

CHAPTER XXV: MINISTRY OF FINANCE

Insurance Division

National Insurance Company Limited

25.1 Report on the General Insurance System Software

Highlights

Liquidated damages of Rs.17.32 lakh were short deducted.

(Para 25.1.5.1)

To assume risk from back date a facility, named Scroll, has been provided in General Insurance System (GENISYS). In 83 cases at Divisions –VII, IX and XI Kolkata–accidents occurred before accounting of cheques and generation of policies.

(Para 25.1.5.2)

Under GENISYS, books are allowed to be kept open up to seven days after transactions. As a result, back date entries in the Cash book can be made and policies with back date can also be generated. Scrutiny of the Inward Remittance Register of Division-XI, Kolkata and cross check with the System revealed that some of the cheques, entered in the Register, were not accounted for in GENISYS and no policy was issued against such cheques.

(Para 25.1.5.2)

In some cases effecting change in recovery of service tax at higher rate was delayed and the difference in collection amounted to Rs.1.24 crore up to 31 May 2003. Further, circulars modifying rates, conditions etc. were not incorporated in the system in time.

(Para 25.1.5.3)

There was no check, either manually or through computer system to see whether all the Cover Notes were accounted for and policies issued. In five cases, premium was collected through Cover Note but no corresponding policies were issued.

(Para 25.1.5.4)

25.1.1 Introduction

National Insurance Company Limited (Company) is engaged in general insurance business and had 24 Regional offices, 304 Divisional offices and 635 Branch offices as on 31 March 2005. The Board of Directors of the Company approved (December 2000) a proposal for procurement and implementation of the front office software 'General Insurance System' (GENISYS), from CMC Limited (CMC) at a cost of Rs.164.50 crore for implementation in 943 offices with interconnectivity.

The software runs on client server architecture in Local Area Network (LAN) set up, for which all the operating offices have been provided with -

- (i) Pentium based system with Windows 2000 operating system for server and clients as hardware platform and,
- (ii) Oracle database at back end and Developer 2000 at front end as Relational Data Base Management System (RDBMS) platform.

GENISYS facilitates processing of underwriting, claims, preparation of accounts and generation of reports and queries.

25.1.2 Scope of Audit

The scope of audit included examination of effectiveness of GENISYS in computerisation of various activities of the company through test check of records at Management Service Department (MSD) and analysis of data besides review of general and application control checks and data integrity.

25.1.3 Audit Objectives

The broad objectives of audit were:

- (i) To review the procurement of Hardware and Software system.
- (ii) To check the effectiveness of controls in the system.
- (iii) To check the security controls in the system.

25.1.4 Audit Methodology

- (i) Study and analysis of the files of Management Service Department at Head Quarters of the Company.
- (ii) Testing of control checks of the system by using dummy data.
- (iii) Analysis of offsite data pertaining to three Divisional Offices and two Branch Offices through Utility software prepared by the Management based on SQL queries framed by the CMC on the basis of specific requirement of audit. The Read Only report, thus generated, was password- protected by Management. This was, thereafter, copied in a separate Excel sheet for further analysis. Findings in

respect of a few selected cases were verified with on line data of respective operating offices and were followed by verification of relevant physical records.

25.1.5 *Audit Findings*

25.1.5.1 *Review of Purchase orders*

Non-recovery of liquidated damages of Rs.17.32 lakh

The GENISYS software was procured from M/s. COMPAQ. Terms of the purchase order provided (May 2001) that if the supplier failed to install any or all of the goods at the respective destinations within the time limits specified in the order, the company would deduct liquidated damages (LD) from the contract price. According to clause 39(b), in case the delivered goods and/or services could not be put to use without the undelivered parts or services, the damages would be calculated considering the total price of the component.

It was noticed that in respect of 106 offices under four Regional Offices, delivery of switches was delayed for periods ranging from two to 409 days. As a result, total components like LAN, Servers and Nodes could not be put to use and GENISYS was also not implemented in time. However, LD was recovered only in respect of value of undelivered goods/services instead of value of total components.

Thus, LD of Rs.17.32 lakh was not recovered.

The Management stated that the system delivered and installed could always be put to use on a standalone basis and this should not be linked to the performance of the vendor. Therefore, LD had been charged correctly.

The reply of the Management is not acceptable as the order on M/s. COMPAQ was placed for supply, installation and maintenance of hardware for Local Area Networking of the Company's offices. The part delivery of goods did not serve the purpose since GENISYS, essentially based on a networked system, can not run in isolation on standalone basis. Therefore, full value of the components (even if part of the hardware was delivered) should have been taken into account for the purpose of calculation of LD as per terms of the order.

