institutions to associated units were categorised as NPAs. Security for the loan was represented by hypothecation of land of 1.42 acres and plant & machinery (including their sister concerns and "leasehold interest in ingress and egress rights").After the unit failed to honour the repayment commitments, APSFC attempted (December 2010) to seize the assets and found that identification of machinery hypothecated was difficult, due to absence of data of machinery of associated units with APSFC. Further, there were no responses to APSFC's advertisement for sale of land, as it was located within the compound wall of the Sanghi Industrial Clusters unit.

- Despite arrears of ₹ 0.23 crore on account of an earlier term loan of ₹ 3.59 crore disbursed (March 2006) as term loan to Cheminnova Remedies, APSFC irregularly sanctioned (March 2010) a medium term loan of ₹ 3 crore, and recovered arrears (which had risen to ₹ 0.45 crore). The unit requested (June 2010) for reschedulement, on account of cheating by its General Manager, which was accepted by APSFC without ensuring the financial viability of the unit which was prerequisite for reshedulement. The loan was classified as NPA in November 2012, with total outstanding of ₹ 4.78 crore[27](arrears of ₹1.27 crore). Clearly, this was attributable to a series of irregularities and undue favours by APSFC.
- Despite a proposal for a term loan for ₹ 7.57 crore to Supriya Corn Products Pvt. Ltd recommended to APSFC's Board for consideration on account of low risk factors and techno-economic viability, the Board sanctioned (March 2011) the term loan but stipulated that the unit should deposit ₹ two crore in the form of FD and assign it as additional security for three years. The unit represented (July 2011) against this condition and did not take the loan. The stipulation of such a condition appears prima facie unreasonable and arbitrary in the context of deviations by APSFC in respect of other parties – in terms of relaxation for collateral security and sanction despite NPA/ OTS status.

Further, Audit noted the absence of a note file system, which would have ensured transparency of action proposed and approved at various levels of the organisational hierarchy so that the basis of a decision is readily available. Although this was reported in the CAG's Audit Report (Commercial) for 2005-06, the absence of a note file system in APSFC continues.

2.4.4 Disbursement of sanctioned loans

As per disbursement manual of APSFC, *ad hoc* disbursements may be released in advance, without being linked with the implementation of the project. Such *ad hoc* disbursements shall be limited to 25 *per cent* of loan sanctioned can be considered selectively with the approval of the Managing Director for speedy implementation; for construction of civil works; for full payment to machinery suppliers to get the delivery of machinery or for full payment to machinery supplier for the imported machinery.

Further disbursements should not be considered, unless the earlier *ad hoc* release is regularised. Also, release of *ad hoc* amounts shall be subject to the borrower bringing 100 *per cent* of the capital and offering CS to a minimum of 50 *per cent* of the amount stipulated otherwise/or offering of 100 *per cent* CS

[27] Media reports (February 2012) refer to the unit's announcement that an Australian nutrition company, Rapid Nutrition Ltd., would be picking up a 74 *per cent* equity stake within 18 to 24 months. It is not known whether APSFC has been able to accelerate loan recovery pursuant to this announcement.

stipulated and bringing a minimum of 50 *per cent* capital stipulated. Also, a*d hoc* amount shall be regularised within 3 months from the release.

Audit scrutiny revealed that APSFC had been disbursing loan amounts on *ad hoc* basis in selective cases without verification of proof of expenditure on acquisition of assets/ project implementation. As of March 2012, *ad hoc* amount outstanding (pending adjustment) was ₹ 100.20 crore, of which ₹ 31.70 crore was pending adjustment for more than six months; this is contrary to RBI guidelines, which stipulate regularisation within three months. In fact, APSFC was irregularly treating these amounts as regular term loan amounts (without actual regularisation) and allowing interest rebate and concessions as for regular loans, whereas non-production of proof of implementation was tantamount to diversion of funds and the loanee should have been treated as a wilful defaulter.

