CHAPTER IX: MINISTRY OF FINANCE

General Insurance Corporation of India

9.1 *Avoidable loss on account of imprudent acceptance of reinsurance treaties*[1]

Imprudent acceptance of reinsurance treaties to cover 'Rajiv Aarogyasri Community Health Insurance scheme' issued by Star Health-resulted in avoidable loss of ₹ 197.80 crore

Star Health and Allied Insurance Company Limited (Star Health) issued (March 2007) Rajiv Aarogyasri Community Health Insurance Scheme[2] (Scheme) to Aarogyasri Health Care Trust, created by the Government of Andhra Pradesh. Star Health after recovering the incidental expenses for administering the scheme from the annual premium ceded[3] (effected from March 2007) a share of it towards obligatory and voluntary cessions to General Insurance Corporation of India (GIC). For the balance, Star Health sought (February 2007) reinsurance cover from GIC on stop loss basis[4] and the same was provided from 1 April 2007 by issuing five treaties for five phases of the Scheme.

Star Health's retained premium ranged from 87.37 *per cent* to 91.50 *per cent* of Estimated Net Premium Income (ENPI)[5]. As against the premium retained by Star Health, loss retention remained almost static at 80 *per cent* of the ENPI (except for the Underwriting Year 2011 where it was 90 *per cent*). However, GIC's maximum liability ranged from 35 *per cent* to 70 *per cent* of ENPI in excess of loss retention of Star Health,

100 *per cent* minus 8.50 *per cent* and 100 *per cent* minus 12.63 *per*

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1 *An agreement between the ceding company and the reinsurer containing the contractual terms applying to the reinsurance of some class or classes of business, usually for a period of one year.*

2 *Implemented in the State of Andhra Pradesh from 1 April 2007 covered population who live Below the Poverty Line, as enumerated and photographed on the Health Card/BPL Ration card. Scheme provided cashless coverage for meeting expenses for hospitalization and surgical procedures for the beneficiary members (floater basis to benefit family) up to ₹ 1.50 lakh per family per year in any of the network hospitals.*

3

Reinsurance cession pattern of Star Health:

Gross Premium-----less----> Incidental Expenses ----less----> Obligatory cession to GIC ----less---->Voluntary Quota share cession to GIC

= Estimated Net Premium Income

----less---> Retained by Star Health (ranging from 87.37 to 91.50 *per cent* of ENPI)

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Balance ENPI to GIC for Stop Loss Cover (ranging from 8.50 to 12.63 *per cent* of ENPI)

4 *GIC would protect Star Health against an aggregate amount of claims over a period, in excess of a specified percentage of earned premium income.*

5 *ENPI was the gross annual premium less incidental expenses of Star Health, obligatory and voluntary cessions to GIC*

during the underwriting years 2007 to 2011 for a premium ranging from 8.50 *per cent* to 12.63 *per cent* of ENPI.

The overall performance of the treaties from Underwriting Year 2007 to 2011 showed continuous losses of ₹ 197.80 crore as detailed below:

Net Results and Claim Ratio of all treaties of Rajiv Aarogyashri Community Health Insurance Scheme

Treaty Number of GIC (Date of commencement)	Phase	Districts covered in the Phase	Net Result (Acceptances less cost of further reinsurance and incurred claims)	Underwriting Year 2007	2008	2009	2010	2011 (₹ In crore)	Grand Total
43788 (01.04.07)	1 and 3	Anantapur, Mahaboobnagar, Sri Kakulam,Medak, YSR(Kadap), Karimnagar,SPS Nellore,Prakasam	**Results**	-3.09	9.24	48.42	-15.75	21.42	**60.24**
			Claim ratio (*per cent*)	No claim	478	588	No claim	188	
45348 (05.12.07)	2	West Godavari,East Godavari,Chittor, Nalgonda, Rangareddy	**Results**	11.15	10.94	19.71	32.30	Not renewed	**74.10**
			Claim ratio ((*per cent*))	209	209	265	253		
45566 (15.04.08)	3 alone	Medak,YSR(Kadap), Karimnagar,SPS Nellore,Prakasam	**Results**	Did not exist	11.46	-13.47	Clubbed with Phase I		**-2.01**
			Claim ratio ((*per cent*))		249	4			
45695 (17.07.08)	4 and 5	Karnool,Adilabad,Hyderabad,Vizianagaram,Vishakhapatnam	**Results**		6.48	14.87	43.35	-10.60	**54.10**
			Claim ratio ((*per cent*))		186	251	352	47	
45698 (17.07.08)	5 alone	Nizamabad,Warrangal,Khammam,Guntur, Krishna districts	**Results**		22.46	-11.09	Clubbed with Phase IV		**11.37**
			Claim ratio ((*per cent*))		335	No claim			
									197.80

Source: SAP BW Reports as on 31.3.2012 Minus indicates profit to GIC and + indicates loss to GIC

The efficacy of underwriting and profitability of treaties was examined and audit observed that: -

- Providing reinsurance cover to Health Insurance Scheme underwritten by Star Health was not obligatory and therefore GIC was free to fix appropriate premium rate as well as terms and conditions.
- The premium to liability ratio of Star Health ranged from 1.09:1 to 1.02:1 as against this, premium to liability ratio of GIC which ranged from 1:4.12 to 1:5.54. The claim ratio[♠] of the GIC in three out (2008, 2009 and 2010) of five years exceeded 100 *per cent* of the earned premium and peaked to 588 *per cent* in 2009 which indicated that the liability accepted by GIC was not commensurate with the premium.

