CHAPTER VII: MINISTRY OF FINANCE

Canbank Factors Limited

7.1 Non-Performing Assets

7.1.1 Introduction

Canbank Factors Limited, Bangalore (Company) was incorporated in 1991 under the Companies Act, 1956, with 70 *per cent* equity held by Canara Bank, 20 *per cent* by SIDBI and 10 *per cent* by Andhra Bank. It was registered with Reserve Bank of India as a Non-Banking Financial Company (NBFC) with the status of 'Non Deposit Taking – Category B company' in 1997 and registered as 'NBFC–Factor' in terms of the Factoring Regulation Act, 2011. The Company has 13 branches[1] across the country.

Factoring is a financial arrangement, wherein a financial institution (Factor) purchases the accounts receivable of a seller (Client) of goods and services, and pays up to 80 *per cent* to 90 *per cent* of the due amount to the Client immediately. The Client assigns the accounts receivable to the Factor, who pays the remaining amount to the Client when the buyer (Customer) actually makes the payment for the transactions. The factor charges interest (discount charges) and service charges. Thus, Factoring provides assistance in the form of working capital for the Client, by immediately converting part of credit sales into cash. Factoring service in India is offered with recourse, *i.e.*, with the right of the Factor to claim bad debts from Client in the event of default by Customer.

The three major activities of the Company include

1. Factoring (Discounting of Sales Bill)

2. Reverse Factoring[2] (Discounting of Purchase Bill) backed by Bills of Exchange/ Hundi or Undertaking Cum Indemnity Bond (UCIB)

3. Invoice Discounting[3] of Sale/ Purchase Bills backed by Letter of Credit (IDLC).

The amount of funds disbursed by the Factor to Clients against bills factored at any point of time is called Funds in Use (FIU). If a factored bill remains outstanding for payment by the Customer for more than 180 days past the due date, as per RBI norms, it is classified as a Non Performing Asset (NPA). The status of FIU and NPA at the end of each year during the period from 2013-14 to 2015-16 was as follows-

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[1] ***Bengaluru, Chennai, Hyderabad, Coimbatore, Hosur, Mumbai, Pune, Delhi, Ludhiana, Ahmedabad, Indore, Chandigarh and Bhubaneswar.***

[2] ***Reverse factoring or Purchase bill factoring means factoring the purchase bills of the clients and making payment to their suppliers on behalf the client. On due date, the client will make the payment to the factor.***

[3] ***Invoice Bill discounting is a method of lending advance against bills of exchange and mostly against security, whereas factoring is an outright purchase of trade debts after providing for returns, allowances and discounts***

(₹ in crore)

Year	Funds-in-Use	Amount of NPAs	Percentage of NPA to FIU	Provision for NPA	Revenue from Operations	Profit Before Tax
2013-14	698.35	129.96	18.61	65.19	80.36	16.07
2014-15	859.89	133.65	15.54	47.16	88.57	22.84
2015-16	793.80	214.51	27.02	80.21	97.20	3.22

NPAs have increased by ₹80.86 crore during 2015-16, representing an increase of about 60 *per cent*, as compared to previous year due to addition of as many as 20 accounts during the year. Similarly, the provisions for NPAs have increased during the year 2015-16 by ₹33.05 crore, with resultant impact on profitability of the company.

7.1.2 Audit Scope, Sample and Methodology

Audit involved examination of Non-Performing Assets (NPA) accounts of the Company as at the end of 2013-14, 2014-15 and 2015-16. There were 73[1] such NPA accounts, out of which Audit selected those accounts which were valued at more than ₹1 crore each. Such criteria resulted in selection of 45 NPA accounts (**Annexure II**), which represented 62 *per cent* of all NPA accounts by number and 95 *per cent* by value. Relevant records at the Registered Office at Bengaluru and four branches (Bengaluru, Hyderabad, Mumbai and Delhi), out of 13 branches of the Company, were examined during May 2016 to September 2016.

7.1.3 Audit Objectives

The objectives of audit were to assess whether

- Adequate due diligence was exercised in verification of business activities of applicants before approval of financing;
- Financing was in compliance with extant Rules and instructions and review of accounts was effective; and
- Mechanism for recovery from NPA accounts was transparent and effective

7.1.4 Audit Criteria

The criteria adopted for examination of issues relating to the Audit objectives were:

(i) Manual of Instructions framed by the company

(ii) Agenda and Minutes of the Board of Directors

(iii) Sanction files/documents pertaining to factoring services

(iv) Factoring Regulations Act, 2011 and RBI guidelines issued from time to time

[1] ***NPA accounts prevailing as at end of 2013-14, 2014-15 and 2015-16 irrespective of the year in which the account was classified as NPA***

(v) MIS Reports, Internal Circulars

7.1.5 Audit Findings

There are various reasons for an account becoming NPA and no single deviation/deficiency in sanctioning the factoring limits is solely responsible for the account becoming NPA. However, deviation from major norms as noticed in 28 out of 45 cases test checked by audit are given in succeeding paragraphs, in which total amount of NPA was ₹143.40 crore **(Annexure III).**

7.1.5.1 Sanction of factoring limits in excess of prescribed limits

(I) Para 9.4.5 (f) of Manual of Instructions framed by the Company stipulates that in case of the Clients who were enjoying Working Capital limits of ₹1 crore and above from banks, a copy of Credit Monitoring Arrangement (CMA)[1] as submitted to Banker was to be obtained and the exposure of the Company was to be justified based on Maximum Permissible Banking Finance (MBPF), if the exposure was within the purview of MPBF.

Audit noticed that in respect of 5 accounts (**Annexure IV**), the factoring limits were sanctioned/disbursed to Clients in excess of MPBF to the extent of ₹35.29 crore on the grounds of the sound financials of the client, factoring volume and strong customer base, in deviation from provisions of the Manual.

The Management stated (November 2016) that as per clause 9.4.5 (b) of Manual of Instructions, MPBF at 20 *per cent* of the projected accepted turnover was normally calculated taking into account one working capital cycle comprising a period of 90 days. However, when the period of credit sales was beyond 90 days, the working capital cycle would also extend beyond 90 days and the 20 *per cent* norms may not be adequate for the smooth functioning of the unit. Sanctioning Authority could consider the limit in excess of MPBF to fund the elongated/extended working capital cycle, since the exposure would be adjusted towards working capital (WC) liability with the Bank.

The reply was not tenable, as instances quoted by audit fall under Para 9.4.5 (f) of Manual and not under 9.4.5 (b) as quoted by Management. As per para 9.4.5 (f) the exposure was to be justified within the MPBF based on the CMA.

(II) The Manual of Instructions does not provide for seeking of information on the factoring limits already availed of by the clients from other Factors and considering such limits in assessing the MPBF.

Audit noticed that out of 6 cases **(Annexure V)**, in 2 accounts factoring limits were sanctioned without ascertaining the factoring limits already availed by the clients and in 4 accounts, the limits were sanctioned despite being aware of the fact that the clients were already availing factoring facility. This has resulted in sanction of excess factoring limit to the tune of ₹71 crore.