25.1.5.2 *Review of GENISYS System*

Inadequate control mechanism in GENISYS application

While reviewing the control mechanism provided in the software, it was found that adequate control checks were not provided in the following areas.

Scroll Entry

According to Section 64VB of the Insurance Act, 1938, no risk can be assumed from a date earlier than a date on which the premium has been received in cash/cheque. In case, the premium is collected by Agent, it is required to be deposited within 24 hours of collection. In case the premium is received by post, the date of post will be reckoned as

date of receipt. To assume risk from back date, a facility, named 'Scroll', has been provided in GENISYS. The issuance of policy through Scroll from back date is fraught with the risk of any of the following misuses:

- (i) The premium may be accounted for only after the claim becomes due.
- (ii) If there is no claim, the cheque may be returned to the party causing loss of business to the company.
- (iii) The cheque may be held if money is not available in the party's account.

Detailed scrutiny of records revealed the following irregularities under the above three situations.

Premiums accounted for after receipt of claims

In 69 cases at Division –XI, Kolkata, accidents occurred before accounting of premium and generation of policy. It was seen that in these cases cheques and cash were held for periods of one day to 164 days. Underwriting and claim files of 69 cases were requisitioned, of which only 13 claim files were produced to Audit and no underwriting file was made available. Audit observed that out of 13 claims

- (i) nine cases relating to mediclaim policy were settled through Third Party Administrator (TPA). In the absence of detailed documents regarding settlement of these cases, no further audit observation could be made;
- (ii) three cases related to Motor Policy, out of which in two cases there was no record to show that premium cheques were received before occurrence of accident;
- (iii) in one case, Marine Cargo Specific Transit Policy was issued after expiry of the risk period, though cheque was received beforehand. The cheque was kept in hand without any entry in the system. The same was accounted for only after the accident occurred.

At Division –VII and IX, Kolkata, in seven cases each, policies were issued through Scroll where accidents occurred before accounting of premium and generation of policy.

In the absence of related files regarding claims and underwriting, circumstances under which policies were generated in these Divisions after the occurrence of the accident, could not be ascertained. It, however, further indicated a lack of validation control.

Return of cheques

On a test check of entries in the Inward Remittance Register (IRR)[♦] of Division-XI with those in the System, it was seen that some of the cheques entered in the Register, were

[♦] *This is a manual register to record incoming premium, in cheque, pending generation of policy and recording in cash book. However, this has been dispensed with in most of the operating offices after introduction of GENISYS.*

not accounted for and no policy was issued against such cheques. Following four such cases relating to the year 2003, 2004 and 2005 were noticed:

IRR No.	Date/Time	Name	Cheque No and Date	Bank Name	Amount (Rs.)	Department
3536	11/08/2003 3.30 PM	Ransal India Private Limited	442599 11/08/2003	Bank of Maharashtra	1,695	Marine
3958	27/08/2003 0.55 PM	Kamrup Tea	492277 27/08/2003	Federal Bank Ltd	6,385	Marine
7106	23/11/2004 5.25 PM	Zenith Exports Ltd	361420 23/11/2004	Canara Bank Overseas	1,170	Marine
4019	27/07/2005 5.25 PM	Ajoy Automobiles	688252 27/07/2005	Bank of India	4,423	Motor (struck out)

It was observed that the above cheques were not deposited in the banks. The ultimate fate of these cheques could not be ascertained as the relevant documents were not produced to audit. It was also seen that many entries of the IRR were struck out without giving any remarks and authorisation.

Retention of cheques

It was seen that at Division-XI, Kolkata, in 20488 cases, cheques and cash were held for periods ranging from one day to 343 days. In 41 cases, where cash was received, there was a delay of three to 15 days in deposit of cash of Rs.0.40 lakh. In 111 cases, cheque dates were later than the Scroll date. Thus, there was no validation control between Scroll date and cheque date.

Assuming risk before receipt of premium violates provisions of 64VB of the Insurance Act 1938. Further, the system of issue of policy after occurrence of accident violates the basic rules of financial propriety.

At Division –VII, Kolkata, in 194 cases, cash was held for periods ranging from one day to 123 days and in 1,922 cases cheques were held for periods ranging from one day to 111 days. Delayed deposit of cheques resulted in unnecessary coverage of risk, in case cheques were dishonoured subsequently.

Opening of books

It was noticed that Under GENISYS, Books were allowed to be kept open up to seven days after the date of transaction in Division VII, IX, XI Kolkata and, Street Branch Bentinck, and MG Road Branch, Kolkata. This is fraught with risk as back dated entries in the Cash book can be made and policies with back date can also be generated.