Selected cases of such *ad hoc* releases, adversely affecting the financial interests of APSFC, are summarised below:

- After sanctioning (November 2007) a term loan of ₹ eight crore to Vensur India Builders and Developers[28], APSFC disbursed ₹ 6.56 crore during February 2008 – February 2009, including *ad hoc* release of ₹ five crore as against eligibility of ₹ two crore (25 *per cent).* As per APSFC's own inspection report of August 2009, the unit carried out civil works amounting to ₹ 3.36 crore only and stopped implementation, diverting balance loan funds for other purposes. APSFC issued (March 2011) a recall-cum-sale notice, but, on the request of the unit, released the collateral security worth ₹ 6.85 crore after accepting ₹ one crore and PDCs[29] for ₹ 2.50 crore (which were dishonoured on presentation). As of June 2012, the outstanding amount on this loan was ₹ 2.81 crore including interest of ₹ 0.31 crore.

APSFC made 14 *ad hoc* disbursements totaling ₹ 1.81 crore between December 2011 and March 2012 to Kandhari Hotels Pvt. Ltd, which were pending regularisation.

2.4.5 Recovery

2.4.5.1 Background

As per SIDBI Guidelines, loan assets are classified as **standard**, **sub-standard** (arrears of more than 90 days but not more than one year three months), **doubtful** (arrears of more than one year three months), and **loss assets** (security not available, losses identified but not written off). Collectively, assets which are not standard assets are termed as Non-Performing Assets (NPAs).

Detailed procedures have been laid down for action to be taken by APSFC in cases of delay in repayment of installments at different "trigger points" – delay of 10 days, 30 days and 60 days (deemed as "bordering on sub-standard") and thereafter. APSFC's recovery policy stipulates that:

- As soon as a loan account becomes sub-standard, a Recall Cum Sale

[28] A partnership firm.

[29] Post-Dated Cheques.

(RCS) notice is served within 15 days. The Recovery Officers inspect the units, and insist on payment of substantial portion of the due amount, as well as a commitment letter for clearance.

- If no response to the RCS notice/ payment is received, the primary assets can be seized and sold under Section 29 of the SFC Act. In respect of collateral securities, the branch has to verify these and issue a notice under the SARFAESI[30] Act, 2002 for recovery. The Branch Manager is to prepare the sale note, get it internally audited, and send the proposal to Headquarters for release of sale advertisement within 10 days of seizure.
- In addition, APSFC can also apply to the concerned District Judge for an order of sale of property, for enforcing the liability of any surety, for transferring the management of the concern etc.
- APSFC can also recover loans from defaulting concerns as arrears of land revenue under the Andhra Pradesh Revenue Recovery Act (RR Act).
- From January 2009 onwards[31], APSFC commenced recovery action as arrears of land revenue under Section 32G of SFC Act. The process involves issue of a notice for settlement within 15 days; in case of no response from the borrower/ surety/ guarantor, approval of MD for issue of a Revenue Recovery Certificate is taken. Subsequently, the Branch Manager (who is authorised to exercise powers of District Collector) issues notices under the RR Act, and the identified assets are sold after valuation of assets and fixing upset price.

2.4.5.2 Overall recovery performance

The classification of APSFC's loan assets as standard, sub-standard, doubtful and loss assets during the period 2007-12 is summarised below:

Table 2.3 – Overall recovery performance

(₹ in crore)

Assets	Amount				
	2007-08	2008-09	2009-10	2010-11	2011-12
Performing Assets					
Standard	1351.89	1546.73	1732.44	2036.66	2284.65
Non-performing Assets					
Sub-standard	42.59	91.00	91.77	84.17	108.59
Doubtful	69.42	66.08	64.90	61.72	92.14
Loss	121.10	115.75	105.82	99.39	96.06
Total NPA	233.11	272.83	262.49	245.28	296.79
Total O/S loans	1585.00	1819.56	1994.93	2281.94	2581.44

As can be seen above, APSFC had heavy NPAs which increased from ₹ 233.11 crore in 2007-08 to ₹ 296.79 crore in 2011-12. Up to March 2012, APSFC had issued 21 Recovery Certificates (RCs) for recovery of dues of

[30] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

[31] Pursuant to GoAP authorising the Managing Director and Branch Managers to authorise and recover amounts due as arrears of land revenue.

₹ 205.64 crore, against which recovery of ₹ 2.12 crore was made in 11 cases involving dues of ₹ 37.78 crore (including principal of ₹ 5.20 crore). No recoveries had been made in respect of the other 10 units.

