Chapter 3: Credit Appraisal and Sanction

3.1 Procedure for credit appraisal and sanction of credit facilities

The procedure followed by IFCI for credit appraisal and sanction of credit facilities is described below:

- Regional Offices (RO) submit loan proposals after preliminary discussions with promoters / borrowers regarding business model, requirement of funds. Further, RO carries out due diligence and 'Know Your Customer' formalities apart from reviewing eligibility criteria, financials, security etc.
- The proposal is put up to the Screening Committee (SC) headed by ED (Credit) and consisting of Chief Finance Officer (CFO)/Chief Credit Officer (CCO)/GM (Recovery), DGM (Risk), GM from field. Screening Committee is the competent authority for *prima-facie* clearance of proposals for detailed appraisal.
- After clearance of the proposal by the Screening Committee, Regional Office carries out the credit appraisal detailing the corporate / project / promoter profile, financials, cash-flow, credit rating, Debt Service Coverage Ratio (DSCR), Fixed Assets Coverage Ratio (FACR) etc. apart from information on security, due diligence, industry scenario, projected financials etc.
- After initial credit appraisal, Credit Risk Management Department (CRMD) finalizes internal credit rating of the borrower/facility representing an evaluation of the credit customer's intrinsic strengths and weaknesses.
- After the detailed credit appraisal, the proposal is put up to Credit and Investment Committee (CIC) which is headed by CEO&MD with DMD, EDs, CFO, CCO and GM (Credit) as members. CIC is the competent authority to sanction financial assistance upto ₹100 crore and recommending authority for financial assistance above ₹100 crore.
- The proposal recommended by CIC for approval are put up to the Executive Committee (EC) of Directors which is empowered to sanction financial assistance in excess of ₹ 100 crore and upto ₹ 300 crore. Financial assistance in excess of ₹ 300 crore is sanctioned by the Board of Directors.
- After sanction of a proposal, it is communicated to the respective RO for onward communication to the borrower together with all the terms and conditions for acceptance by means of a Letter of Intent (LoI).
- On acceptance of LoI by the borrower, the process of documentation is taken up including the creation of security after which disbursement is approved by the CEO&MD in line with the recommendation by the Regional Office.
- Relaxation / variation in the proposals regarding eligibility criteria, Security Cover, Loan Tenure or any other terms are to be approved by the Board of Directors. However, from 2014-15 onwards, such relaxation / variation is to be approved as per the Delegation of Powers.
- Modification and relaxation of the terms of sanction regarding interest rate, security cover and loan tenure are to be approved by the sanctioning authority. Any other terms of sanction can be modified by CEO&MD under report to the sanctioning authority.

However, from 2014-15 onwards such modification / relaxation is to be approved as per the Delegation of Power /Committee headed by CEO&MD.

3.2 General Lending Policy

For sanction of loans, IFCI is guided by its General Lending Policy (GLP) which is formulated annually and approved by the Board of Directors. The policy stipulates the eligibility criteria for various categories of borrowers in manufacturing sector, services sector, infrastructure sector etc. as well as the type of funding to Holding/Investment Companies/SPVs. The GLP also details the policy for creation of security, valuation of security, credit administration and monitoring. The GLP aims to aid sanctioning financial assistance to corporates in consonance with the main business objectives of the Company, along with compliance with the other statutory guidelines to optimize the risk return trade-off with diversified portfolio.

Audit selected and reviewed 128 cases of loans sanctioned during the four years ending 31 March 2016 with a view to examine whether the loans were sanctioned as per the extant GLP and the terms of the agreement. Out of these 128 cases reviewed, Audit observed that in respect of 69 cases (54 *per cent*), the loans were sanctioned in deviation from the eligibility conditions prescribed in the relevant GLP. Further, it was observed that in respect of 20 cases (16 *per cent* of the sample cases), the borrowers had defaulted in interest payments of ₹ 184.58 crore.