[♠] ***(GIC's Incurred claims/Premium earned)*100***

- Although, GIC in 2008 worked out a renewal premium rate of 21.73 *per cent* considering the claim ratio @ 104 *per cent*, it had actually charged only 12.63 *per cent*. This had also enhanced the loss ratio. GIC failed to safeguard its interest by charging a higher premium rate.

The *reply of the Ministry (February 2012) was as under:*

- GIC took a decision to accept the business with a long term perspective more so when the subject of coverage was mass health insurance to cover BPL population. It was also stated that Star Health was placing all the business with GIC only and not selectively.
- The observation that GIC should have restricted its liability to the premium, goes against the very basis of insurance practice which was to take risk and not otherwise. Further, such a proposition would lead to the situation of GIC refunding unpaid portion of the premium to the insured which was not the basis of insurance.
- Corrections viz. Inclusion of loss corridor of 5 *per cent* in excess of 95 *per cent* the year 2010-11 and increased to 10 *per cent* from 110 *per cent* to 120 *per cent* in the year 2011-12, were introduced at the time of renewals
- The treaty was underwritten based on their experience with the client and with future outlook. The referred note was only a rough working sheet and had no relevance to the strength of the client, volume of the premium involved and the perpetuity of the scheme.
- The rate charged was workable and attractive was substantiated in the rating of the scheme given to Kalignar Kapittu Thittam of Government of Tamil Nadu where GIC had charged 12.63 *per cent* and made a profit of ₹30.47 crore.

The contention of the Ministry was not acceptable for the following reasons:

- Each risk was required to be evaluated based on its individual merits and demerits. Since reinsurance contracts being annual contracts and renewal is never guaranteed, the contention of underwriting for long term perspective is not valid. Further, considering the results of all five treaties which were overall loss making at various phases, the acceptance was not prudent.
- The original policy issued by Star Health included the condition of refunding the premium in the event of profit. Thus the contention of insurance practice is not valid. The premium to liability ratio was to be in tandem with that of Star Health in the interest of the Company.
- As the scheme was ended in 2011-12, the introduction of loss corridor in 2010-11 was at the end of the scheme. It could reduce the loss only by ₹18.05 crore in the year 2010-11. Further, as against revision of loss corridor from 110 *per cent* to 120 *per cent* in the year 2011-12, GIC increased its share from 90 *per cent* to 100 *per cent*. Hence, it was practically an ineffective measure.
- GIC's contention that the premium rate calculation made as 21.73 *per cent* was a rough work is not valid as the working had a definite basis i.e. said calculations were made considering estimated claim ratio at 104 *per cent*. Moreover, charging premium rate of 12.63 *per cent* for attracting the insurer is an after thought and is

not acceptable especially when there is no competitor for GIC in the domestic insurance market.

- Kalaingar Kapittu Thittam (KKT) was introduced by the Government of Tamil Nadu in the year 2009 was not exactly as the same as Rajiv Aarogyasri Community Health Insurance Scheme introduced in 2007. As already statedeach risk had to be evaluated based on individual merit. Hence KKT was not available for comparison in Underwiriting Year 2007. The loss mitigation efforts during the succeeding years were not adequate as detailed above.

Thus, imprudent acceptance of reinsurance treaties to cover 'Rajiv Aarogyasri Community Health Insurance scheme' issued by Star Health, a private general insurance Company, resulted in avoidable loss of ₹ 197.80 crore.

National Insurance Company Limited, The New India Assurance Company Limited, The Oriental Insurance Company Limited and United India Insurance Company Limited

9.2 Avoidable loss in group health insurance scheme

Four PSU insurers suffered a loss of ₹ 121.81 crore, during the four year period ending June 2012, due to their imprudent decision to enter into a co-insurance agreement with Star Health and Allied Insurance Company.

In November 2007, the Government of Tamil Nadu (GoTN) invited bids from the general insurance companies to provide health cover (Insurance Scheme) to the employees (including their family members) of the government departments, state public sector undertakings, local bodies, state government universities and statutory boards under the control of GoTN.