Instances of deficiencies/ deviations in terms of recovery action noticed in audit scrutiny are summarised below.

2.4.5.3 Delay in disposal of seized assets

Audit scrutiny indicated that as against 617 loan accounts under doubtful category (arrears of principal of ₹ 92.14 crore as of March 2012), APSFC seized assets in respect of only 54 loan accounts (arrears of principal – ₹ 19.03 crore; total arrears – ₹ 77.06 crore). These assets were seized between 1996 and 2012, and were lying unsold; their valuation as of March 2012 was just ₹ 35.56 crore. Of these seizures, 28 assets seized were more than five years ago, and two assets were between four and five years ago.

Further, audit scrutiny revealed that out of the 54 cases, sale notices were yet to be issued in 3 cases; sale was not undertaken, due to pending action under OTS by APSFC in 11 cases; responses to sale advertisements were not received in 16 cases; and 10 cases were under litigation.

2.4.5.4 Acceptance of Defective Securities and Improper Release of Securities

Audit scrutiny revealed following instances of acceptance of defective securities, and improper release of security:

- In respect of Viceroy Garden function hall, submission of original link documents was relaxed by taking an affidavit from the proprietrix, as the loan (₹ 0.51 crore) was guaranteed by her husband who was then Vice-Chairman of the AP Wakf Board. The loan appraisal also indicated that the proprietrix had solvency of ₹ 2.90 crore. However, after the account became NPA (March 2005) and when APSFC wanted (September 2008) to seize the collateral security, it was found that as per Wakf records, the function hall was built on a Muslim graveyard and amounted to encroachment. Against the outstanding dues of ₹ 1.36 crore, APSFC approved (November 2011) OTS for ₹ 75 lakh against which only ₹ 11.20 lakh was paid by the borrower, and the outstanding amount has risen to ₹ 1.43 crore.
- In respect of Usha Art Printers/ Unnati Graphics P Ltd[32], two terms loans and one working capital term loan totalling ₹ 2.63 crore were sanctioned between March 2001 and May 2003, and ₹ 2.48 crore disbursed. Collateral for the two term loans in the form of 117.03 acres of agricultural land (Medak District) and 14250 sq. yards of land (RR District) which was disposed off partly prior to mortgaging and partly thereafter and for working capital loan, a building at Hyderabad was offered. After several defaults, APSFC had sold (March 2007) the plant and machinery for ₹ 1.15 crore. The working capital term loan was closed and security documents returned in May 2009. However, after APSFC advertised the agricultural land (May 2008) for sale, a suit was filed for partition of this

[32] Which took over Usha Art Printers.

land amongst multiple persons, and the Court allowed the rights of one-third of this land to two other persons. Further, it was found that the remaining two-thirds of this land was occupied by Scheduled Tribes and Lambada Thandas, and APSFC was informed that they had purchased the land 20 years back. On verification of the land (14250 Sq. Yards) in Rangareddy District, it was found that the passbooks with APSFC and the landholder did not tally, and the property was not actually mortgaged to APSFC. As of December 2011, the account had outstanding dues of ₹ 3.97 crore, and APSFC had addressed the unit for a detailed OTS proposal, failing which it threatened action against the collateral security.

- APSFC extended (October 1982) a term loan of ₹ 0.24 crore to Larsvin Appliances Pvt. Ltd. by accepting duplicate copy of sale agreement for land allotted by APIIC as against the requirement of obtaining original document. After the unit fraudulently obtained the original sale deed directly from APIIC and sold the land and building, APSFC could not enforce the security through legal proceedings and finally extended (March 2010) OTS for ₹ 0.14 crore against arrears of ₹ 11.52 crore (including interest of ₹ 11.38 crore).