An analysis of the nature of deviations (Annexure-1) revealed that the eligibility criteria relaxed related mainly to adherence to the stipulated financial ratios, requirement of minimum security cover, nature of security and profitability of the borrower company during the previous three years etc. as shown below:

Table-3: Deviation from the norms prescribed in General Lending Policy while sanctioning loans

Sl. No.	Nature of deviations from stipulated criteria	Number of cases where deviation was noticed*	Percentage
1.	Deviation from criteria relating to financial ratios (Profitability ratios, liquidity ratios, leverage ratios and coverage ratios)	67	52
2.	Deviation from criteria as relating to credit rating, minimum net worth and previous years profitability	31	24
3.	Relaxation to the minimum security cover and nature of security and its valuations.	38	30
4.	Deviation from other stipulated conditions as per sanctioned terms	17	13
5.	Sanction to wilful defaulters	3	2

** Details of the cases where deviations were observed are given in Annexure-1. One case may fall under multiple categories of deviations.*

A. Non-adherence to Financial Ratios

Assessment of the overall financial strength of an entity includes analysis of its performance and its financial indicators, as derived from the financial statements. The key parameters for this assessment are profitability ratios, liquidity ratios, leverage ratios and coverage ratios. While liquidity ratios like Current Ratio measure a firm's ability to meet its current obligations, profitability / operating ratios like margin of Gross Profit, Net Profit and Operating Profit measure management's ability to control expenses and earn a return on the resources committed. Leverage ratios like Debt Equity Ratio, Total Outstanding Liabilities to Tangible Net-worth Ratio etc. measure the degree of company's leverage i.e. its debt load. Coverage ratios like Debt Service Coverage Ratio, Fixed Assets Coverage Ratio and Interest Coverage Ratios are a measure of the degree of protection to lenders of long-term funds i.e. the Company's ability to meet its financial obligations. Thus, financial ratios provide a tool to evaluate the creditworthiness of the borrowers and measure their financial health. IFCI stipulated various minimum and maximum ratios that were to be considered, while sanctioning loans with the above objectives in mind.

Financial ratio stipulations as per financing guidelines were found to have been deviated from / relaxed in respect of 67 cases (52 *per cent*) out of the sample reviewed.

B. Deviations from credit rating, minimum net worth and borrower's profitability criteria

GLP of IFCI specified a minimum credit rating of the borrower, which reflected the credit risk involved. Credit rating from external agencies like CRISIL, ICRA, and CARE etc. were used as benchmarks. Similarly, a minimum net-worth of the borrower which reflected the credit worthiness of the entity was specified and was an important determinant of the value of the entity. In addition, profits of three years prior to date of sanction were also prescribed as criteria.

A review of the sample cases revealed that these criteria were deviated from/ relaxed in respect of 31 cases (24 *per cent* of sample cases).

C. Deviations from the Security Cover

Security management as per extant provisions of the GLP involved creation of enforceable charge over the borrower's /third party assets in favour of IFCI before the disbursement of advances / loans. Its proper valuation /storage /maintenance and insurance is required at regular intervals so that advances given by IFCI remained secured adequately. Further, the charged securities were to be periodically valued and stipulated margin as per sanctioned terms needed to be maintained throughout the credit period. The General Lending Policy also prescribed the nature of the security charged and the security classification as given below:

(i) Primary securities were to be taken to cover the full core facilities and a charge / lien created in favour of IFCI. Acceptable kinds of securities were:

a. For long-term loans and guarantees: Primary security was to be a charge over specific fixed assets financed.
b. For project loans: A mortgage of fixed assets and hypothecation of movable assets of the project was required.

(ii) Additional security like corporate guarantee, personal guarantee of promoters, subservient[6] charge on assets etc. could also be obtained as additional security.

Review of the loans sanctioned over the four years ending March 2016 revealed deviations from the above eligibility conditions in 38 cases (30 *per cent* of the sample cases) which defeated the objectives of the security norms of covering risks in case of default.

D. Deviation from other conditions stipulated in the GLP/terms of sanction

Certain conditions were stipulated as per the terms of sanction of the agreements as well as in the relevant GLP like restrictions on lending against shares, receipt of upfront fees / legal fees prior to disbursement, increase in loan tenure and recovery of other charges like liquidated damages etc. from the borrowers.

A review of the sampled cases brought out these deficiencies in 17 cases (13 *per cent* of the sample cases) defeating the purpose of reducing the risks involved in sanctioning the facilities.

E. Sanction to wilful defaulters

The General Lending Policy of the Company specifically prohibits the sanction of loan to the borrower whose promoter or whole-time directors are appearing in the 'Wilful defaulters' list of Credit Information Bureau (India) Limited (CIBIL). However, it was noticed that in three cases (two *per cent* of the sample cases), the Company had sanctioned the loans to the borrowers whose promoters/directors were appearing in the wilful defaulters list.