[1] ***Credit Monitoring Arrangement (CMA) data is provided by client to its bank for getting loan/credit, on the basis of which the bank decides Maximum Permissible Banking Finance limit.***

The Management stated (November 2016) that the fact of enjoying prior factoring limits were discussed in the appraisal note and was taken into account for assessment purpose based on the disclosed financials by the Client and data available in public domain.

The reply was not acceptable, as the Company did not seek disclosure of prior factoring limits availed of by the Client, and did not also adjust such prior sanctioned limits in computing the current limit to be sanctioned, even when it was aware of such prior limits. This inadequacy in internal control resulted in avoidable increase in exposure of the Company to credit risk.

7.1.5.2 Waiver of obtaining Undertaking Letter / Lack of direct communication with customers

(I) Para 6.1 (m) of the Manual of Instructions provides that an Undertaking Letter (UTL) was to be normally obtained from the Customer to make direct payment to the Company for the outstanding debts. Selectively, sanctioning authority may waive the requirement for submission of UTL, depending on the merits of the case and other factors, which were not specified.

Audit noticed that in 8 cases **(Annexure III)**, the Company waived the requirement of obtaining UTL from Customers on the ground that these Customers were Government Organisations, financially sound and reputed Companies.

The Management stated (November 2016) that Manual provides that Sanctioning Authority may waive requirement of obtaining UTL, depending on the merits of the case and other factors. In the absence of UTL, pass sheets of Client Bank accounts and previous payment advice from Customers have to be verified, in order to examine instances, if any, of delays in payments and to ensure the genuineness of transactions.

The reply from the Management was not acceptable as waiver of UTL from customers defeated the operating procedure of the factoring business, as Audit noticed instances of customers making payments directly to the Clients, which in turn were not remitted to Company. It was further observed that some client submitted fake invoices or customers rejected material which was not informed to the Company. This risk could have been reduced if the Company had obtained UTL from the customers.

(II) Audit further observed that there was lack of direct communication and independent cross verification with the customers. As a result in 5 accounts[1] the Company accepted the forged UTL/fake invoices submitted by the client. The customers subsequently denied being party to factoring arrangement, furnishing UTL and receiving the materials. Similarly in 3 cases[2], the Company was unaware of the rejection of materials by the customers. When Company approached for payment on due date, the customers refused payment of rejected materials.

The Management stated (November 2016) that in case of rejection/short supply of goods, it is the bounden duty of the customer to inform the Company immediately about the

[1] ***Srl No.6, 9, 18, 19 and 20 in Annexure III***

[2] ***Srl No.7, 21 and 27 in Annexure III***

rejection, with advice to adjust the dues from them. In such cases, the Company also proportionately reduced the advances to Client.

The reply is silent about the forged agreement/UTL, fake invoices. The reply on rejection of materials is not acceptable as two out of three accounts cited did not have UTL from customers and as such the customer was not bound to inform the company about such rejections.

7.1.5.3 Factoring of invoices on allied/related parties of Clients

Para 7.2 (m) of the Manual of Instructions specified that factoring of invoices was not to be normally considered in respect of sales made by Clients to their allied/related parties.

Audit noticed that in 3 cases **(Annexure III)** Company sanctioned factoring facility where the sales were to the allied/related parties of the Client. In the case of two of these clients, factoring limit was granted without any justification despite being aware of the fact that the customers were allied/related parties. In the other two cases, neither did the Client inform nor did the Company verify the credentials of the customers to examine whether they were allied/related parties of the clients. Upon verification, Audit observed that they were related parties. The bills factored pertaining to related/allied parties which became NPA amounted to ₹2.76 crore.

The Management stated (November 2016) that the Manual did not specifically bar factoring invoices of allied/ group concerns, which could be considered on a selective basis by the Sanctioning Authority. However, the risk was noted and additional control/monitoring measures such as direct interaction with customers, verification of movement of goods and rendering of services, verification of pass sheets of Clients Bank accounts would be adopted, to ensure there was no diversion of the amount due to the Company.

The reply was not acceptable as neither was any justification provided for granting the exemption nor due diligence exercised for verification of credentials of the customers.

7.1.5.4 Disbursement of funds in deviation from the conditions of sanction

As per pre-disbursement conditions attached to the sanction letter, branches were to allow withdrawals to the extent of 25 *per cent* of the fresh Customer Sub-Limits and balance 75 *per cent* was to be released after satisfactory operation/ payment of the first cycle[1].

Audit noticed that in two cases **(Annexure III)**, the Company released ₹12.25 crore, as against permitted release of ₹3.55 crore, being 25 *per cent* of sanctioned amount, without completion of first cycle of operations by accepting payment against non-factored invoices.

The Management stated (November 2016) that Sanctioning Authority was empowered to decide the percentage of release at the initial stage or stipulate/ waive the same subsequently, on case to case basis based on merit.

[1] 90 days period is considered as one working capital cycle

The reply was not acceptable, as the excess disbursement was made by the branches without specific waiver of the condition by the competent authority prior to the disbursement.

7.1.5.5 Failure to reduce the limits despite clear signs of incipient sickness in Clients

Paras 18.2, 18.3 and 19.3 of the Manual of Instructions provide for Client visits, Customer visits and Mid-term Reviews to be conducted by the Company in order to assess the up to date and potential financial health and to decide on the continuance or otherwise of the factoring arrangements.

Audit noticed that in 4 accounts **(Annexure VI)**, the existing sanctioned factoring limits continued despite being aware of adverse financial health, irregular operations and incipient sickness of Client, as was evident from the fact that these clients were declared NPA by their working capital bankers or were referred for Corporate Debt Restructuring Mechanism etc.

The Company did not pro-actively limit and reduce its risk exposure to those Clients displaying clear signs of incipient sickness that subsequently resulted in the accounts turning into NPA accounts. An amount of ₹14.88 crore was disbursed in these cases after being aware of the potential sickness.

The Management stated (November 2016) that in general, even on noticing warnings of incipient sickness, the Company cannot stop factoring operations as such an action would adversely affect the entire exposure and the Client would probably not remit future payments received from other Customers. The Company can only progressively reduce the exposure by stipulating higher margin on realisation and ensure phased reduction of liability.

Audit did not find any evidence of progressive reduction in the exposure of factoring limit in the cases pointed out above.

7.1.5.6 Other issues of interest

(I) Audit observed that in three cases **(Annexure III)** the client had disposed off immovable property provided as collateral security, without the knowledge of the Company, even though they were registered through Equitable Mortgage Transactions. The Management replied that it undertook physical inspection/verification once in three years *i.e.,* at the time of valuation of the mortgage properties. Had the company undertaken physical verification more frequently such instances could have been avoided.

(II) Audit observed that the Company accepted collateral security from one client (**Annexure III)** in the form of Client's own equity shares with market value at ₹16.35 per share (March 2013) with lock-in period up to July 2015. The Company came to know about the lock-in period of shares only after the client became NPA. It tried to sell the shares (April 2014) and the market value of the shares had fallen to ₹0.15 per share (July 2015) due to which the Company could not dispose off the shares. The lack of due diligence in accepting such Equity Shares meant that the Company was unable to dispose such shares on the date of NPA, which resulted in blockade of funds to the tune of ₹7.98 crore.