Star Health and Allied Insurance Company Limited (STAR), in association with ICICI Lombard, quoted (11 February 2008) lowest rate of insurance premium at ₹ 675 per employee per annum. The four public sector insurance companies[1] (NIA, NIC, OIC and UIIC: PSU insurers) had also participated in the bidding by quoting a premium ranging from ₹ 720 to ₹ 780[2] per employee per annum. After further negotiations with GoTN, STAR agreed to a final premium of ₹ 495 per employee per annum.

Even though the premium quoted by the PSU insurers was much higher than finally agreed to by STAR, the four PSU insurers entered into a co-insurance agreement (18 February 2008) with STAR as leader. According to the agreement, the four PSU insurers shared 15 *per cent* each in the Insurance Scheme. The premium, claims and agreed expenses were to be shared in the ratio of 21:19:60 among STAR: ICICI Lombard: the four PSU insurers. Subsequently, STAR issued (June 2008) the Health Insurance Policy covering a period of four years ending June 2012.

Under the scheme, for the period from June 2008 to June 2012, the four PSU insurers received premium of ₹ 137.33 crore and accepted an expenditure of ₹ 259.14 crore

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[1] *(1) The New India Assurance Company Limited (NIA), (2) National Insurance Company Limited (NIC), (3) The Oriental Insurance Company Limited (OIC) and (4) United India Insurance Company Limited (UIIC).*

[2] *NIC ₹780; NIA ₹730; OIC ₹725 & UIIC ₹720*

towards claims, administrative charges and other expenses. The PSU insurers suffered a total loss of ₹ 121.81 crore on this insurance scheme as per details given below:

Details of actual premium received and claims accepted against 15 *per cent* of agreed share (figures: ₹ in crore)					
	NIA	**NIC**	**OIC**	**UIIC**	**Total**
A. Share of Premium	34.31	33.62	34.04	35.36	**137.33**
B. Share of claims honoured & other expenses	64.50	62.87	62.75	69.02	**259.14**
Loss (A-B)	30.19	29.25	28.71	33.66	**121.81**

It was also observed in Audit that the PSU insurers agreed to STAR's rate of premium without any recorded reasons and even without having the details regarding number of employees to be covered, composition of age group, previous medical history, morbidity, mortality of the persons to be insured etc. The PSU insurers were not informed of the details of the actual number of employees and their family members to be covered as at the beginning of each policy year, in the absence of which, the adequacy of the premium distributed by STAR could not be verified. It was also noticed in Audit that the co-insurance agreement did not contain any provision for verification of the claims/costs allocated to PSU insurers by STAR and to withdraw from the co-insurance agreement any time during the policy period by mutual consent.

UIIC/ NIA stated (July 2012/January 2013) that the acceptance of lower premium was on account of group discount and coverage of specific diseases only. NIC stated (October 2012) that, as STAR had experience and expertise to manage such large schemes, it was agreed to be a co-insurer at the rate accepted by STAR. OIC stated (September 2012) that, as was the practice, all the PSU insurers signed a common co-insurance agreement with STAR.

The above reply was not acceptable as:

- The decision of the four PSU insurers to undertake the co-insurance with STAR, at abnormally reduced premium compared to their own quotes, was not based on any documented analysis. In fact, they accepted a premium rate which was a negotiated one by STAR only.
- There were no checks in place to ensure that the premium, claims and costs was correctly allocated by STAR to the PSU insurers.
- Although the share of 15 *per cent* was common to each of the four PSU insurers, surprisingly, each PSU insurer had received varying amounts of premium and accepted different amounts of expenditure as indicated in the above table.

In sum, a substantial part of claim was borne by the four PSU insurers, who accepted the co-insurance in spite of low premium and without putting in place appropriate checks and balances to safeguard their financial interests.

The matter was reported to the Ministry in August 2012, their reply was awaited (March 2013).

The Oriental Insurance Company Limited

9.3 Loss due to excess retention of risks in outward placements

The Company suffered a loss of ₹ 17.67 crore due to excess retention of risks in outward placements

Insurance Regulatory & Development Authority of India (IRDA) (General Insurance Reinsurance) Regulations, 2000 govern the reinsurance arrangements in India. Clause 3(4) of IRDA regulation stipulates that the reinsurance programme of every insurer shall commence from the beginning of every financial year and every insurer shall submit it to IRDA. According to the reinsurance programme of The Oriental Insurance Company Limited (the Company), it cedes a specified percentage of the sum insured (obligatory cession) to the Indian reinsurer, which is General Insurance Corporation of India (GIC). Surplus after obligatory cessions may be offered to the Indian insurers (intergroup cessions). Further, surplus after intergroup cessions are ceded in the treaties of the Company. Remaining balance of sum insured is placed facultatively to the individual reinsurers on 'case to case' basis at the time of issuance of policy for each risk as and when the same is underwritten by the Company.