3.3 Audit findings

Few illustrative cases of major relaxations/deviations from eligibility criteria in sanction of loans resulting in loss of ₹ 25.57 crore apart from doubtful recovery of ₹1094.65[7]crore including outstanding interest of ₹ 97.03 crore are detailed below:

3.3.1 Cases of deviation from the General Lending Policy with regard to creation of security

Audit observed that IFCI had sanctioned credit facilities to borrowers by deviating from the provisions of its General Lending Policy relating to proper creation and valuation of the securities. Further, acceptance of unmarketable securities was also observed. The securities were found to be overvalued as these were not in line with the valuation method prescribed in

[6] Subordinate charge over the assets i.e. residual charge after satisfying the lenders holding primary charge.

[7] In cases of Monnet Ispat and Energy Limited, Bhushan Steel Limited, VBC Industries Limited and Pipavav Marine and Offshore Limited/Pipavav Defence and Offshore Company Limited.

the extant General Lending Policy. A few cases of deviations regarding security creation are detailed below:

a. Mandava Holdings Private Limited

The Company sanctioned (August 2014) a loan of ₹ 250 crore to Mandava Holdings Private Limited (MHPL) to be secured by an exclusive charge on tangible security (1.75 times) and pledge of unlisted shares (0.5 times) of Nuziveedu Seeds Limited (NSL, a group company) along with personal guarantee of the promoter. Total amount of ₹ 245.74 crore was disbursed (September 2014/December 2014/January 2015) in three tranches of ₹ 80 crore, ₹ 105 crore and ₹ 60.74 crore respectively while the balance was cancelled. The borrower requested (September 2014) first disbursement on the basis of mortgage of agricultural land and pledge of unlisted NSL shares. However, this land was not accepted as agricultural land was not enforceable under the provisions of Securitization and Asset Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (SARFAESI Act, 2002) and disbursement was made against pledge of NSL shares only.

Audit observed that pledge of unlisted shares was taken on the basis of a valuation done by a private party, which was considered as the market value in violation of the extant provisions of the General Lending Policy which stipulated creation of pledge at lower of book value or the price assessed by an IFCI appointed valuer. The Company neither assessed the book value of shares nor got the valuation conducted by an independent valuer. During the second disbursement (31 December 2014), IFCI accepted security of a land in a notified Special Economic Zone (SEZ) for Information Technology (IT) and IT enabled Services (ITeS) at Hyderabad despite clear stipulation (23 June 2014) by the Screening Committee of IFCI that the mortgaged property should be non-SEZ property. Reasons for deviating from the Screening Committee stipulation were not found on record. As per Rule 11(9) of SEZ Rules, 2006, the developer cannot sell the land. This put IFCI at risk in case the land was to be sold in case of default by the borrower. The outstanding amount as on March 2016 was ₹ 245.74 crore.

Management stated (November 2016) that the pledge of shares of NSL was done on the basis of valuation conducted by Axis Capital in line with the other lenders. It also stated that the SEZ Act does not restrict the developer from mortgaging the leasehold rights in favour of the lender. The legal opinion sought by the Company stated that SEZ land could be enforced under SARFAESI; however, in case of sale the transferee should use the land for industrial purpose only.

Reply is not tenable as IFCI deviated from its General Lending Policy by accepting pledge of shares of NSL without carrying out valuation by an independent valuer. Further, mortgage of SEZ land was in deviation from the Screening Committee's observation and provisions of rule 11(9) of SEZ Rules, 2006 which stipulated that the developer cannot sell the SEZ land.

b. Reliance Infrastructure Limited

IFCI sanctioned (January 2015) a corporate loan of ₹ 500 crore to Reliance Infrastructure Limited (RIL). The loan was disbursed (February 2015) by providing interim security of two times of the loan amount by way of pledge of shares of Reliance Power Limited (RPL). The primary security of first *pari passu* charge on land of Dahanu Thermal Power Station was to be created in eight months. The loan was to be repaid in 11 equal quarterly instalments after a moratorium of 27 months. The outstanding amount as on March 2016 was ₹ 500 crore.
Audit observed that IFCI sanctioned loan to RIL with a security cover of 1.25 times only as against the stipulated security cover of 1.75 times (out of which security cover of at least 1 time i.e. equal to the amount of loan was required to be in the form of tangible assets). Loan was disbursed on the basis of interim security of pledged shares of Reliance Power Limited as IFCI granted eight months' time for creation of primary security being mortgage of Government land which was originally allotted (August 2003) to Bombay Suburban Electricity Supply (BSES) and yet to be transferred to RIL[8]. However, it was observed that IFCI accepted the same security in respect of which RIL had previously failed to obtain no objection certificate from the Government of Maharashtra for creation of mortgage in February 2014 in respect of another loan. Due diligence was not exercised in accepting an unenforceable security resulting in non-creation of mortgage till date. Further, the External credit Rating of RPL, whose shares were being pledged, was 'A-' as against required minimum rating of 'A'.