When a separate facility of Scroll entry for generating policy with the date effective from an earlier date exists, system should ensure daily closing of Cash book to avoid manipulations.

Deficiencies in the system regarding Fire Policy

(i) Silent Risk

According to All India Fire Tariff (AIFT), in case of risk becoming 'Silent'[♦], it shall not be entitled to any discounts. However, on a test check through dummy data, it was noticed that policy was generated allowing 15 *per cent* claim experience discount and 10 *per cent* Fire Extinguishing Appliances (FEA) discount for risk that fell in the category of 'Silent' risk.

The Management accepted the Audit observation and also stated that suitable rectification would be made in GENISYS.

(ii) Ratings

In GENISYS the 'Risk Code Menu' of the underwriting module, does not display description of all types of risks prescribed in the tariff. It was observed in Audit that the option to select storage risks outside the compound of industrial/manufacturing units was not available. Further, in the menu the system did not incorporate the list of hazardous goods issued by Tariff Advisory Committee (TAC). Thus, the user had to manually consult the tariff chart to identify the risk code applicable.

The Management stated that 'Risk Code Menu' against utilities located outside industrial and manufacturing risk was available in GENISYS. The Management's reply is not correct as on verification it was seen that 'Risk Code Menu' does not show the description of property. Thus, there is a chance of wrong classification and charging of wrong premium by the user.

Failure to cancel motor policies in respect of Cash Loss/Total Loss

In case vehicle is totally damaged/or when the net cost of repair is almost close to the Market Value or the Insured Estimated Value (IEV) or the vehicle is stolen, the claim can be considered as a Total Loss. If loss is extensive but does not warrant consideration of the claim on 'Total Loss' basis, claim can be settled on 'Cash Loss' basis. According to 'Claims Settlement Manual' of the Company, in these cases the policy should be cancelled and Regional Transport Office (RTO) should be informed by registered post about the cancellation of the policy in such cases.

It was seen that the GENISYS software did not have appropriate validation controls to ensure cancellation of the policy after settling such claims. On analysis of the data it was observed that in three cases of Division-VII, eighteen cases of Division-XI, two cases of Bentinck Street Branch, and four cases of MG Road Branch, Kolkata, claims were settled on 'Total Loss' basis but the policies were not cancelled leaving scope for further claim under the policy.

[♦]*when a factory remains closed for a period more than 30 days*

Mediclaim policy

In case of Mediclaim insurance policy, if there is any gap in renewal of policy, cumulative bonus can not be allowed unless it is approved by the competent authority. However, the GENISYS system allows cumulative bonus on renewal of insurance policy even though there is a gap in renewal and there is no approval of competent authority. In MG Road Branch, Kolkata, 25 Mediclaim policies were issued where there was a break in continuity. In test check of two of these cases, it was seen that cumulative bonus was allowed despite absence of approval of competent authority in the absence of appropriate validation check.

25.1.5.3 Delay in giving effect to modifications in the software

It was noticed from records that the Company launched new products without any provision in the GENISYS to underwrite the same.

The Management stated that there was some time gap between introduction of a product and incorporation of relevant module in the software.

Necessary provisions should have been incorporated in the GENISYS before launching the product.

As per the agreement entered with CMC, for making changes in the system at global level, patches/versions are prepared by CMC. This patch/version is thereafter sent to all operating offices to run and update the system.

The Government revised service tax from five to eight *per cent* on 14 May 2003. However, GENISYS version (5.9.1.2) for enhancing service tax was released by CMC on 19 May 2003.

On a test check of records it was noticed that there was delay in implementation and recovery of service tax at higher rate, which in some cases was delayed till 31 May 2003 and the difference in collection amounted to Rs.1.24 crore.

The Management stated that delay was due to failure of the operating offices in loading the patch in time. They also stated that there was no loss to the exchequer as service tax paid to service provider like Bharat Sanchar Nigam Limited could be set off against the collection of service tax on the insurance premium. The Management also stated that the differential Service Tax was collected and kept in excess premium account to be adjusted subsequently.

The reply is not tenable as the fact remains that there was a loss to the Company due to delay in communication and implementation of revision of service tax patch by the Company. The short collection of Rs.1.24 crore was arrived at after considering subsequent differential collections.

The Management of Bentinck Street Branch stated (December 2005) that excess commission paid due to delayed implementation of changes in GENISYS was adjusted/recovered subsequently.

Circulars modifying rates, conditions, etc. not incorporated in the system in time

With effect from August 2003, the agency commission on motor business was revised, and as a result, no commission was payable on Third Party (TP) portion of package policies irrespective of the insured category. It was, however, noticed that the system allowed agency commission on total amount of premium. The system, thus, lacked control in this regard. In Bentinck Street Branch, Kolkata and in M.G Road Branch, Kolkata, excess commission of Rs.0.61 lakh had been paid.