The Management stated (November 2016) that since equity shares furnished as collateral security were not actively traded shares, they could not be disposed off immediately.

The reply was not specific as to why the Equity Shares with lock in period were accepted as collateral security.

(III) Para 6.1 (h) of the Manual of Instructions provided that obtaining of Opinion Letter (OPL) from the Bankers of the Client was to be insisted upon and that the opinion was verified to be satisfactory. In case, OPL was not forthcoming, the Company was to satisfy itself on the conduct of the Client through scrutiny of statement of bank accounts (pass sheet or ledger extract of the bank accounts for the previous one year).

Audit noticed that in some cases the Company sanctioned factoring limit without obtaining OPL. In the case of a Client, M/s Varia Engineering Works, the Company sought opinion letter from the bank on 08 October 2014 and sanctioned the factoring limit on the same day without waiting for the OPL. The same was received from the bank on 28 October 2014 stating that the Client account was classified as NPA. However, in the intervening period, the Client drew an amount of ₹5.43 crore, which turned into NPA.

The Management stated (November 2016) that as a matter of policy, obtaining OPL from the Banker to the Client was insisted upon. However, there might be a few practical instances wherein there would be a delay in receiving the OPL by Bankers. When such delays occurred, verification of periodical pass sheets of Client Bank account was stipulated, which all Branches of the Company were complying with.

The reply was not acceptable as the options in lieu of OPL, as specified in the manual, like verification of pass sheets etc was to be exercised only after not receiving OPL from the bank within a reasonable time.

Conclusion

Non-compliance with terms and conditions of Manual of Instructions and lack of adequate and effective due diligence in verification of Client and Customer details resulted in increased exposure of the Company to credit risk. The internal controls which were overlooked by Management included:

- Sanction of factoring limits in excess of prescribed limits as computed as per methodology prescribed by the Company.
- Sanction of factoring limits without adjustment against factoring limits already availed from other Factor Companies.
- Failure to obtain Opinion Letters from Bankers and Undertaking Letters from Customers.
- Sanction of factoring limits in case of related party Customers.

- Disbursement of funds to the Client in deviation from the conditions of sanction.
- Non reduction of limits despite clear signs of incipient sickness in Clients.
- Lack of establishment of direct channel of communication with Customers.

Recommendations

The Company may:

- ***Consider the working capital finance and prior factoring limits already availed of by Clients for assessment of factoring limits to be sanctioned.***
- ***Adopt stricter internal controls to periodically verify the status and value of its Collateral Securities.***
- ***Introduce appropriate internal mechanism to establish direct channel of communication with Customers, and to monitor status of acceptance of invoices and payments made by Customers.***
- ***Reduce risk exposure and factoring limits for Clients in cases where early warning signals of incipient sickness are brought to notice of the Company by third parties.***
- ***Follow instructions given in Manual strictly with option of available deviations being resorted to only in exceptional cases and with appropriate approvals.***

The matter was reported to the Ministry in December 2016; their reply was awaited (January 2017).

IFCI Venture Capital Fund Limited

7.2 Failure to exercise due diligence before sanctioning/disbursing loan led to non-recovery of dues

IFCI Venture Capital Fund Limited failed to exercise due diligence before sanctioning/disbursing loan to M/s Shri Lakshmi Defence Solution Limited which led to non -recovery of dues of ₹14.92 crore.

IFCI Venture Capital Fund Limited (Company/IVCFL) sanctioned (March 2013), a corporate loan of ₹12 crore to M/s Shri Lakshmi Defence Solution Limited (SLDSL). As per the loan agreement (April 2013), the loan was secured with a total security cover equal to 3 times the outstanding loan amount, consisting of 2 times by way of pledge of shares of Shri Lakshmi Cotsyn Limited (holding company of SLDSL) and the balance 1 time by way of mortgage of commercial land located in Fatehpur (Uttar Pradesh). In addition, personal guarantee of promoters and post-dated cheques by the Company for principal and interest repayment were also obtained as security for the loan. The loan agreement further stipulated that the borrower should top up pledge of equity shares immediately upon

5 *per cent* or more fall in the value, to maintain a security cover of shares of at least twice the outstanding dues at all times during the currency of the loan. The borrower was also required to provide cash margin upon 15 *per cent* or more fall in share price as compared to the price at the time of first pledge. The tenure of the loan was 17 months including moratorium period of 5 months. Accordingly, it was repayable from September 2013 in 12 equal monthly instalments of Rupees one crore each. Interest at the rate of 15 *per cent* per annum was payable monthly on the last day of the month.

Audit observed that:

(i) The loan was sanctioned by the Company despite the fact that the holding company of SLDSL (Shree Lakshmi Cotsyn Limited, whose shares were pledged) had defaulted on repayment of an existing loan to IFCI Limited (parent organisation of the Company). Further, the loan was sanctioned as a general corporate loan and the amount of ₹9 crore was disbursed to IFCI Limited towards repayment of outstanding loan, though there was no provision in the lending policy for sanctioning of loan for repayment of previous loan. Accordingly, the security for the loan (shares of Shri Lakshmi Cotsyn Limited and mortgaged land) was shared (40:60) between IFCI and the Company in proportion of their respective outstanding balances of ₹5.96 crore[1] and ₹9 crore respectively.

(ii) The Executive Committee of Board of Directors was also not apprised of the fact that the purpose of the loan was changed from general corporate purpose to repayment of a previous loan.

(iii) The Company accepted the shares of M/s Lakshmi Cotsyn Ltd despite being aware that the trading volume per day was 8500 shares only against the required trading volume of 2.79 lakh shares per day (83,62,984/30 days) to liquidate the shares in open market as prescribed in the lending policy of the Company for the year 2012-13.

(iv) The security of 83,62,984 equity shares valuing ₹30.65 crore available with IFCI reduced by more than 5 *per cent* on 8 May 2013 and 15 *per cent* on 11 May 2013 but SLDSL failed to provide top-up/cash margin as per terms of the agreement. Accordingly, IFCI, on behalf of the company sold the pledged shares as under:

Period of sale	**Number of shares sold**	**Range of share prices during the period of sale (₹)**	**Amount remitted by IFCI to the Company**
31 May 2013 to 14 June 2013	16,216 shares (60 *per cent* of 27,028 shares)	18.01 to 23.63	₹3.11 lakh
December 2013; September 2014 to February 2015	15,95,478 shares (60 *per cent* of 26,59,130 shares)	12.40 to 13.54; 2.32 to 11.03	₹55.43 lakh

[1] ***₹14.96 crore (total outstanding to IFCI) – ₹9.00 crore (disbursed by IVCFL)***

Though there was a continuous default in payment of interest and principal from June 2013 and September 2013 respectively, the Company did not sell the shares during July 2013 to November 2013 and from January 2014 to August 2014 during which period the share price[1] ranged from ₹33.13 to ₹12.30 and from ₹23.44 to ₹11.07 respectively.