The Management (April/November 2016) accepted that it waived/modified the terms of sanction in view of the borrower's reputed promoters and the mortgage of land had not been created due to the pending process of changing the name in the land register. Further, the process of obtaining necessary approval for creating the security in favour of IFCI has made substantial progress and the cover of pledged shares is 2.18 times at present (based on the closing market price on 07/10/2016) as against the stipulated cover of 2.00 times.

The reply is not tenable as the borrower's failure to obtain no objection certificate from the Government for creation of mortgage of the same land in 2014 (even after six years of transfer) did not deter IFCI from accepting the same again. Moreover, even though the security cover of shares is 2.18 times, the General Lending Policy stipulation requiring the tangible security cover not to be less than the loan amount has not yet been complied with.

c. Vishvaraj Infrastructure Limited

IFCI sanctioned (July 2015) a corporate loan of (₹ 100 crore) to Vishvaraj Infrastructure Limited (VIL) and disbursed (September 2015) ₹ 98 crore. The loan was to be repaid in 14 quarterly instalments after a moratorium of 18 months from the date of disbursement. The primary security was mortgage of a commercial complex and pledge of unlisted shares of VIL and its Special Purpose Vehicle, (SPV). This commercial complex was to be built on the land owned by Nagpur Municipal Corporation (NMC) which was transferred (8 May 2014)

[8] The name of BSES Limited was changed to Reliance Energy Limited with effect from 24 February 2004 and the name of Reliance Energy Limited was changed to RIL with effect from 28 April 2008.

to Orange City Mall Private Limited (OCMPL), an SPV of VIL and Kakde Infrastructure Limited (KIL), for development of the above land on the basis of a Build, Operate and Transfer (BOT) Agreement. There was an outstanding principal of ₹ 98 crore (as on 31 March 2016).

Audit observed that the loan was sanctioned on a security cover of 2.41 times and current ratio of 1.1 as against the General Lending Policy stipulated minimum security cover of 2.5 times and current ratio of 1.2. IFCI also ignored warning signals of poor financial health of the borrower which were evident from the declining trend of revenue, profits, cash accruals, interest coverage etc. in 2013-14 and 2014-15. The consolidated result showed a loss of ₹ 3.45 crore in 2013-14 from a profit of ₹ 7.76 crore in 2012-13. The revenue from operations was also declining for the last two years and cash flows from operating and investing activities were negative during 2012-13 and 2013-14.

As per BOT Agreement, OCMPL was entitled to raise finance from the lending institutions and secure the same by way of hypothecation / mortgage of the project or project site with prior intimation to NMC. However, as against the requests of IFCI and OCMPL to NMC (16 and 21 September 2015) to issue no-dues certificate for creation of mortgage of the project site and project[9] respectively, NMC permitted (28 September 2015) hypothecation/mortgage of 'project' only. It was observed that though IFCI created mortgage on the land and the structure thereon, the same would be difficult to enforce in case the borrower defaults on its loan, as it was created without NMC's permission to mortgage the project site.

As per the BOT agreement (with OCMPL), no financial encumbrance[10] over the project or the project site could be created beyond the stipulated date of the contract period or its earlier termination. It also stated that the construction should be completed in all respects by 6 August 2016. In view of the above, it is observed that as the construction on the said land has not yet started, it would be difficult to enforce the mortgage in case of termination of the contract by NMC.

The Management replied (August/November 2016) that the deviations were approved by the competent authority. It also accepted the fact that OCMPL did not have ownership over the project site and stated that NMC had acknowledged that the Mortgage created in favour of IFCI on land and buildings on 29 September 2015 was legal and valid.

The reply is not tenable as the deviations were approved after ignoring warning signals on the poor financial health of the borrower and enforcement of the security would be difficult in case of default by the borrower as the permission by NMC was specifically for the project only which did not include the permission to mortgage land.

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[9] The Project under BOT Agreement includes the construction, development and operation of the facility including shopping malls, markets, hotels, commercial areas, restaurants, entertainment areas, parking area or any other development in accordance with the terms of BOT Agreement.

[10] As per BOT Agreement encumbrance include mortgaged charge, pledge, lien, hypothecation or security interest or any other fetter.