- Shree Chakra Papers (SCP) and Shree Papers (SP), were given Term Loans amounting to ₹ 12.75 crore (September 2003 to December 2007) and eight Working Capital Term Loans amounting to ₹ 8.24 crore (July 2001 to December 2009) respectively. Despite rescheduling of loans under special regulatory treatment for both units in March and December 2009 respectively, repayment of both loans was irregular from December 2009 onwards. As against the securities of ₹15.03 crore available (₹5.63 crore for SCP; ₹9.40 crore for SP), the outstanding amount was ₹23.84 crore (₹ 18.41 crore – SCP and ₹ 5.43 crore - SP) as of June 2012, thus falling into Doubtful-I category[33]. However, in March 2011 (when the assets were substandard), the APSFC Board permitted release of part of the collateral security valuing at ₹ 2.50 crore, by accepting just ₹ 1.50 crore from the promoters; this was contrary to APSFC's policy to return of any part of collateral security only after payment equal to its present value or value at the time of accepting the property (whichever was higher). Although APSFC had issued (February 2012) notices against the primary/ collateral security holders, the value of securities (₹15.03 crore) available with APSFC was substantially less than the outstanding amount (₹ 23.84 crore).

- APSFC sanctioned (March 2002) a term loan of ₹ 2.50 crore to Avera Graphics Pvt Ltd., and released ₹ 2.37 crore up to August 2002. APSFC released (September 2005) collateral security valuing ₹ 3.50 crore on payment of ₹ 2.30 crore and a PDC for ₹ 0.34 crore (without ensuring realisation) and considering primary security of machinery valued at ₹ three crore. The cheque was dishonoured, and when APSFC seized (May 2007) the unit, it noticed that machinery worth ₹ 0.48 crore was missing but lodged a police complaint in September 2008. After being advertised

[33] The principal and / or interest arrears for more than one year three months but not more than two years three months are classified under Doubtful I category.

six times, three machines were sold for just ₹ 0.03 crore, leaving outstanding arrears of ₹ 0.70 crore as of March 2012.

- APSFC sanctioned (July to December 2007) three loans totalling ₹ 14.10 crore to Raghava Estates, RP Transporters and PANC Transporters (all promoted by the same promoters, with owners of the collateral security properties being either the promoters or their family members). Due to volatility in the real estate market, APSFC proposed (March 2010) to credit the sale proceeds of any property in any loan account either to all accounts or one or two accounts, which was agreed to by the promoters. However, although the total outstanding loan amount as on 31.3.2010 was ₹ 17.09 crore and the collateral securities available were ₹ 15.50 crore, APSFC released properties worth ₹ 4.19 crore between March 2010 and March 2011. Consequently, as of December 2012, the collateral securities available (₹ 11.31 crore) were less than the outstanding balance of ₹ 13.09 crore.
- APSFC sanctioned one term loan and two working capital loans (November 2007 to February 2010) totalling ₹ 13 crore to KLR Industries Ltd. Despite the unit being a chronic defaulter and its cheques being dishonoured several times, APSFC accepted (February 2012) the unit's request for return of collateral security of four acres at Shamshabad valued at ₹ 1.20 crore on the grounds that collateral security of ₹ 8.45 crore was more than the outstanding amount of ₹ 6.72 crore. This was, however, contrary to APSFC's guidelines, as APSFC did not consider the repayment track record, nor did it revalue the collateral security to identify reduction in value, if any. The unit again defaulted and arrears as of June 2012 amounted to ₹ 0.71 crore.

2.4.5.5 Other Deficiencies

- In pursuance of the SFC Act, APSFC has, since December 2005, been appointing nominee directors on boards of units with aggregate sanctioned loan of ₹ 1 crore and above; this limit was raised (September/ November 2009) to ₹ 5 crore and ₹ 10 crore. In January 2010, APSFC decided to appoint nominee directors only for loans sanctioned for ₹ 5 crore and above and whose accounts were in NPA. However, the 11 units for which nominations were made were not inviting the APSFC nominees for their board meetings.
- The terms and conditions of sanction stipulate levy of 3 *per cent* premium on premature payments of principal amounts exceeding two instalments. However, audit scrutiny in Hyderabad, Rajahmundry and Eluru branches indicated that 85 loan accounts had been closed prematurely during 2007-12, and APSFC waived ₹ 59.35 lakh of premature repayment premium. Further, there was no transparent system for deciding waiver of such charges (varying from 25 *per cent* 75 *per cent*).