Audit further observed that the post-dated cheques deposited (October 2013) by the Company were also dishonoured and therefore the Company filed (November 2013/April 2014) a complaint u/s 138 of Negotiable Instruments Act. Personal guarantee of the promoters and Corporate Guarantee of the group company were also invoked (December 2013). Pursuant to non-payment of outstanding dues, a recovery suit was filed (April 2014) before Debt Recovery Tribunal-I, Delhi which is still sub-judice. Subsequently, IFCI Limited took (June 2014) possession of mortgaged land under SARFAESI[2] Act and put it to auction (August 2014), at a reserve price of ₹12.15 crore but no bids were received. Six subsequent auctions held from February 2015 to February 2016 with reduced reserve prices from ₹ 8.10 crore to ₹4.78 crore also failed, as no bids were received. Total outstanding dues amounting to ₹14.92 crore including interest of ₹5.92 crore remained unrecovered as on March 2016.

The Management**,** while not commenting on the issue of not selling the shares, stated (July 2016/ September 2016) that buyers were not evincing interest in the property due to sluggishness and slowdown in the market**.** The Management further stated (January 2017) that the loan was sanctioned as a general corporate loan but on the specific request (April 2013) of SLDSL, the disbursement of ₹9 crore was made to IFCI instead of to SLDSL.

The reply is not acceptable since the loan should not have been disbursed for repayment of a previous loan (holding Company) as there was no enabling provision in the lending policy to that effect. Thus, the Company failed to exercise due diligence before sanctioning/disbursing loan to M/s Shri Lakshmi Defence Solution Limited, which led to non-recovery of dues of ₹14.92 crore.

The matter was reported to the Ministry in October 2016; their reply was awaited (January 2017).

National Insurance Company Limited

7.3 Loss of Premium in respect of Group Mediclaim Insurance Policies

National Insurance Company Limited suffered a loss of revenue of ₹89.29 crore due to non-collection of additional premium on account of adverse claim ratio experienced in Group Mediclaim Insurance Policies issued to Kolkata Police during July 2012 to August 2016, violating specific directions of the Ministry.

In July 2005, National Insurance Company Limited (NICL), a public sector general insurance company, entered into a Memorandum of Understanding (MOU) with Kolkata Police for health insurance of police personnel and their dependent family members under

[1] *Source for share price is http://www.bseindia.com/markets/equity*
[2] *Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002*

Group Mediclaim Policy (GMP). The MOU stated that if the claim ratio of the health insurance policy exceeded 70 *per cent* at any time during the currency of the policy, the renewal premium would be loaded on "70 *per cent* as if basis" and NICL would have the unilateral authority of inserting all necessary conditions to ensure restriction of claims. The 70 *per cent* claim ratio was subsequently relaxed to 85 *per cent* in June 2010.

To address the continued losses suffered by public sector general insurance companies in the group health insurance portfolio, Department of Financial Services, Ministry of Finance, issued guidelines (May/July 2012) which stressed that group health insurance policies should be appropriately priced, duly considering the burning cost[1], management expenses, medical inflation etc. to ensure that the Combined Ratio[2] should be less than 95 *per cent* and that policies not conforming to this ratio ought not be renewed. In July 2012, it was reiterated that these guidelines were mandatory and no discretion in this regard was available to the companies.

Audit observed that since inception (July 2005) of the GMP of Kolkata Police, NICL experienced alarmingly high ICR[3], ranging between 181 *per cent* and 398 *per cent* during 2011-12 to 2015-16. Despite the MOU providing for loading of premium in case of adverse claim ratio and strict instructions of the Ministry to check loss making group health policies, NICL continued to renew the GMP of Kolkata Police without charging appropriate additional premium. Even if NICL acted upon the specific instructions (May/July 2012) of the Ministry to keep the loss ratio within 95 *per cent*, it would have collected additional premium[4] of ₹89.29 crore during July 2012 to August 2016 and avoided loss of revenue of the same amount during this period.

While accepting the facts of the case, the Management stated (August 2016) that:

- The guidelines of the Ministry were issued as an advisory to the companies for implementing loss control measures, to make the overall health insurance sector sustainable over the years in future. The guidelines were applicable to corporate bodies to control the ICR of their group health policies and were not directed at group health policies meant for weaker sections of society, government employees engaged in occupation for maintaining essential services, security and protection of citizens at large etc.

- The PSU insurance companies had an obligation in social and rural sectors to serve the citizens by coming out with policies catering specifically to their needs, sometimes ignoring the actual outgo involved. For pricing such socially beneficial product, NICL had consciously not attempted to recover the entire outgo. Kolkata Police, engaged in providing security and maintaining law and order, deserved to be treated as a special group and not as a corporate body.

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[1] ***The ratio of incurred losses within a specified amount in excess of the theoretical amount of premium it would take only to cover losses.***
[2] ***Incurred Claim plus Management Expenses plus Agents'/Brokers' commission plus Third Party Agency (TPA) commission and any other expenses***
[3] ***273% in 2005-06, 190% in 2006-07, 163% in 2007-08, 193% in 2008-09, 182% in 2009-10, 202% in 2010-11, 363% in 2011-12, 393% in 2012-13, 398% in 2013-14, 315% in 2014-15 and 181% in 2015-16***
[4] ***Based on the claim experience of the expired policies***

- NICL had taken some serious and effective loss control measures in addition to substantial increase in premium amount during the last few years to control the outgo and ICR was progressively reduced to 181 *per cent* in 2015-16.

- As worked out by Management, the short collection of premium from July 2012 to August 2016 was ₹81.12 crore, the under-collection for the period September 2015 to August 2016 being ₹13.24 crore on "stop loss basis"[1] against ₹21.40 crore computed by Audit.

The above contentions of the Management are not acceptable in view of the following:

- The guidelines of the Ministry were mandatory and not advisory and did not allow for discretion of NICL in loading the premium of group health insurance policies appropriately. Moreover, it did not exclude any category of group health insurance policy.

- The contention of the Management that Kolkata Police has been considered as a special group in view of its social obligation and the Company has consciously not attempted to recover additional premium to counter its loss is not borne out by the terms of the MOU signed for the health insurance policy. In fact, NICL failed to adhere to the terms and conditions of the MOU, agreed upon by Kolkata Police, for collection of additional premium. The ICR of 181 *per cent* in 2015-16 was nearly double the mandated level of 95 *per cent* and as such, additional premium should have been collected for compliance of repeated directives of the Ministry.

- The under-collection of ₹13.24 crore in 2015-16 worked out by Management is not acceptable as it has been worked out on the basis that the maximum claim would be limited to ₹23 crore on stop loss basis. However, the stop loss clause would be effective only from 2016-17 for adjusting the excess claim outgo of 2015-16. The under-collection of premium of ₹21.40 crore in 2015-16 is computed by Audit on the basis of actual claim outgo incurred by NICL during 2014-15.

Loss to NICL due to non-charging of additional premium despite adverse claim ratio in respect of Group Mediclaim Policies issued during 1998 and 2003 to Kolkata Police Family Welfare Centre was highlighted in Audit Report No. 3 of 2005 (Para 9.2.1). In response, NICL had not renewed the policy 2003-04 onwards and had assured that such instances would not recur. The Ministry had then agreed that there has been a lapse on the part of NICL in not loading the premium on renewal, based on the past experience.