3.3.2 Sanction to wilful defaulter

Audit observed that in respect of three cases, the loans were sanctioned to the borrowers whose promoters/ independent directors were appearing in wilful defaulters list. This was in deviation from the General Lending Policy. While one case is detailed hereunder, the second case relating to Sew Infrastructure Limited has been discussed in para 6.3.1 and the third case relating to Jubilant Life Sciences Limited has been mentioned in Annexure 1.

Mantri Developers Private Limited

IFCI sanctioned (June 2014, September 2014) two corporate loans of ₹100 crore each to Mantri Developers Private Limited (MDPL) to finance its real estate projects. MDPL created (June 2014, October 2014) security by way of mortgage of two plots of land located at Bangalore valuing ₹ 258.74 crore and ₹ 251.18 crore (DSV). As on 31 March 2016, the total outstanding loan was ₹ 177.39 crore.

RBI guidelines specifically prohibited the sanction of loan to listed wilful defaulters. Further, the extant General Lending Policy stipulated that no deviation shall be allowed by any sanctioning authority in extending credit facilities to the companies whose promoters were in CIBIL's wilful defaulters list. However, Audit observed that the first loan was sanctioned to MDPL by the Credit & Investment Committee of IFCI (10 June 2014) in deviation from its lending policy as the promoter of MDPL was in the CIBIL’s wilful defaulter list since 2007. This deviation was approved by the Executive Committee and the Board of Directors (12 June 2014) although the General Lending Policy did not permit approval of this deviation at all. The loan was disbursed on 16 June 2014.The loan was sanctioned by IFCI without analyzing the risks highlighted by the Credit Risk Management Department regarding the poor health of MDPL with respect to its exposure of ₹ 1200 crore in its group concerns as well as the large contingent liability of around ₹ 1800 crore as on 31 March 2013. Even the projected Debt Service Coverage Ratio considered was 1.5 for the loan tenure (2014-15 to 2018-19) despite the ratios of previous two years being 0.32 and 0.36 (2012 and 2013). IFCI failed to take cognizance of the fact that the estimated growth of turnover was projected at high rates for the next three years (65 *per cent*, 15 *per cent* and 25 *per cent* respectively) even though the actual trend of turnover for the previous three years prior to sanction had shown only marginal growth (around 3 *per cent*) as pointed out in the Credit Audit Report (July 2014).

The second loan was sanctioned three months after sanctioning of the earlier loan to MDPL despite its promoter’s name still appearing in CIBIL's wilful defaulters list. The financial triggers of lower income/profits in 2013-14[11] than those projected while sanctioning the first loan were also not taken note of before sanctioning the second loan.

Management stated (April/November 2016) that the deviation regarding promoter’s name being in wilful defaulters’ list was approved by the Board in June 2016. Moreover, the rich

[11] Actual income and PAT of ₹ 522 crore and ₹ 70 crore as against projections of ₹ 670 crore and ₹ 118 crore respectively.

experience of MDPL in the real estate sector and satisfactory conduct of the account were the factors considered at the time of sanction of the credit facility to MDPL.

Reply is not tenable as the General Lending Policy as well as RBI guidelines specifically prohibited the sanction of loan to wilful defaulters. Further, the extant GLP specifically stated that this deviation shall not be allowed by any sanctioning authority. Moreover, Debt Service Coverage Ratio should have been calculated conservatively especially in view of the opinion of its Credit Risk Management Department to calculate it under stressed scenarios to assess the adequacy of cash flows for meeting financial commitments with several projects being under execution/planning stages.

3.3.3 Sanction of loan in deviation from financial ratios

Audit observed that in respect of the cases detailed below, the loans were sanctioned in deviation from the eligibility conditions which required that the borrower's financial ratios be in line with those stipulated in the General Lending Policy. Due diligence was not exercised during credit appraisal resulting in the loans being sanctioned to the borrowers with poor debt servicing capabilities. Specific cases are discussed below:

a. Monnet Ispat & Energy Limited

The Company subscribed (February 2014/March 2014) to Non-Convertible Debentures (NCDs) issued by Monnet Ispat & Energy Limited (MIEL) amounting to ₹ 250 crore, secured by first *pari passu* charge on all fixed assets with a Fixed Assets Coverage Ratio (FACR) of minimum 1.25 times over NCD's tenure. MIEL defaulted in interest payment (November 2014 onwards) and also failed to clear the first principal repayment of ₹ 31.25 crore due on 1 April 2015. Meanwhile, its credit rating was downgraded twice from CARE A+ (at the time of sanction) to CARE A- (October 2014) and subsequently to CARE BBB- (November 2014) which gave IFCI a right to reset the coupon rate as per the terms of debenture subscription. The Joint Lenders Forum invoked (August 2015) Strategic Debt Restructuring (SDR) in pursuance of which a portion of the outstanding interest (₹ 11.69 crore) of IFCI was converted into equity[12]. The outstanding principal amounted to ₹ 250 crore and outstanding interest was ₹ 22.76 crore (March 2016).