2.4.6 One-Time-Settlement (OTS)

2.4.6.1 Introduction of OTS Scheme and continuance

APSFC initially introduced the One Time Settlement (OTS) scheme in June 1992, with the objective of realising "sticky" overdues. Since September 1997, the OTS scheme has been continuously in existence, despite a COPU recommendation (March 2006) that the OTS scheme should be operated within a fixed timeframe. However, after being pointed out (2003) in audit, APSFC indicated (September 2003) the cut-off date for eligibility under the OTS scheme as 31 March 2004. SFC has been extending OTS scheme every year continuously till date (December 2012). The eligibility criteria for OTS are as follows:

- All doubtful assets as on 31 March 2004, and continuing in the same category as of the date of approaching APSFC for OTS settlement and all loss assets as on the date of approaching APSFC for OTS are eligible.
- The scheme does not provide settlement for wilful defaulters.
- Working capital term loans and loans sanctioned for commercial & residential complexes are normally not covered under OTS Guidelines. However, the OTS guidelines can be extended to loss assets covered under these categories, but only after the primary and collateral securities offered for these loans are disposed off.

During 2007-12, APSFC settled 1903 loan accounts under the OTS scheme, receiving ₹58.10 crore against outstanding dues of ₹1862.88 crore.

Audit scrutiny revealed the following deficiencies in implementation of the OTS Scheme.

2.4.6.2 Settling loan accounts under OTS for less than security available

Audit scrutiny revealed that during 2007-12 APSFC settled 33 accounts with outstanding dues of ₹ 44.65 crore for ₹ 17.10 crore, when the total security available was more than the OTS amount. Sale of securities by APSFC would have fetched it ₹ 10.92 crore more than the amounts received under OTS. Further, in 19 cases, APSFC settled for loan amounts deviating from the amounts collectable as per guidelines, which resulted in a loss of ₹ 2.31 crore as against the collectible amount of ₹ 3.92 crore. Despite the recommendation of COPU (March 2006) to obtain GoAP approval for any deviation from the approved OTS guidelines, APSFC settled OTS cases in deviation to the approved guidelines without obtaining GoAP's approval. Selected cases involving loss due to extending undue favour to the industrial units on account of OTS are summarised below:

- Against outstanding balance of ₹ 76.97 crore (including interest of ₹ 75.41 crore), APSFC agreed (December 2008) to settle the account of Ravi Rock Products under OTS by accepting ₹ 0.40 crore. APSFC's justifications for the OTS were contrary to the statements at the time of loan appraisal/ sanction viz. 50 acres of land in Kodangal, promoters' interest in Ravi Crane Services. Further, the affidavit that the promoter's wife had acquired house property in Hyderabad valued at ₹ 1.50 crore through "sthree dhanam" was not verified by obtaining sale deed/ gift deed.
- APSFC approved (September 2009) OTS by accepting payment of ₹ 0.22 crore from Sonar Caps & Lamps Ltd duly writing off of the balance principal of ₹0.22 crore and waiving interest of ₹27.81 crore although the promoter of the company was a reputed businessman in Anantapur District

having fertiliser factory, vegetable oil mill, residential houses and godowns. The OTS was granted without assessing the value of these assets.

- Despite COPU (March 2006) pointing out various irregularities committed and recommending action against officials responsible for these lapses, APSFC approved (August 2009) OTS for ₹ 0.12 crore, writing off/waiving ₹ 1.87 crore (including interest of ₹ 1.72 crore) of Avanti Kopp Electricals. As regards staff accountability, APSFC indicated (November 2006) in the Action Taken Report that there was no *malafide* intention, and no involvement of any staff member.
- APSFC approved (March 2008) OTS for ₹ 0.61 crore to Yugandhar Offset Printers duly waiving interest of ₹ 0.06 crore. However, despite the borrower's failure to pay the OTS amount, APSFC allowed the promoter to sell the machinery (valued at ₹ 0.27 crore) to Ajantha Art Printers for ₹ 0.40 crore, of which ₹ 0.10 crore would be a down payment and ₹ 0.30 crore would be treated as a term loan from APSFC. Further, APSFC waived (January 2010) 50 *per cent* of the interest for delayed period amounting to ₹ 0.04 crore.
- APSFC sanctioned (February 2004) a term loan of ₹ 0.30 crore to Samrat Scampi Hatchery, despite the unit falling under "not to be encouraged" category. Based on the request (February 2011) of the chief promoter, APSFC extended OTS by accepting ₹ 0.32 crore and waiving outstanding interest of ₹ 0.11 crore.