Thus, NICL failed to apply underwriting prudence and learn lessons from past experience besides violating directions of the Ministry regarding collection of premium for group health insurance policies. Non collection of additional premium despite adverse claim ratio led to loss of ₹89.29 crore to NICL (during July 2012 to August 2016) in underwriting GMP issued to Kolkata Police.

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[1] ***The clause to restrict the ICR to a certain per cent of premium***

The Ministry stated (January 2017) that NICL is committed to ensure that the GMP issued to Kolkata Police would be managed in a manner so as to keep the ICR within the limit prescribed by the Government.

United India Insurance Company Limited

7.4 Absence of monitoring mechanism for assessment and prompt recovery of reinsurance claims

Due to absence of monitoring mechanism, United India Insurance Company Limited, failed to assess and promptly recover claims amounting to ₹10.79 crore from the reinsurer.

United India Insurance Company Limited (UIIC) had been arranging an excess of loss[1] cover from General Insurance Corporation of India (GIC Re) to protect its net retained account[2] from motor third party claims and claims under Workmen Compensation Employers Liability policies. This reinsurance cover ensured that claims settled beyond the specified limits would be reimbursed by the reinsurer when claimed by the Company, irrespective of the time limit. The reinsurance department of the Company used Integrated Reinsurance System (IRS) for ceding the premium and recovery of claims from the reinsurers. The input data for IRS flowed from CORE (Comprehensive Online Real-time Environment) System, a software operated at office level for underwriting policies and claim management. Lists of claims above the specified limit settled by offices of UIIC across India were being generated by the Reinsurance Department at Head Office of the Company on the basis of which recovery invoices were being raised on GIC Re.

Audit observed that neither IRS nor CORE had a mechanism to extract the cumulative amount of claims paid to different claimants against a policy in a single event/accident. It was also noticed that a system of periodical reconciliation of claims recoverable from reinsurers was absent. Due to this, in many cases, claim amount paid beyond the limits specified under the excess of loss cover, was not raised on GIC Re. Audit retrieved the data relating to motor claims lodged with the reinsurers from the IT systems of UIIC and found that in 22 policies, claims amounting to ₹10.79 crore which were settled during the period 2012-2016 and which were in excess of the limit under the reinsurance arrangement, were not raised on GIC Re as of March 2016.

The Management informed (August 2016) that recovery of the above amount had been raised now with GIC Re and the same was being followed up. It further stated that the delay in raising the recovery happened due to migration from Genisys (earlier software used by operating offices) to CORE.

The reply needs to be viewed in the light of the fact that UIIC neither had any mechanism to get the details immediately on settlement of claims through its IT Systems nor did it have a system of periodical reconciliation of claims recoverable from reinsurers. This resulted in non-identification/delayed identification of claims to be filed with the

[1] ***An agreement which indemnifies the reinsured against all or a portion of the amount of loss in excess of the re-insured's specified loss retention.***

[2] ***The amount of loss the reinsured wishes to retain for its own account.***

reinsurers. Recovery on GIC Re was raised in August 2016 only after the same was brought to the notice of UIIC by Audit and it was yet to be effected (December 2016).

Thus, lack of inbuilt monitoring system resulted in delay in recovery of claims amounting to ₹10.79 crore from GIC Re.

The Ministry endorsed (January 2017) the reply of the Management and confirmed that action was initiated for recovery.

7.5 Implementation of CORE Insurance Solution

7.5.1 Introduction

United India Insurance Company Limited (Company), Chennai, is one of the general insurance companies in operation since February 1938. The Company was nationalised in 1972. As on 31 March 2016, the Company had 29 regions and 2051 operating offices under its control with a gross premium collection of ₹12,250.36 crore during the year 2015-16.

7.5.2 Computerisation in UIIC

The Company implemented General Insurance System (Genisys) between 2000 and 2002. Genisys was developed by CMC Ltd and it was an operating office level application used for underwriting policies and settlement of claims. Later, in October 2003, the Company implemented Genisys Enterprise Module (GEM) for consolidation of operating office level data.

In May 2006, Government of India (GOI) initiated the National e-Governance Plan (NeGP), comprising 27 Mission Mode Projects (MMPs) which included insurance sector. The main objectives of the Insurance MMP were to perform business activities through electronic mode, create a database of policyholders, agents, brokers, surveyors etc., and to facilitate information sharing and interfacing with Government and Regulator. In line with the NeGP the Company conceptualised (January 2007) implementation of Comprehensive Online Real-time System (CORE) with the following main objectives:

- Launch new and highly differentiated products faster in a de-tariff scenario.
- Tap alternate business distribution channels like portals, payment gateways, etc.
- Make available centralised real-time data for Decision Support System.
- Have relatively low IT related workload at operating offices.
- Create ability to group specialists and people with similar financial powers, irrespective of physical location to centralize large business accounts and claim.
- Formulate integrated document management system to achieve reduction in processing time.

- Achieve seamless integration with auxiliary modules such as Customer Relationship Management (CRM), Human Resource Management (HRM), etc.

7.5.3 Audit objectives, scope, criteria and methodology

The objective of audit was to ensure that

(i) Planning, implementation and migration of legacy data was done effectively and as per the timelines;

(ii) Business rules of the Company have been effectively mapped and controls are in place; and

(iii) CORE insurance solutions have been efficiently integrated with SAP financials, HR, Investment and Reinsurance.

During the audit, transactions for the period 2011-12 to 2015-16 were covered. Audit adopted Corporate Rules, Government regulations, IRDA guidelines and best practices for system controls as the criteria for examination.

The centralised database of the company was accessed and exception reports were generated using SQL queries. The data generated were test checked with the records maintained at operating offices in three Regional Offices (Hyderabad, Kochi and Chennai).

7.5.4 Organisation structure of IT department

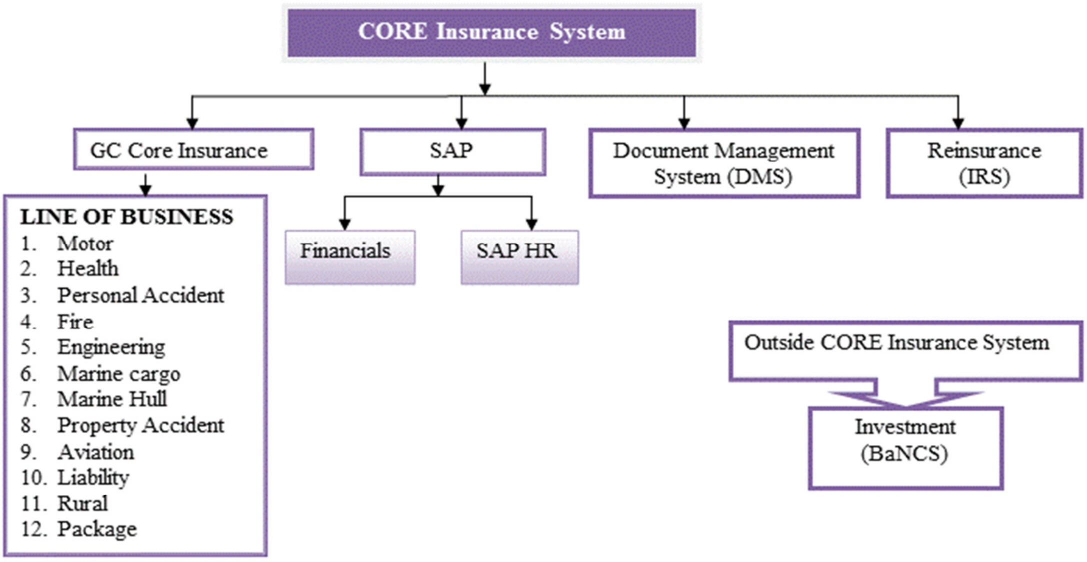
The Information Technology Department is headed by General Manager (GM) who reports to the Chairman cum Managing Director (CMD). The GM is assisted by DGM (IT) and is in turn supported by Chief Managers and Managers.