As per IRDA circular on Reinsurance Arrangement – Guidelines for good Corporate Governance (November 2004):

- The authority to approve the reinsurance programme of the insurer shall rest solely with the Board of Directors. Any changes found necessary during the process of placement of the programme or at a subsequent date should be reported immediately to the Board and their prior approval obtained for the changes.
- The management shall not have the authority to increase the net retention of the insurer either through failure to place reinsurance or through placement of reinsurance on terms different from the terms of the original risk, without prior written approval of the Board of Directors.
- An insurer shall 'not go on risk' without the required reinsurance having been fully placed.

During a review of reinsurance operations of the Company, it was observed that the Company suffered loss of ₹ 9.93 crore in one case due to excess retention of risks beyond the limits specified in reinsurance programme and loss of ₹ 8.54 crore in another case due to underwriting the risk on terms different from that given by the reinsurers. The details of these two cases are as under:

(i) The Company issued a special contingency policy to M/s Neo Sports Broadcast Private Limited covering the risk of loss of revenue in broadcasting three live One Day International (ODI) cricket matches between India and Australia held on 17 October 2010 at Kochi, 20 October 2010 at Vizag and 24 October 2010 at Goa. Two claims occurred under the policy due to cancellation of the first and third ODI cricket matches at Kochi and Goa.

Audit observed that the Company did not reinsure the risks as per reinsurance programme for that year. As per reinsurance programme, the net retention of the risk in respect of first ODI cricket match should have been only 28.47 *per cent* while the Company retained 56.24 *per cent* of the risk in its net portfolio resulting in excess retention of risk by 27.77 *per cent* without any recorded justification. Similarly, there was additional retention of risk by 23.33 *per cent* (47.62 *per cent* instead of 24.29 percent) in respect of third ODI cricket match. This additional retention of risk in its account was in violation of IRDA circular on Corporate Governance, 2004 according to which the Company should not have gone on risk without the required reinsurance having been fully placed. This resulted in loss of ₹ 5.60 crore (27.77 *per cent* of claim amount of ₹ 20.17 crore) and ₹ 4.33 crore (23.33 *per cent* of claim amount of ₹ 18.56 crore) in respect of first and third ODI cricket matches, respectively, totaling ₹ 9.93 crore.

Management accepted additional retention which was a result of policies being issued from two different locations due to which accumulation of risk was not noticed at the time of inception of risk and added that to avoid recurrence of such errors, the Company had taken steps to centralise approvals for cricket matches.

(ii) The Company issued a Comprehensive Mega Risk Policy to M/s Krishak Bharti Co-operative Limited for the period 1 April 2006 to 31 March 2007 covering the risk of Material Damage viz. Building, Stock, Plant & Machinery and Loss of Profit of the insured. There were two claims under the policy viz. Material Damage (MD) and Fire Loss of Profit (FLOP) for loss due to 'Flood' and 'Inundation' due to 'Heavy Rains' from 8 August 2006 to 11 August 2006 which were approved by the Company for ₹ 15.87 Crore (January 2009) and ₹ 13.33 Crore (November 2009) respectively.

Audit observed that the Company issued the Policy containing terms that were different from that given by the reinsurer for facultative support. As per 'reinsurance slip' of the reinsurer, the deductible[♣] for MD was ₹ 3.5 Crore and the deductible for FLOP was profit for 21 days. The Company issued the Policy with ₹ 25 lakh as deductible for MD and profit for 14 days as deductible for FLOP. However, no justification for doing so was found recorded. No prior approval of the Board of Directors of the Company was obtained for such deviations which was in violation of IRDA circular on Corporate Governance, 2004.

The Company settled both the claims mentioned above after deducting ₹ 25 lakh and profit for 14 days from MD and FLOP respectively. Thus, the issuance of policy on different terms and conditions of deductibles (MD and FLOP) resulted in loss to the Company amounting to ₹ 3.25 Crore (₹ 3.50 Crore less ₹ 0.25 Crore) in MD claim and ₹ 5.29 Crore (₹ 15.86 Crore, deductible of profit for 21 days as per Reinsurer *less* ₹ 10.57 Crore, deductible of profit for 14 days as per policy issued) in FLOP claim totaling ₹ 8.54 Crore.

Management justified (September 2012) their decision of underwriting the risk with changed terms of deductibles as they had collected an additional premium of ₹ 79.78 lakh, going by the spirit of the guidelines of IRDA dated 28 September 2006 on collecting additional premium commensurate with the additional risk resulting from variation of terms, though no specific guidelines were available at the time of commencement of risk on 1 April 2006.

Reply of Management that there were no specific guidelines, is not acceptable in view of the fact that IRDA had issued the circular on Reinsurance Arrangement- Guidelines for

[♣] ***Deductible is the amount of expenses that must be paid 'out of pocket' by the insured before an insurer pays any expenses***

Good Corporate Governance in November 2004 i.e. well before commencement of risk. As per this circular, the Management of the Company did not have any authority to increase the net retention of the insurer without prior written approval of the Board. Thus the circular of September 2006, ibid, was subsequent to the policy. It directed the filing of full particulars, of such cases where insurer varied the terms from those quoted by the reinsurer, with IRDA, which was not done. Even after considering additional premium, the Company had suffered a loss of ₹ 7.74 crore in this case.