2.4.6.3 Extension of OTS to wilful defaulters

As per APSFC' OTS guidelines, wilful defaulters are not eligible for OTS benefits. However, audit scrutiny revealed instances of irregular extension of OTS to wilful defaulters, as summarised below:

- Though the sale of Veerabhadra Binny Modern Rice Mill was approved (June 2003) by APSFC, it refunded the sale consideration to the new purchaser who alleged that the original promoter had threatened him with dire consequences, and ultimately approved (March 2009) OTS by accepting ₹ 0.06 crore and waiving ₹ 0.20 crore.
- APSFC approved (September 2009) OTS by accepting ₹ 0.12 crore from Malasani Oil Mill Pvt. Ltd. and waived ₹ 7.95 crore, despite the promoter having shown properties as his own though actually were not.
- APSFC approved OTS at the request (September 2011) of one promoter of Resqu Drugs, accepting ₹ 2.65 lakh, and waiving ₹ 8.98 lakh; this was despite APSFC's noting that the promoter had shifted the machinery unauthorisedly and not lodging a police complaint, and also concurrent's audit pointing out that the managing partner of the unit was running a private limited company worth ₹ two crore.
- APSFC approved (September 2008) OTS, by accepting payment of ₹ 0.31 crore from Hyderabad Auto Service Corporation and waived interest outstanding of ₹ 1.55 crore after withdrawal of court cases by both APSFC and the borrower, despite the collateral security documents

deposited with APSFC being declared by the Court as forged documents.

2.4.6.4 Extension of OTS for Working Capital Loans

APSFC's OTS Guidelines stipulated that in respect of working capital term loans, OTS can be extended only after disposal of primary and collateral security and deposit / adjustment of sale consideration against outstanding dues. However, audit scrutiny revealed deviations from these guidelines:

- APSFC approved (February 2011) the OTS request of Roys Industries Ltd. for accepting an amount of ₹ 1.11 crore and waiving outstanding interest of ₹ 0.53 crore, despite collateral security properties valued at ₹ 8.60 crore available with APSFC.
- APSFC settled (September 2010) the account of Sri Sai Lakshmi Trading Company for ₹ 0.32 crore and waived ₹ 0.23 crore, despite collateral security of ₹ 1.21 crore available with APSFC.
- APSFC settled (August 2009) the account of Jahnavi Cotton Industries for ₹ 0.45 crore and waived interest of ₹ 0.22 crore, despite collateral security of ₹ 0.46 crore available with APSFC.

2.5 Planning and Mobilisation of Resources

2.5.1 Planning of financial resources

APSFC raises its financial resources through borrowings from SIDBI, issue of bonds to banks / institutions, acceptance of fixed deposits and internally generated resources (plough back amounts). Of these, SIDBI is the main source of finance, especially for the MSME Sector. Every year, APSFC prepares the disbursement targets as part of its Business Plan and Resource Forecast (BPRF), and submits it to SIDBI for approval. The targets projected by APSFC in the BPRF, targets accepted by SIDBI and funding actually availed/utilised by APSFC is indicated below:

Table 2.4 – Targets and actual funding from different sources during 2007-12

(₹ in crore)

Particulars	Target projected in BPRF	Target accepted by SIDBI	Actuals	Variation
Borrowings from SIDBI	1575	1195	1302	107
Non-SLR Bonds	475	475	600	125
Banks	125	505	445	(-) 60
Others	146	146	159	13
Internal resources (Plough back)	1950	1950	1392	(-) 558
Disbursements	**4271**	**4271**	**3898**	**(-) 373**

Audit scrutiny, further, revealed that:

- APSFC could not generate the targeted plough back of internal resources fully as planned in any of the last five years. Due to shortfall (₹ 558 crore) in plough back of internal resources, APSFC incurred additional expenditure of ₹ 47.66 crore towards borrowing cost for the period from

2007-08 to 2010-12.