The CORE insurance system is maintained by staff of Hewlett-Packard (HP) and the legacy system (Genisys and GEM) is maintained by staff from CMC Limited.

7.5.5 CORE Insurance Solution

The CORE Insurance solution covered the insurance module having 12 line of business (LoB), Financials, Accounts, Human Resource Management and Document Management System.

The CORE Insurance solutions was planned for implementation with Sirius for Insurance (S4i) for Insurance Module (later substituted with Insurance package of CMC Limited). SAP-ERP was planned for finance, accounts and HR management and NewGen’s solution for the Document Management System.



After following a system of pre-qualification and inviting tenders from seven consortia, out of which six submitted their bids, the contract was finally awarded (June 2007) to Hewlett-Packard (HP) India Services Limited for design and development of CORE Insurance Solution at a cost of ₹122.78 crore. The contract included procurement of required Hardware (₹24.39 crore), System Software and Database Management Systems (₹35.07 crore), Application Software Systems *viz.* S4i, SAP, DMS and customisation, data migration and implementation and maintenance of system (₹63.32 crore). HP had entered into a contract with Sirius for Insurance for design, development and customisation of S4i insurance system.

The CORE System's insurance application has been hosted in HP Integrity superdome Servers running with UNIX with database in Oracle 10gR2. The SAP application servers are in Windows 2003 and SAP database in MS-SQL servers.

7.5.6 Audit Findings

7.5.6.1 Implementation of the System

(I) Delay in implementation of CORE Insurance Solution

The tenure of the agreement entered (October 2007) into with HP was seven years which included two years for design, development and implementation and five years for post implementation maintenance. Initially, the implementation was scheduled to be completed by September 2009 with S4i insurance software. As Sirius for Insurance delayed customizing the product, HP recommended (December 2010) its substitution by CMC's 'Genisys Configurator' for insurance module. The Board of the Company approved (January 2011) the recommendation without any additional payment to HP. As per the revised implementation schedules/milestones, the product was to be delivered in March 2011 with final roll out by March 2013.

It was observed that:

- Even after lapse of 36 months since the revised timelines, the implementation was not completed (March 2016) due to initial selection of inappropriate software, delay in data migration etc. and testing etc. as discussed in subsequent paragraphs.

- The contract with HP, which expired in September 2014, was neither signed off nor extended though the implementation was not completed.

- The Company entered into (February 2015) another contract with HP for annual maintenance of the Hardware and the CORE Insurance solution for a period of three years at a contract price of ₹91.49 crore which was 74.52 *per cent* of the original contract value.

- Implementation of Document Management System (DMS) for which an amount of ₹5.30 crore has been spent, had not proceeded beyond the proof of concept stage.

The Management stated (December 2015) that the S4i Software was not commensurate with the expectations and was therefore, substituted with CMC's software. Consequent customisation, testing etc. delayed the implementation. Further, changes in business requirements and de-tariffing during the roll out period also delayed the process.

The reply is to be viewed against the fact that changes in business requirements were continuous process and not an unexpected event. Further, one of the objectives of implementation of CORE was to launch new and highly differentiated products faster in the de-tariff scenario, which was not done.

(II) Payment of Technical Support Charges

The Company had an agreement with CMC Ltd for carrying out maintenance of the legacy systems (Genisys and GEM) which was renewed in July 2009 for a period three years. The agreement provided for deployment of 72 persons at a cost of ₹ one lakh per man month. The contract was renewed again in July 2012 for a further period of three years involving deployment of 82 persons at a cost of ₹1.20 lakh per man month.

As per the contract with HP, the implementation of CORE Insurance system should have been completed by September 2009. The delay in implementation of CORE Insurance system had resulted in continuation of Genisys and GEM. The Company did not fix any cut-off date for discontinuance of legacy system which resulted in continuing their services and consequent avoidable expenditure on maintenance charges amounting to ₹59.09 crore for the period from January 2010 to March 2016.

The Management stated (December 2015) that it was inevitable to run Genisys & GEM parallel during the transition period. The fact remains that though switch over from Genisys to CORE is stated to be in transition, the old system continued for a long period due to delay in implementation of CORE insurance system. This led to continuance of payment towards maintenance charges for legacy system which were avoidable.

(III) Data Migration - Finalisation of contract without firming up the number of offices

The Company, without firming up the number of offices to be covered under the data migration, entered into a contract with HP for data migration for 20 offices. However, a ‘change order document’ was issued (September 2009) to HP for supply of technical resources to support Company’s team for data migration and to carry out roll out tasks at a cost of ₹7,122 per man day for the remaining offices and also utilised the technical support of CMC Ltd. for the said work.

Data migration work for all offices should have been a part of Request for Proposal (RFP). Failure of the Company in not including the work for other offices in the RFP resulted in the Company foregoing the advantage of competitive price. The total payment made for this work was ₹27.51 crore[1].

The Management stated (December 2015) that considering the complications involved, technical assistance was required for migrating data for the remaining offices beyond the 20 pilot offices. Further, two migrations happened due to change of Insurance software. Increase in data due to spreading the rollout over a period of time, creation of about 700 new offices and correction of rejected data had also contributed to the cost escalation.

The Company could have foreseen the complications involved in data migration, had it conducted a feasibility study.

7.5.6.2 System design and validation deficiencies

(I) Incomplete mapping of business rules and deficient system controls

Audit noticed lack of validation and input controls, system design and control deficiencies, non-integration issues which resulted in short collection of premium, assumption of higher risk, lack of audit trail, doubtful integrity of data, non-compliance with the provisions of India Motor Tariff 2002, various IRDA Regulations and Guidelines, Company’s internal circulars etc. as discussed below

(a) Absence of system module to calculate premium short collected due to revision in tariff resulted in short-collection of premium of ₹7.18 crore

Insurance Regulatory Development Authority (IRDA) has been notifying the Motor Third Party (TP) premium every year with effect from 1 April. On receipt of notification from IRDA, the company issues a circular to all Regions for charging the revised premium for the risk commencing from 1 April. However, absence of system module to calculate short collection of premium due to revision in tariff, resulted in short collection of premium to the tune of ₹7.18 crore (1,75,774 policies) during the period covered.

The Management replied that whenever a claim is registered, the system prompts the recovery of difference in TP Premium.

[1] ***₹10.30 crore to CMC and ₹17.21 crore to HP***

The reply cannot be accepted as the revised TP premium has to be collected in all cases and not only on policies where claim was reported. Even though the revised TP premium was updated at the later stage, the system should have a provision to extract such short collection and enable the operating offices to recover the short collection.