Thus, the Company suffered loss of ₹ 17.67 crore due to excess retention of risks in outward placements in the two cases.

The matter was reported to the Ministry in November 2012, their reply was awaited (March 2013).

PNB Housing Finance Limited

9.4 Doubtful recovery of loan due to inadequate scrutiny

Recovery of ₹ 24.82 crore has become doubtful due to inadequate scrutiny of a secured asset, relaxing the debt equity norms for sanction, non compliance with pre-disbursement conditions and deficient monitoring of Escrow Accounts.

PNB Housing Finance Limited (the Company) has been in the business of providing housing and non housing loans to individuals and corporate bodies since the last 25 years. During audit of construction finance at Corporate Office two instances of lapses came to notice because of which an amount of ₹ 24.82 crore has become doubtful of recovery:

A. Loan to Aura Infrastructure Private Limited

A term loan of ₹ 16 crore was sanctioned (December 2007) for undertaking the construction of seven blocks of 280 flats (Phase-1) out of a total of 14 Blocks, under the banner "Aura Chimera" at Ghaziabad at an estimated project cost of ₹ 38.60 crore with scheduled completion by March 2009. The loan was disbursed in four instalments between December 2007 and September 2008. The borrower defaulted in repayment of loan instalments from the first instalment itself (due in October 2009) as well as interest payment from May 2010. Project construction came to a standstill in the second half of 2009. As the loan account had become 'NPA' in January 2010, the Company took over possession of the secured asset (project land) in March 2010, but could not sell it because of involvement of third party interests who had filed a case against the borrower for non-delivery of flats booked. Work of construction was not completed till January 2013.

Following deficiencies were observed in this case:

- There was deficiency in assessment of the credit worthiness of borrower company, being recently incorporated (May 2006) at the time of sanction as corroborated by low net worth of ₹ 5.22 crore as compared to the total project cost of ₹ 38.60 crore. Also, the promoters were common to the other four group companies with a liability to complete 14 projects at hand.

- The loan was to be disbursed subject to receipt of the specified amount of promoter's contribution and customer's advances. However, the second, third and fourth instalments of ₹ 4 crore, ₹ 2 crore and ₹ 2 crore respectively were released despite the fact that promoters' contribution including advances from customers were short of the specified amount by ₹ 14.76 crore, ₹ 13.03 crore and ₹ 7.07 crore respectively in violation of the prescribed condition for disbursements.

- As per special terms and conditions of project loans, 'Debt Equity' ratio was to be maintained within 2:1 during the period of loan. However, Company's treatment of unsecured loans as quasi capital instead of debt in violation of established accounting principles, resulted in sanction of loan at an extremely high debt equity ratio of 4.37:1.
- As per the terms of sanction, an Escrow account was to be opened by the borrower for depositing the sale proceeds of the project, from which only a specified amount was permitted to be withdrawn. However, the Company failed to monitor flow of funds into and withdrawals from the Escrow Account in violation of the sanction terms**,** which resulted in withdrawal of ₹ 17.32 crore (till October 2009) from the account by the borrower as against permissible limit of ₹ 8.03 crore. The Company did not ensure that the loan disbursed was utilized for the earmarked project. This was revealed during site visit by the officers of the Company (May 2010) for verification that the amount disbursed was utilised on all blocks including those in phase-II, instead of only seven blocks that were financed.

Management stated (July 2012 and September 2012) that:

- The credit worthiness and project evaluation was properly done before sanction.
- Disbursements were in order based on Chartered Accountant's and Architect's Certificates.
- Debt Equity Ratio (including quasi equity) was maintained at 2:1.
- Escrow Account was managed effectively and that the maximum amount of ₹ 15.18 crore was permitted for withdrawal therefrom.

Reply of the Management is not acceptable in view of the following:

- The credit worthiness of the borrower was not properly assessed, as being common promoters, they were burdened with the liability to finish 14 other projects, besides servicing the present loan.
- The project stage completion certification by the Architect (Aug 2008) as 79.4 *per cent* complete was incorrect, as the subsequent technical assessment by the Company (December 2010) revealed that the project was, approximately, 47 *per cent* complete.
- Treatment of unsecured loans as 'equity' was not as per established accounting principles.
- ₹ 15.18 crore was only a projected amount of advance to be received from customers and could not be construed as the maximum permitted amount to be withdrawn from Escrow Account**.**

***B. Loan to AJS Builders**:*

A term loan of ₹ 4 crore was sanctioned (May 2008) for completion of construction of a residential project which had commenced in November 2005 in the name of "Media

Majestic Towers" at Ghaziabad. The project was to be completed by September 2008. The loan was disbursed in two instalments of ₹ 2 crore each in May 2008 and September 2008 respectively. The borrower defaulted in repayment of first instalment itself (November 2008), as well as in the interest payments from July 2009. The Company took over possession of the project land along with superstructure (July 2010). Aggrieved with the possession order, the flat allottees approached Debt Recovery Tribunal (DRT) (September 2010) in which the Company was made a respondent. DRT vide order dated 7 August 2012 set aside the possession of secured asset by the Company, as being bad in law. Company filed an appeal against the order of DRT as well as a criminal case against the borrower.

