CAG Report Summary
Loans to Independent Power Producers by REC and PFC

The Comptroller and Auditor General of India (CAG) submitted a compliance audit report on the 'Loans to Independent Power Producers (IPPs) by Rural Electrification Corporation Limited (REC) and Power Finance Corporation Limited (PFC)' on August 10, 2017. The audit covered the loans disbursed to IPPs between 2013-14 and 2015-16. During this time period, REC and PFC disbursed loans amounting to Rs 47,707 crore to IPPs. A significant proportion of loans extended to IPPs became stressed or turned into non-performing assets (NPAs). In this context, the audit reviewed the procedures adopted by REC and PFC for appraisal, sanction and disbursement of loans to IPPs. Key observations and recommendations of the audit report include:

- **Appraisal of loan proposals:** The CAG observed that REC and PFC did not conduct appropriate due diligence while examining the credit worthiness of the loan applicant. Both REC and PFC deviated from their internal guidelines and also did not conform to the Reserve Bank of India (RBI) guidelines on credit appraisal. Further, the experience and ability of the promoters/ borrowers to develop the projects was not assessed objectively. It also noted that loans were sanctioned to promoters who did not have relevant sector experience and were financially weak, resulting in delayed completion of projects, and consequent cost overruns.
- **Financial capacity of the promoter:** The financial capacity of the promoter to bring in equity for the project in the face of competing demands was not adequately assessed. For example, nine projects had to be restructured multiple times. This increased the interest during construction by Rs 13,313 crore in six loan cases and resulted in NPAs of Rs 3,038.44 crore in three loan cases.
- The CAG recommended that the process of appraisal of loan proposals, their sanction and disbursement may be strengthened. The existing appraisal norms may be revisited to design objective guidelines for assessing financial and technical capabilities of the promoters. Further, compliance with internal guidelines and RBI norms may be ensured at every stage of the appraisal, sanction and disbursement of the loans. Further, data submitted by the promoters may be verified independently to ensure its accuracy. The information available from independent credit rating agencies may also be considered to evaluate the financial capability of the promoter/ borrower in a realistic manner.
- **Viability of projects:** Typically, Power Purchase Agreements (PPAs) specify the appropriate tariff that would make the projects viable. The CAG noted that the internal guidelines of REC and PFC did not specify the method of arriving at the appropriate tariff in cases where the PPA had not been signed (PPAs are usually signed between IPPs and discoms). REC and PFC estimated a higher tariff at the time of appraisal of loan proposals which resulted in sanction of loans worth Rs 8,662 crore in six cases. However, in all these cases, the generation cost was higher than the actual tariff. This made the viability of the projects doubtful. Further, additional loans were sanctioned to seven projects by REC and PFC though these projects were not financially viable at the time of restructuring the loan.
- **Loan pre-disbursement conditions:** As per the Common Loan Agreement (between IPPs and REC/PFC), loan funds were to be disbursed after fulfilling the pre-disbursement conditions mentioned in the loan agreements. This helps mitigate the risks perceived at the time of appraisal. However, it was observed that pre-disbursements conditions were relaxed by REC and PFC from time to time in five loan cases.
- **Adjustment of loans:** The CAG observed that in certain cases with loans amounting to Rs 3,294 crore, REC adjusted Rs 496 crore towards interest during construction. Further, even though no repayment was made by the borrower as per the loan servicing schedule, this was not reflected in the loan account. If the interest had not been adjusted, these loan accounts would have become NPAs in 2013 itself. This was also in violation of REC's internal guidelines. At the end of 2015-16, gross NPAs of Rs 11,763 crore for IPP loans were recognized in the books of accounts of both REC and PFC.
- The CAG recommended that loan monitoring mechanisms may be strengthened to ensure that: (i) loans disbursed are used for the specific purpose for which they have been sanctioned, and (ii) incidents of diversion of loan funds are eliminated.

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August 30, 2017