- During 2008-09, APSFC could not avail of the loan of ₹ 120 crore (at a concessional rate of 7.75 *per cent* per annum) sanctioned by SIDBI, since it could not provide additional security sought by SIDBI through extension of charge on the land alienated by GoAP to APSFC since some of the land allotted was unauthorisedly occupied as well as did not materialise guarantee from State Government for ₹ 40 crore.
- During 2010-11, APSFC could not issue non-SLR bonds at an interest rate of 8.3% p.a. (as GoAP did not provide guarantee) and was forced to borrow from banks at higher interest rates of 9.37 *per cent* per annum resulting in additional expenditure of ₹ 1.21 crore.

2.5.2 Excess payment of interest to SIDBI

APSFC had been repaying the outstanding SIDBI Loans as on 1 December 2003 at an interest rate of 9.73 *per cent*, after a reduction of 2 *per cent* from the weighted average rate of 11.73 *per cent*. However, this weighted average interest rate on outstanding balances as on 1st December 2003 was calculated incorrectly, and, as per audit's calculations worked out to only 11.68 *per cent*. This resulted in excess payment of interest to SIDBI of ₹ 0.68 crore for the period 2004-12.

2.5.3 Mobilisation of Fixed Deposits

While mobilising Fixed Deposits, APSFC did not comply with the RBI stipulated conditions of not raising deposits of more than ₹ 70 crore and not providing loans against term deposits accepted. As of September 2010 and February 2011, it has raised fixed deposits of ₹ 84.80 crore and ₹ 72.42 crore, and had also accepted FDs of ₹ 15.06 crore and ₹ 5.75 crore respectively as collateral security for loans sanctioned.

Further, SIDBI advised (December 2009) APSFC to ensure conformity with RBI guidelines for rollover the fixed deposits raised, since its CRAR of 8.65 *per cent* as of March 2009 was less than the RBI-stipulated norm of 10*per cent*. Further, APSFC also did not conform to the revised criteria of 4 *per cent* of Gross NPA to Gross Loans and Advances, with ratios of 6.23 *per cent* and 4.63 *per cent* as of March 2010 and March 2011. APSFC finally stopped mobilisation/ renewal of FDs only in May 2011. These violations were also not brought to the notice of APSFC's Board.

Conclusions

- ***GoAP's efforts towards strengthening of APSFC's equity base were limited to alienation and allotment of 271.39 acres as equity contribution in kind. However, it failed to stop illegal quarrying on this land and hand over encroachment-free land to APSFC, resulting in the equity contribution remaining notional and inflating APSFC's net worth and capital adequacy. GoAP and APSFC were also not able to ensure full compliance with the terms of the tripartite MoU with SIDBI.***
- ***Audit scrutiny revealed numerous deficiencies in appraisal of proposals (particularly with regard to application of KYC norms), arbitrary/ non-transparent grant of interest concessions, irregular sanction of term***

loans to educational institutions, and other instances of non-compliance with its own lending policy and instructions.

- ***We also found delays/ deficiencies in taking timely recovery action in accordance with stipulated procedures, including delay in disposal of seized assets, acceptance of defective security and improper release of security. Further, APSFC had been operating the OTS Scheme for 15 years continuously without any fixed timeframe; we also noticed deficiencies in OTS implementation, including settling accounts for less than the available security, and irregular extension of OTS benefits to wilful defaulters as well as working capital loans.***

Recommendations

- ***GoAP should immediately ensure land allotted to APSFC as equity contribution in kind is encroachment-free.***
- ***APSFC should ensure that while sanctioning loans, due diligence is conducted not only in respect of the promoters, but also of funds brought in by third parties. Further, the lending policy and instructions should be followed strictly; deviations therefrom should, with proper justification, not only be approved by the Board but also intimated to GoAP.***
- ***Specific financial limits (both absolute and as a proportion of the sanctioned loan) should be set for "ad hoc" releases. Further, ad hoc releases must be regularised within 3 months, or treated as NPAs with necessary consequences.***
- ***In order to minimise problems in recovery of loans, APSFC should put in place systems for updating of customer data (promoters, guarantors and investors) on a periodical basis. Further, APSFC needs to implement its recovery policy diligently, and ensure that action for seizure of assets is initiated in timely manner (without a discretionary approach, especially for higher value loans). This also needs to be followed by quick action for sale of such assets (especially depreciable assets like plant and machinery).***
- ***APSFC must offer 'One Time Settlement' (OTS) only within very short, clearly defined timeframes, and implement the approved OTS guidelines scrupulously.***