Audit observed that subscription to NCDs was made even though the security cover by way of FACR was 1.25 only as against the General Lending Policy stipulated FACR of 1.75. The observations of Credit Risk Management Department (CRMD) on low FACR were mitigated by stating that the liquidity position based on future cash flows was more relevant to service debt obligations than coverage ratios. Further, despite low FACR and suggestion of Credit and Investment Committee (CIC)/CRMD, additional security was not obtained. MIEL's average projected Debt Service Coverage Ratio (DSCR) during the tenure of NCDs was 1.29 though the General Lending Policy stipulated an average DSCR of 1.4. The DSCR projections made during the sanction turned out to be unrealistic as actual DSCR during the years 2013-14 and 2014-15 remained below one. The Company did not reset the coupon rate

[12] 34.18 lakh shares @ ₹ 34.20 (₹ 10 each at a premium of ₹ 24.20 per share).

as per the terms of debenture subscription despite the downgrading of credit rating of the borrower.

Management (November 2016) replied that MIEL was rated 'CARE A+' at the time of sanction and the banking system had a total exposure of ₹ 5540 crore in it. Profitability of MIEL suffered in Financial Year 2014-15 as the Hon'ble Supreme Court de-allocated all the coal mines including five mines allotted to the Monnet group and it also had to bear a royalty payment of ₹ 252 crore. It also stated that in a consortium arrangement, IFCI shall be guided by the terms of the consortium and hence the security cover was stipulated at 1.25 times in line with the terms of sanction of the other NCD subscribers.

Reply is not tenable as documents to establish the fact that the present facility was under a consortium arrangement were not made available. Even in consortium arrangement, Company should have adequately safeguarded its financial interest and should have obtained additional security as suggested by CIC/CRMD.

Since Strategic Debt Restructuring has been invoked whereby IFCI's share in MIEL's equity is to the extent of ₹ 11.69 crore only, the recovery of remaining outstanding amount of ₹ 272.76 crore is doubtful.

b. Bhushan Steel Limited

Bhushan Steel Limited (BSL) was sanctioned/disbursed a corporate loan of ₹ 300 crore (August/September 2013) for capital expenditure and repayment of corporate loans.This loan was to be repaid in 4.5 years after a moratorium of two years. The security of first *pari passu* charge on present/future movable and immovable fixed assets of the company was to be created within six months. It was further secured by the personal guarantee of the Directors. As BSL was facing problems in repayment of dues to its lenders on account of liquidity crunch, a Joint Lenders' Forum (JLF) was formed and Corrective Action Plan (CAP) was implemented (April 2014) by JLF. IFCI sanctioned (July 2015) an additional loan of ₹ 100 crore to it under the CAP. It had a principal outstanding of ₹ 389.58 crore and interest default of ₹ 12.96 crore (31 March 2016).

Audit observed that the loan was sanctioned in violation of the extant General Lending Policy of IFCI as the Debt Equity Ratio was 2.24:1 as against the maximum Debt Equity Ratio of 1.5:1 and the current ratio was 1.06 as against the stipulated minimum of 1.33. The average Debt Service Coverage Ratio projected for the loan period was 1.42 times as against the stipulated minimum of 1.5. It was further observed that the operating profit margins and the net profit margins declined continuously in the last three years prior to sanction and the margins were expected to further decline as per the projections for FY 2014[13]. It was pointed out by the CRMD in its risk note that reduction in profit margins might have an impact on BSL's liquidity and ability to service its debt obligations and securing the loan by way of charge on exclusive immovable fixed assets may be explored. Even then the loan was

[13] The operating profit margins (19% in 2011, 13% in 2012, 11% in 2013) and the net profit margins (14% in 2011, 10% in 2012, 8% in 2013). The expected operating profit margin and net profit margin were 8% and 6% respectively.

sanctioned only on *pari passu* basis and disbursement was made only on the security of personal guarantee of the Directors. Even the Debt Equity Ratio had increased continuously in the last three years prior to sanction of the loan ranging from 1.83 times to 2.24 times.