Following deficiencies were noticed in this case:

- Loan was advanced in May 2008 whereas construction had come to a halt in April 2007. The Company failed to verify the fact that the builder did not have permission to construct 9^{th} and 10^{th} floor as was revealed during proceedings of DRT (August 2012).
- The Company did not ensure fulfilment of pre-disbursement conditions on receipt of promoters' contribution and customer advances as there was a shortage of ₹ 88.71 lakh at the time of release of first instalment.
- As per the terms of loan sanction, the Company was to monitor the flow of funds into the Escrow Account. Though no deposits were made in the Escrow Account between May and September 2008**,** the Company released second instalment of ₹ 2 crore in September 2008.
- Though the building was already complete upto 9^{th} floor, the Company failed to verify status of the superstructure and later it was found that individual flats were already mortgaged to other financial institutions (May 2005) by the buyers and taking over of possession of site by the Company under SARFAESI[♣] Act was also quashed by the DRT (August 2012).

Management stated (July 2012) that:

- Disbursements were made after receipt of promoters' contribution**.**
- No amount was deposited in Escrow Account as payment of subsequent instalments by buyers could not materialise due to dispute between flat buyers and the Builder.
- The member's bookings did not create a mortgage in favour of banks who had given them the credit.

Management's reply is not acceptable in view of the following:

- There was a shortage of ₹ 88.71 lakh at the time of release of first instalment.
- An amount of ₹ 43.57 lakh was received from customers between the two disbursements which were not routed through Escrow Account. The Company overlooked this fact and released the second instalment.

[♣] ***Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002***

- The Company's action of taking over of the possession of the secured asset was quashed by the DRT in respect of the flats already sold due to the fact that it did not receive any title in respect of the same.

Thus, inadequate scrutiny of the secured asset's title, non compliance with pre-disbursement conditions and debt equity norm, deficient monitoring of Escrow Accounts and loan utilisation led to avoidable disbursement of loans of ₹ 24.82 crore (Principal ₹ 19.97[1] crore and interest ₹ 4.85[2] crore) whose recovery is doubtful.

The matter was reported to the Ministry in November 2012, their reply was awaited (March 2013).

SBI Cards and Payment Services Private Limited

9.5 Avoidable loss due to short payment of Service Tax

Avoidable payment of interest of ₹ 23.91 crore on delayed payment of ₹ 61.40 crore towards service tax due to lack of internal control.

SBI Cards and Payment Services Private Limited (the Company) is engaged in provision of Credit card services to the customers in India. The services provided by the Company were brought under the service tax levy from 16 July, 2001. The service tax was to be deposited with Service Tax Authorities on collection basis up to June 2011 and on accrual basis thereafter with the introduction of Point of Taxation Rules, 2011[3]. In accordance with Rule 6 of Service Tax Rules, 1994, the service tax was payable within 5 days of the month (6 days in case of electronic deposit of tax) immediately following the calendar month, in which payments were received for the value of taxable services up to June 2011, and thereafter, in which the service is deemed to be provided in terms of the Point of Taxation Rules. In case of delayed deposit of service tax, interest was payable on delayed deposit at the rate of 18 *per cent* per annum (13 *per cent* p.a. up to March 2011) as per Notification No.14/2011 – Service Tax dated 1 March 2011.

The Company was making payment of service tax amount collected from its non-delinquent customer on receipt basis (till June, 2011) and reversing its income including service tax amount on customer becoming delinquent. The Company on receipt of payment from such delinquent customers was required to deposit the service tax amount payable on such receipts.

The Company, however, failed to deposit service tax amounting to ₹ 36.63 Crore collected from delinquent customers for the period 2008-09 to 2010-11 which was deposited in April 2011 along with interest of ₹ 7.01 crore on delayed deposit of service tax for the period 2008-09 to 2010-11 in May 2011. The Company at the time of remittance of service tax (May 2011)informed the Service Tax Authority that it would investigate its IT system for any short payment of tax for the period 2006-08. The

[1] ***₹15.97 from Aura Infrastructure and ₹4 crore from AJS Builders.***

[2] ***₹2.86 crore from Aura Infrastructure and ₹1.99 crore from AJS Builders***

[3] ***As per Point of Taxation Rules, 2011 - Point of taxation was:***

(a) ***the time when invoice for the service provided or to be provided was issued or fourteen days from the date of completion of provision of service, whichever is earlier;***

(b) ***in case of receipt of payment by service provider before time specified in (a) above, the time when payment is received.***

Company finally computed its service tax liability for the period 2006-07 and 2007-08 based on audited financial statements and deposited the differential tax liability of ₹ 24.77 crore in March 2012 along with interest of ₹ 16.90 crore, on delayed payment of differential amount of service tax for the period 2006-07 and 2007-08, in April 2012. Thus the Company incurred avoidable expenditure on payment of interest of ₹ 23.91 crore (₹ 7.01 crore + ₹ 16.90 crore) due to delayed payment of ₹ 61.40 crore (₹ 36.63 crore + ₹ 24.77 crore) towards service tax for the period from 2006-07 to 2010-11.