(b) Grant of No Claim Bonus to ineligible motor policies – ₹2.48 crore

According to General Regulation 27 of India Motor Tariff, the insured becomes entitled to No Claim Bonus (NCB) only at the renewal of a policy after the expiry of the full duration of twelve months without any claim. However, the system allowed renewal of policies with NCB irrespective of claims in the previous year due to lack of input controls. Audit observed that NCB was allowed to 12785 motor policies where claims were reported in the previous year as against the provision resulting in short collection of premium of ₹2.48 crore.

Even though Management had agreed to take corrective action (December 2015), it was noticed that NCB was allowed even in respect of policies issued subsequently and the short collection of premium went up to ₹2.68 crore (March 2016) in 13891 policies.

(c) Granting personal accident cover to policies issued to Companies / Firms / Body Corporate

As per General Regulation 36 of India Motor Tariff, compulsory personal accident (PA) cover cannot be granted where a vehicle is owned by a Company, a Partnership firm or a similar Body Corporate or where the owner driver does not hold an effective driving licence. In all such cases, where compulsory PA cover cannot be granted, the additional premium for the compulsory PA cover for the owner-driver should not be charged and the compulsory PA cover provision in the policy should also be deleted. Thus, when a policy is issued to a Company or a partnership firm, the system, by default should not grant compulsory PA cover. However, scrutiny of records indicated that in respect of 75478 policies issued during 2011 – 2015, compulsory PA cover was given for vehicles owned by Companies. Lack of input control, thus resulted in violation of provisions of India Motor Tariff leading to assumption of higher risk by the Company.

The Management accepted the observation and agreed to take corrective action**.** However, it was observed that no action was taken till March 2016 as the number of such policies went up to 98751.

(d) Procurement of business by agents with expired licenses

According to Regulation 8 (ii) (a) of IRDA (Licensing of Insurance Agents) Regulations, 2000, no insurance agent shall solicit or procure insurance business without holding a valid licence. However, due to lack of validation controls, system allowed booking of business from agents whose licence had already expired. Data analysis revealed that during the period from 2011-12 to 2014-15, 2,77,121 policies were booked through agents whose licences had expired. The commission of ₹8.71 crore payable to such agents was outstanding since 2012.

It was replied that the agency commission in respect of the agents whose licences had lapsed was not released till the licences were renewed. This was not acceptable as the acceptance of business against lapsed licence of an agent itself was a violation of the Regulations. Further verification revealed that 61,705 policies were procured during 2015-16 from agents who licenses had not been renewed upto March 2016.

(e) Appointment of surveyors with expired licenses

Similarly, due to inadequate validation control, system allowed appointment of surveyors for assessment of loss even after the expiry of their license period. During 2011-12 to 2014-15, in respect of 72630 claims, surveyors whose license had expired were appointed to conduct survey which was against the provisions of IRDA Regulations, 2000. The Management replied that survey fee would not be released unless licence is renewed. The reply is not acceptable as the validity period of surveyor license was only five years and appointment of surveyors after the expiry of licence period is violation of IRDA regulations. Further, verification upto March 2016 revealed that 2,248 claims were assigned to such surveyor during 2015-16 also.

(f) Absence of date range validation controls

It was observed that for the period from 2011-12 to 2014-15:

- in respect of 2,035 Motor claims, the date of registration of the claim was prior to date of loss.
- in 384 claims, the date of loss was after the expiry of the policy period and
- in respect of 65 claims, the date of loss was prior to commencement of the policy period.

All these instances indicate lack of validation controls in the system design. Management accepted the observation, and agreed to examine the issue.

Further analysis of data (March 2016) revealed that in respect of 364 claims the date of claim registration was prior to date of loss, in 972 claims, the date of loss was after the expiry of the policy period and in respect of 47 claims the date of loss was prior to commencement of the policy period.

(g) Issuance of policies for invalid periods due to inadequate validation controls

Instances of issuance of policies covering risk for the period 2045-2046 and 2105-2106 were observed. Management replied (December 2015) that action would be taken to bring in a limit up to which advance renewals could be initiated. However, audit observed (March 2016) that action was yet to be taken as the system continued to issue policies for such invalid periods.

(h) Lack of input controls/validation controls in recording identity of vehicle

For the period from 2011-12 to 2014-15, in respect of 31,389 motor policies the registration number was captured as 'NEW' at the time of renewal. Further, in respect of 11,24,674 policies, the engine number was captured as chassis number and in 8,780 policies, the registration number was shown against the details of engine/ chassis number. Thus, data integrity in the system was not ensured. The Management agreed (December 2015) to put in adequate validation controls. Further, analysis (March 2016) revealed that the registration number was captured as new at the time of renewal in 41,724 policies and in respect of 14,08,280 policies engine number was captured as chassis number and in 13,659 policies the registration number was captured against engine/chassis number.

(i) Design deficiency in ratification of marine policies underwritten by Regions

Marine policies (589 policies) were issued (2011 to 2015) below the rate of 0.01 *per cent* without the concurrence of Head office (HO) in contravention of HO guidelines due to inadequate mapping of business rules. Management replied that marine policies are referred to HO when the basic Marine rate plus Strike, Riot and Civil Commotion (SRCC) rate is less than 0.01 *per cent*. The reply is not acceptable as "File and use" guidelines of IRDA require HO approval when the basic rate is less than 0.01 *per cent.* Further analysis (March 2016) revealed that 703 such policies were issued without HO approval.

(j) Absence of input controls in underwriting Marine Open policy

The system allowed underwriting of marine policies with NIL deductibles as against the minimum of 0.5 *per cent* of consignment value as per Head Office circular. The Management replied that issue will be taken up with the vendor for correction in system design.

(k) Absence of input control - Marine Hull Policies

The system accepted (i) deductibles more than the sum insured (ii) NIL deductibles and (iii) any amount as deductible, contrary to the amount/rate specified in the HO circular. Management replied that correctness of the deductible logic would be verified and appropriate action will be taken.

(l) Allowance of staff discount on Mediguard Policies to non-employees

The company uses CORE Insurance solution for its business operation and SAP (HCM) for administrative purpose. CORE insurance solution was not integrated with employee master of SAP (HCM) resulting in grant of staff discount even to non-employees in Mediguard Policies. Management replied that (i) Validation control would be possible only after integration with SAP (HCM) and (ii) Operating offices have been advised to collect the difference in premium wherever the error has been observed. The reply is not acceptable as instances of such loss would continue as long as the design deficiency continued.

(II) Lack of validation control in management of cover note

A cover note is a temporary document, issued by authorised officers, for assumption of risk, pending issuance of policy. As per Rule 142(2) of Central Motor Vehicle Rule, 1989, cover note is valid for a period of 60 days from the date of issue and the insurer shall issue policy before the expiry of such period. Cover note is a contractual document evidencing the liability of the company in respect of risks covered under it. Any deficiency in the system regarding the use of cover notes would have larger legal and financial implications to the Company.

Audit analysed the data regarding the cover notes from the data base and noticed that:

- Out of 17,20,758 cover notes utilised, only 56,805 cover notes were tagged with policies. For the remaining cover notes, there was no audit trail in system to ascertain whether policies were issued subsequently within the time limit.