Management replied (April, November 2016) that the facility was sanctioned wherein all the deviations were duly approved by the Competent Authority and the profitability was expected to improve significantly with sales going up.

The reply is not tenable as there was decline in profit margins at the time of sanction with further decline as per the projections and increase in the level of indebtedness which would impact BSL's liquidity and the ability to service its debt obligations. Further, the proposal submitted by BSL for restructuring its debts under the Scheme for Sustainable Structuring of Stressed Assets of RBI was under consideration (February 2017). Also, in view of substantial increase in its debt burden[14] as well as huge losses[15] during 2014-15 and 2015-16, the chances of recovery of ₹ 402.54 crore are doubtful.

3.3.4 Swapping of the credit facilities due to defaults in repayment

Audit observed that IFCI sanctioned new credit facilities to other group companies of the borrower for swapping its existing exposure in the borrower company when the borrower defaulted in the repayment of loan / buyback of equity investment. The Company, thus, closed the old facilities and swapped the same with new facilities thereby evergreening its earlier exposure which could not be recovered due to defaults. A few cases of swapping of facilities due to defaults are illustrated as under:

a. VBC Industries Limited

IFCI sanctioned (March 2013) subscription of ₹ 56.74 crore in non-convertible debentures (NCDs) of VBC Industries Limited (VBCIL) for the purpose of swapping the Company's existing exposure valuing ₹ 45 crore in the equity holdings in Konaseema Gas Power (KGPL) which was a group Company of VBCIL. The reason for the swap was KGPL's failure to honour its buyback[16] commitment (July 2012) along with the failure to pay the outstanding return of ₹ 11.74 crore (@ 16 *per cent*) thereon till the date of buyback. The disbursement took place on 2 April 2013 with first coupon @ 5 *per cent per annum* being payable on 15 April 2014 and the balance return at 7 *per cent per annum* being payable as premium on redemption of NCDs. The security was only in the form of pledged shares of KGPL and VBCIL and no other tangible security was asked for. The borrower defaulted in payment of the first coupon (April 2014) itself and no payments were received since then. The Company re-scheduled (October 2014) the outstanding NCD assistance by funding unpaid interest of ₹ 25.83 crore from 2 April 2013 to 30 September 2016 and deferring the commencement of principal repayments to September 2018.

[14] Long-term borrowings increased from ₹ 25,566.10 crore in 2013-14 to ₹ 30,927.72 crore in 2014-15 and ₹ 32,326.02 crore in 2015-16.

[15] From a profit of ₹ 95.33 crore in 2013-14 to a loss of ₹ 1254.95 crore in 2014-15 and ₹ 3573.85 crore in 2015-16.

[16] to repurchase the shares.

Audit observed that sanctioning of this facility was to facilitate buyback of investment of IFCI in equity shares of KGPL as it had defaulted in buying back these shares due to liquidity issues. This resulted in booking of unearned income of ₹ 11.74 crore (payable by KGPL) as it constituted the defaulted return on the equity facility sanctioned to KGPL, which was not actually received from the borrower, but was now extended as NCDs to VBCIL.

Further, the new swap facility was sanctioned without analyzing the repayment capability of the borrower. At the time of sanction, the borrower's plant was non-operational (March 2013) which IFCI did not verify as no site visits were carried out. The facility was sanctioned with insufficient and unmarketable securities, as at that time KGPL shares were unlisted and VBCIL shares were under lock-in period and thinly traded, thereby limiting the exit options for enforcement of the security in case of default by the borrower. The Company did not take any action even when the borrower expressed his inability (2 April 2014) to service the NCDs. Despite these defaults, the facility was treated as a standard asset. The Credit Risk Audit Report (July 2014) wherein this facility was ranked at High Risk, was closed with the justification that there was no deficiency in the process.

The Management accepted that the promoters had no liquidity to buyback IFCI's equity holding in KGPL or to service the assured return in view of dismal cash flow position. It admitted that the main aim of swap was to recover its dues through legal means. They accepted the fact that the borrower's operations were shut down at the time of sanction. It was further stated that VBCIL had an Earnings before interest, tax, depreciation and amortization (EBITDA) of Rupees seven crore at the time of sanction which was expected to improve with future growth in demand.