Management stated (September 2012) that IT systems of the Company deployed for computing service tax were deficient and added (October 2012) that it has duly rectified the process gap in IT systems which had resulted in involuntary short payment and had paid the applicable service tax liability from April 2011, in the normal course.

It was noticed in Audit, however, that the Company failed to take cognizance of continuously increasing trend in outstanding liability towards service tax appearing in the books of accounts (liability on account of service tax was ₹ 2.06 crore as on 31 March 2002 and it stood at ₹ 65.39 crore as on 31 March 2011) and defaulted in payment of statutory dues. Deficiency in IT system, if any, could have been remedied through internal audit of IT system had the Company made any attempt to ascertain the specific reasons for accumulation of liability towards service tax in the books of accounts.

Ministry stated (December 2012) that loss in the form of interest paid to the service tax authorities got compensated as the amount available in the Service Tax Payable Account contributed to the 'working funds' of the Company which resulted in a lesser bank borrowings and interest thereon.

Reply of the Ministry is not tenable as statutory dues are not meant for meeting working capital requirements of the Company.

Thus lack of internal control in ascertaining reasons for huge accumulation of liabilities towards service tax in the books of accounts led to avoidable payment of interest of ₹ 23.91 crore due to delayed payment of service tax of ₹ 61.40 crore for the years 2006-07 to 2010-11.

9.6 Avoidable expenditure on expired cards

Company incurred avoidable expenditure of ₹ 22.13 crore towards processing and management charges on expired cards

SBI Cards and Payment Services Private Limited (the Company) was incorporated as a Joint Venture between State Bank of India (SBI) and General Electric Capital Corporation (GECC) for issuing, sale and marketing of Credit Card products in India, under the brand name and logo of SBI, with 60 *per cent* equity participation of SBI and 40 *per cent* of GECC. The Company's responsibility was to develop a frame-work, strategy and policies for issuing Payment Products in consultation with GE Capital Business Process Management Services Pvt. Ltd. (GECBPMSL), the backend Company, which was formed as a Joint Venture simultaneously by SBI and GECC with 40:60 equity participation to undertake processing activities.

As per pricing agreement (June 2002) between the Company and GECBPMSL, the entire processing activities pertaining to Payment Products were to be exclusively undertaken by GECBPMSL. The Company was to pay a fixed amount per Card in Force (CIF) per annum for specialized credit card processing service charges. In addition, the Company agreed to reimburse business process management service charges on actual basis upto February 2011 and at the rate of ₹ 387 per CIF from March 2011 to March 2012. The pricing agreement was renewed annually.

The Company incurred excess expenditure of ₹ 22.13 crore towards processing and management charges on 1.40 lakh expired cards (1.03 lakh cards expired prior to April 2008, 0.32 lakh cards expired during 2008-09, 0.004 lakh cards expired during 2009-10 and 0.05 lakh cards expired during 2010-11) during 2008-09 to 2011-12 as detailed below:

Avoidable payment of back end charges on expired cards

Particulars/ date of expiry of cards	**Prior to April 2008**	**2008-09**	**2009-10**	**2010-11**
No. of cards	102578	32390	376	4733
Rate of payment (₹) for backend services[♣]	1702.55 (a to f)	1322.77 (b to f)	1035.99 (c to f)	713.64 (d+f)
Total avoidable payment (in ₹)	17,46,44,174	4,28,44,520	3,89,532	33,77,658

Management stated (September 2012) that there was a 'valid up to' date mentioned on Credit Cards issued and as long as the customers continued to pay applicable fees, cards remained active till the date mentioned on the card. Avoidable payment pointed out above, however, is on account of cards whose validity had already expired.

The matter was reported to the Ministry in December 2012, their reply was awaited (March 2013).

The New India Assurance Company Limited

9.7 Settlement of fire claim arising from acceptance of avoidable liability through imprudent risk underwriting

The New India Assurance Company Limited issued a Standard Fire and Special Peril Policy covering the finished goods stock of jute and hessian materials of the insured overlooking a vital requirement that jute godowns should be detached from process block, so essential for deciding on the eventual acceptance of risk, resulting in settlement of an avoidable claim of ₹ 6.91 crore.