- The Company notified loss of 199 cover notes through intranet during the period 2012-2015. However, the analysis of database showed loss of only 10 cover notes during the period.

Failure of the system to tag the cover notes with the policies issued subjects the cover notes to the risk of fraudulent use. This may take the form of misappropriation of funds and settlement of claims without policy document in case any claim was reported as in such cases the premium would have already been received by the agents legally binding the Company to settle claim. The system followed by the Company was, thus, deficient.

The Management stated (December 2015) that the operating offices would be appropriately instructed to initiate action for better administrative control. However, further analyses of database (March 2016) revealed that only 62,973 cover notes were tagged with policies out of 17,32,760 cover notes. The system design needs to be modified to match cover notes with policy issued.

(III) Un-reconciled balances in Scroll in GENISYS and CORE system

Scroll account is a suspense head where premia received are kept in suspense till the issue of policy. After issuance of policy, the amount kept under scroll would be transferred to Premium account, otherwise refunded to the customers. Any amount kept in scroll account at the end of financial year would be shown in the financial statements as liability representing policy holder’s fund.

The reasons for amounts remaining as balances in scroll are mainly on account of (a) amount received and policy issued for part amount leaving a balance (b) amount received but policy not issued and (c) duplicate entries for a receipt of single premium.

Audit observed (August 2015) that ₹102.70 crore (9,04,391 records) was pending as at August 2015 in scroll account. The Management stated (December 2015) that operating offices were advised to account for unutilised scroll balances.

Further, a direction under 143(5) of Companies Act 2013 was issued to statutory auditors and it was replied that transaction wise details are available and there is no impact on the Accounts.

The reply of the Management and Statutory Auditors are to be viewed against the fact that fraudulent use of scroll balances by issue of back dated policies and consequent payment on claim of ₹2.20 crore was reported in a Divisional Office, Latur. This substantiates the risk of vulnerability of the system. Further analysis of database revealed that the balance outstanding as at March 2016 was ₹34.79 crore since 2011. Hence, proper reconciliation has to be done to avoid such fraudulent use of available balances.

(IV) Pending help desk calls

The issues/problems faced by the field offices on CORE insurance solution are reported online to HP support team and a ticket is raised for each call. Analysis of data in audit indicated that 10,481 help desk calls were pending (June 2015) unattended. This included call of critical nature (528), high priority (104) average priority (5,921) made during the period between July 2014 and June 2015. The earlier contract with HP did not have penalty clause for delay in attending to help desk calls.

The Management stated (December 2015) that the new agreement with HP defines severity levels 1 to 4 for Helpdesk calls, as well as the turnaround times for each severity level and penalties have been stipulated for non-compliance of the turnaround times.

However, irrespective of incorporating severity levels, turnaround time and penalties in the revised agreement, the fact remains that 9,231 help desk calls were pending as on March 2016. The number of pending calls is an indicator of inadequate help desk support or weak system controls.

(V) Integration with other system modules

The Company intended to implement CORE Insurance solution with an objective of providing centralized application software for General Insurance operations covering quote generation, proposal form, policy underwriting, claim management, reinsurance, accounts, various analysis and operational reports, all other Statutory and non-statutory statements etc.

Audit noticed that

- Finance and Accounts department of Company had to continue using the erstwhile e-format system for consolidation of financial data and preparation of annual financial statements due to delay in implementing SAP (Financials) even after spending ₹10.67 crore.

- Reinsurance department was still using the legacy Integrated Reinsurance Software (IRS) since the re-insurance module of CORE Insurance system was not rolled out.

- CORE Insurance solution design did not cover non- MACT (Motor Accident Claims Tribunal) cases. These details were still maintained manually at operating offices and the consolidated details submitted to IRDA periodically

Thus, the basic objective of having an integrated Comprehensive Online Real-time System remained largely unfulfilled even after seven years of initialisation of the project.

The Management stated (December 2015) that Reinsurance was integrated with CORE system and necessary reports were being generated from of the system and also stated that bringing data into a centralised system had thrown up challenges and resulted in delay in implementation and stabilisation.

The reply is to be seen against the fact that the reinsurance department still continue to use the erstwhile IRS (Integrated Re-insurance System) and the shortcomings stated in the paragraph still continued (March 2016).

7.5.6.2 Network Security issues

(I) Information Security Management System (ISMS) Policy not in conformity with current standards

The Government of India had issued (July 2006) guidelines to prepare Information Security plan as per ISO 27001 and other guidelines and standards as appropriate. The Company's present Information Security Management System (ISMS) policy was based on ISO 27001:2005 The Company was yet to update its ISMS policy in accordance with ISO standards (March 2016).

(II) Scope of ISMS

As per instructions (July 2006) of Ministry of Finance, Government of India, insurance PSUs were required to classify organisational units as most critical, moderately critical and less critical based on the criticality of functions/services and the likely impact in the event of an attack. This was to ensure better security management. Audit observed (March 2016) that the Company did not carry out any such classification.

(III) Vulnerable system security

It was observed that the Company's website (https://uiic.co.in) was defaced on 27 March 2015 by Tunisian hackers. The IT team of the Company analysed and found that malicious content had been injected in the server which caused the defacement. Further analysis by the Company indicated that this had been done by compromising vulnerable ports which had been left open during website maintenance.

The Management replied (December 2015) that appropriate action had been taken after the event to prevent any unauthorised access. However, it was observed that several security lapses were reported later also in the quarterly security checks conducted by external security consultants.

The Management decided in March 2011 that the scope of their ISMS would also be extended to cover Regional Offices, large corporate and brokers cell (LCBs), Service hubs, Divisional offices, Branch offices and Micro offices in a phased manner. However, these locations, were not brought under the scope of ISMS.

The Management stated (December 2015) that such classification was an ongoing exercise which would be implemented. However, Audit observed (March 2016) that steps were not initiated to cover above locations.

Conclusion

The implementation of CORE Insurance system was delayed by 7 years due to initial wrong choice of S4i application, lack of planning for data migration at the tender stage and consequent delay in data migration.

Critical modules like SAP Financials, Human Resource Module, Reinsurance Module have not been fully implemented and integrated with CORE Insurance system. The Company's finance and accounts department continue using the erstwhile e-format software (March 2016) and Reinsurance department continued using legacy system (IRS) for its operation, the implementation of Document Management System did not proceed beyond proof of concept stage.

Design deficiencies, deficient systems control, inadequate User Acceptance Testing and migration issues of data had resulted in loss of revenue, incorrect reporting and security issues.

These issues resulted in non-achievement of the basic objectives of having a centralised integrated real-time data for Decision Support System.

Recommendations

It is recommended that:

- ***implementation of CORE system needs to be expedited and the legacy GENISYS be retired at the earliest.***
- ***a review of modules implemented with reference to present business rules, guidelines be carried out to avoid loss of revenue and ensure compliance with Government regulation and IRDA guidelines.***
- ***the Information Security Policy may be implemented in line with ISO standards and the integrity and security of the system, application, data and network be monitored to minimise vulnerabilities.***

The matter was reported to the Ministry in January 2016; their reply was awaited (January 2017).