Management's acceptance revealed that the purpose of sanctioning this facility was for evergreening its equity exposure in KGPL due to buyback default. This resulted in doubtful recovery of ₹ 71.76 crore[17] as on 31 March 2016 apart from future liability of the borrower as regards repayment of funded interest of ₹ 10.81 crore[18] increasing the risk of IFCI.

b. Pipavav Defence & Offshore Engineering Company Limited and Pipavav Marine and Offshore Limited

IFCI sanctioned (March 2014/March 2013) loans of ₹ 150 crore and ₹ 202.22 crore to Pipavav Defence & Offshore Engineering Company Limited (PDOECL) and Pipavav Marine and Offshore Limited (PMOL) respectively for the purpose of swapping IFCI's existing exposures in respect of two facilities sanctioned earlier (May 2010 and April 2011) to SKIL Infrastructure Limited (SKIL, group company) viz. a short-term loan (STL) of ₹150 crore and Optionally Convertible Debentures (OCDs) of ₹ 200 crore.

The short-term loan to SKIL, which was swapped with loan to PDOECL, was itself sanctioned though its profits were not commensurate with its repayment capacity. Further, SKIL was already indebted to other entities to the tune of ₹ 615 crore and the group companies whose listed shares were accepted as security, were either new or were earning meager profits, which was against General Lending Policy which required that the company

[17] Including the funded interest of ₹ 15.02 crore (upto 31 March 2016).
[18] ₹ 25.83 crore-15.02 crore.

whose shares are pledged should be profit making and preferably dividend paying for the last three years.

Audit observed that the loan to PDOECL was sanctioned with the condition to utilize the same for part repayment of SKIL's loan despite being aware of its poor financial health. The Debt Equity Ratio was 2.33 which was higher than the GLP stipulated maximum of 1.6 and security cover was only 1.78 times as against a GLP stipulated minimum security cover of two times. Further, at the time of sanction it was unable to service its debt regularly to other consortium lenders. While swapping of this facility, IFCI adjusted (June 2014) ₹ 9.50 crore and ₹ 27.78 crore towards principal and interest respectively towards the loan taken by SKIL and waived-off ₹ 12.65 crore towards penal interest and liquidated damages which were levied due to default in the repayment by SKIL. The outstanding dues of PDOECL were ₹ 181.09 crore inclusive of interest of ₹ 31.09 crore as on March 2016.

As regards swapping of OCDs with the loan to PMOL, it was observed that PMOL was a newly incorporated company (June 2012) with a paid up capital of just ₹ 5 lakh. The security cover at the time of sanction was also inadequate being only 1.32 times as against the GLP stipulation of two times cover. While swapping of this facility, IFCI waived the return of ₹ 12.92 crore on OCDs of SKIL. The outstanding dues against PMOL were ₹ 166.50 crore inclusive of interest of ₹ 15.20 crore.

Audit also observed that IFCI has still classified both the facilities as standard assets despite the fact that the original facilities to SKIL was rescheduled and were further swapped with the loans extended to PDOECL and PMOL.

Thus, swapping of old facility with the new one within group companies resulted in circumventing it from becoming NPA and evergreening the same. IFCI's exposure as on 31 March 2016 of ₹ 347.59 crore (including interest ₹ 46.29 crore) for both the facilities remains doubtful. In addition, there was loss of revenue of ₹ 25.57 crore[19] due to waiver of penal interest, liquidated damages and the return on OCDs.

The Management replied (July/December 2014[20] and November 2016) that sanction of loan to SKIL was a conscious business decision, based on its financial position and future plans which could not materialize due to unexpected slowdown in the economy. The account stands closed as regards SKIL. The loan to PDOECL has been restructured under the aegis of CDR. Pursuant to takeover of PDOECL / PMOL by the Reliance Group, they have made a proposal for refinancing the existing facilities on fresh terms. The new loan to PMOL was given just to improve the asset quality for investment in SKIL. The present security cover in respect thereto was 1.22 times.

Replies are not tenable as the swapping has resulted in evergreening of a doubtful facility despite repeated defaults. Sanction of STL/OCDs on the expectation of improvement in the security cover was imprudent in view of the weak financial health of the borrowers. The refinance terms of the Reliance Group were still only at the proposal stage (November 2016). The security cover of 1.22 times in respect of PMOL facility is still below the General Lending Policy stipulation of two times.

[19] ₹ 12.65 crore in PDOECL and ₹ 12.92 crore in PMOL.

[20] Reply relates to the draft para issued to the Ministry (November 2014) now included in the Performance Audit.