Divisional Office – VIII, Kolkata of The New India Assurance Company Limited (NIACL) issued a Standard Fire and Special Peril Policy to M/s Hoogly Mills Company

♣

Rate of backend service charges per CIF/Year	2008-09	2009-10	2010-11	2011-12
Specialized card processing excluding Service tax(ST)	338	260	260	260
Business process management excluding ST	-	-	32.25	387
Rate of Service Tax	12.36 *per cent*	10.30 *per cent*	10.30 *per cent*	10.30 *per cent*
Specialized card processing including ST	379.78 (a)	286.78 (b)	286.78 (c)	286.78(d)
Business process management including ST			35.57 (e)	426.86 (f)

Limited (the insured) covering their stock of finished goods (jute and hessian materials) held at Gondalpara Unit for the period from 1 April 2008 to 31 March 2009. A claim was lodged by the insured for damage of finished goods stock held in 'Broad Loom Shed' due to fire on 14 May 2008 which was settled on 17 June 2009 for an amount of ₹ 6.91 crore.

The policy covering stock of finished goods in various godowns and/or sheds within the mill premises for a sum insured value of ₹ 14 crore was issued subject to the stipulation that jute godowns be detached from process block. Add on cover for Spontaneous Combustion was also obtained by the insured under the stated policy.

It was observed in audit that the entire mill was segregated into main mill block, raw material godown, finished goods godown (comprising separate units numbered 8, 9, 17, 18 & 21), yarn shed godown, and broad loom shed cum finished goods godown. The broad loom shed cum finished goods godown was under single common roof with no partition or demarcation. Though all the above godowns were separated from each other, 50 *per cent* of stock of finished goods were being stored in a part of the Broad Loom shed. No demarcation/separation was there for the portion used as looming section installed with looming machinery.

Final Surveyor had opined in his report that the Broad Loom shed was divided into five equal bays out of which two bays were occupied for storage of finished goods and the remaining three bays were installed with (a) conventional looms for weaving Quality Hessian Fabrics and for value added products and (b) precision winding machines for compact winding of yarn. It was also observed by the Surveyor that (a) the fire could have been caused by short-circuiting, (b) in three out of five bays being used for weaving, the fluff which had accumulated in the area had acted as a fuse for the fire to spread fast, and (c) the entire power distribution i.e. Power Cables, Distribution Boards and the Switches were totally damaged by the fire.

Tariff Advisory Committee (TAC) accredited auditor, while calculating the probable maximum loss had observed from the stock position that 50 *per cent* of the total stock of finished goods was kept in the 'Broad Loom Shed' and the remaining 50 *per cent* was stored in the other godowns and that in case of fire, the probable maximum loss of finished goods in the 'Broad Loom Shed' would be about 90 *per cent* whereas in the other seven godowns which were detached from the main mill block it would be around 75 *per cent* of the declared value of stock.

It was also noted that even though the property was previously insured with United India Insurance Company Limited (UIICL), details of premium collected and claims lodged over the last three years were not obtained long before underwriting the risk or settling the claim.

It is thus evident that underwriting of the risk was imprudent on the following grounds:-

(i) the condition imposed in the policy that jute godowns be detached from process block was not capable of being met by the insured given the nature of construction of the 'Broad Loom Shed',

(ii) risk was underwritten (w.e.f.1 April 2008) prior to risk inspection (16 April 2008) being carried out by the Tariff Advisory Committee (TAC) accredited auditor,

(iii) claim experience details from the previous insurer (UIICL) were not obtained,

(iv) even though the risk inspection report mentioned that the probability of loss was higher in the case of finished goods stored in the 'Broad Loom Shed', steps were not taken by the insurer to intimate the insured to ensure removal of the stocks from the 'Broad Loom Shed', thereby minimising the probable risk.

The Management stated (September 2012) that:

- Underwriting of the risk was acceptable as the stocks mentioned in the policy were essentially covered as they were stored within the premises of the jute mills which further establishes that godowns, irrespective of whether being attached to or detached from process blocks, are covered under the policy for which a rate of ₹3.15 per mille was charged pursuant to Risk Code 111 of Section 4 of the Company’s Internal Guide Rates (applicable w. e. f. 01.01.2008).
- Even if audit observed some godowns as attached, acceptance of the risk was not rendered incorrect since the rate charged was adequate for stocks located within the compound of the mills.

The reply of the Management is not acceptable in view of the following:

- Vital factors, i.e. specific stipulation in the policy regarding detachment of jute godowns from process blocks, timely conduct of risk inspection and consideration of past claim experience were totally ignored prior to underwriting the risk.
- The rate charged coupled with the rider provided in the form of detachment of jute mills from process blocks did not in any manner establish that godowns irrespective of whether being attached to or detached from process blocks, were covered under the Policy as contended by the management.

Thus, imprudent underwriting by NIACL without considering the related risk factors resulted in settlement of a fire claim for ₹ 6.91 crore, which could have been avoided had the policy not been underwritten, given the layout of the 'Broad Loom Shed'.

The matter was reported to the Ministry in October 2012, their reply was awaited (March 2013).