As per TAC direction, if claim experience ratio was more than 100 *per cent*, in case of Fire Policy, the matter was to be referred to TAC. This provision was changed with effect from 16 April 2004 and loading of slabs was introduced even in cases where claim experience was more than 100 *per cent*. On a test check with dummy data, claim experience was entered as 600 *per cent* and system did not impose any loading even though as per tariff 100 *per cent* loading was to be imposed. Therefore, this vital change was not incorporated in the system.

The Management accepted (March 2005) the audit observation.

TAC issued directions from time to time regarding tariff. On a test check it was found that the guidelines contained in the following circulars were not incorporated in the system.

- (i) Circular dated 25 March 2004 regarding voluntary Deductibles regarding Act of God.
- (ii) Circulars dated 31 March 2005 regarding clarification on risk code and rate code, clarification regarding tariff item namely “Dwelling, places of worships.....” and refund on cancellation of long term policy.
- (iii) Company’s guidelines issued on 13 March 2003 regarding prohibiting commission from second year in respect of package policy on commercial vehicle other than tractor.

25.1.5.4 Audit through GENISYS

Audit through Genisys revealed the following cases where mistakes occurred due to users’ fault.

Cover Note

Cover Note is a vital document committing the Company to undertake the insurance of the risk. This is considered as a temporary policy. The Cover Notes are to be issued only when full particulars of insurance are gathered and the premium is calculated. Therefore, a close control is required to minimise the chance of fraud through misuse of the Cover Notes. Though there is a provision to enter Cover Note number in the system, it was not followed many times. As a result the register of Cover Notes, generated by the system, remained incomplete and effective control over the utilisation of Cover Notes could not be exercised.

On a test check of some Cover Notes issued by the agents of Division –XI, Kolkata, through the system, it was seen that in the following four cases premium was collected through Cover Note but no corresponding policies were issued.

Sl. no.	Cover note no.	Book no.	Amount (Rs.)	Name of the insured	Risk start date	Development officer/agent code
1	214888	8596	3,580	A.Keay Power Foods (P) Ltd.	28/08/2003	-DO-
2	401840	16074	7,515	Zulfikar Alam	17/08/2004	-DO-
3	214891	8596	847	Animesh Kr. Saha	28/08/2003	-DO-
4	401421	16057	1,567	Ganesh Mondal	06/12/2004	01075

It was further noticed that money collected by the agents in the above cases was not deposited with the Company and, at the same time, there was also no record that the above cover notes were cancelled subsequently.

Issue of policy in favour of National Insurance Company Limited

On data analysis of MG Road Branch, Kolkata, it was seen that a policy was issued in the name of the Company under which one TP claim and one Own Damage claim was settled TP was settled for an amount of Rs.31.12 lakh and the Own Damage claim was settled for Rs.0.89 lakh. On discussion, the Management stated that this dummy policy was generated to adjust the entire TP claim paid by the Divisional office on behalf of Branch office but regarding Own damage claim there was no explanation. However, no record was produced to Audit in favour of the arguments.

The Company may consider any other adjustment module for the purpose since a Company can not insure its own property with itself.

25.1.6 Conclusion

There was lack of control in the system to combat the following situations:

- (i) risk was covered before receiving premium in violation of section 64VB of the Insurance Act 1938,
- (ii) cash book remained open up to seven consecutive days with consequent risk of manipulation,
- (iii) guidelines issued by the TAC and the HO of the Company were not incorporated,
- (iv) agents collected money through cover note but did not deposit with the Company and data validation of scroll date with cheque date was absent.

25.1.7 Recommendation

- (i) Business process should be re-engineered to ensure that Scroll entries and Cash book entries are made simultaneously on receipt of premium in the shape of either cheque or cash. Separate facilities may be provided to take care of situation where premium is collected by agent or by post.

Report No. 12 of 2006

- (ii) The system should restrict any violation of Section 64 VB of Insurance Act, 1938 which prohibits assuming risk before receipt of premium.
- (iii) Periodical report on exception to the above should be generated and sent to Regional Office for investigation/reconciliation
- (iv) Provisions contained in the tariff and changes made from time to time may be incorporated in the system instantly through a prompt change management system to avoid any financial loss (es).
- (v) Adequate validation controls should be imposed to ensure that data received for processing was correct, complete, and without duplication.
- (vi) Provision regarding keeping daily accounts open for seven days from the date of transaction may be reviewed and daily closing of Cash book may be ensured.

The matter was reported to the Ministry in December 2005; its reply was awaited.