

**ANNUAL REPORT  
OF THE INTERNAL AUDIT DEPARTMENT  
OF ZAVAROVALNICA TRIGLAV D.D.  
ON INTERNAL AUDITING IN 2016**

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Recipients of the report: Management Board  
Audit Committee  
Supervisory Board  
General meeting  
Auditor of the financial statements

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**TABLE OF CONTENT**

1 PURPOSE OF THE REPORT ..... 3

2 OVERVIEW OF WORK UNDERTAKEN BY THE INTERNAL AUDIT DEPARTMENT AND  
IMPLEMENTATION OF THE PLANNED INTERNAL AUDIT ACTIVITIES ..... 3

3 SUMMARY OF IMPORTANT FINDINGS BASED ON THE PERFORMED INTERNAL AUDITS ..... 7

4 ASSESSMENT OF THE ADEQUACY OF FUNDS FOR THE WORK OF THE INTERNAL AUDIT  
DEPARTMENT ..... 10

5 FINDINGS OF THE EXTERNAL AUDIT OF THE QUALITY OF PERFORMANCE OF THE INTERNAL AUDIT  
DEPARTMENT ..... 12

6 STATEMENT OF INDEPENDENCE AND IMPARTIALITY OF THE INTERNAL AUDIT DEPARTMENT AND  
INTERNAL AUDITORS ..... 13

## **1 PURPOSE OF THE REPORT**

Pursuant to Article 281a of the Companies Act, Article 165 of the Insurance Act and Articles 40 and 42 of the Internal Audit Policy of Zavarovalnica Triglav d.d., the Internal Audit Department (hereafter also referred to as the Department) shall produce an annual internal audit report and submit it to the Management Board, the Audit Commission, the Supervisory Board and the Auditor of financial statements; and the Management Board shall present this report to the General Meeting, including the opinion of the Supervisory Board on the report.

The Department also prepares other detailed reports on individual internal audits for the Management Board and the persons responsible for the audited areas; and other periodical reports (quarterly or half-yearly) on internal audits for the Management Board, the Audit Commission and the Supervisory Board.

The purpose of the annual internal audit report for 2016 is to familiarise the Management Board, the Audit Commission, the Supervisory Board, the General Meeting and the Auditor of financial statements with:

- the work performed by the Department and the implementation of the planned internal audit activities in the period considered;
- the summary of important findings of internal auditors based on performed internal audits in the period considered, including the assessment of adequacy and efficiency of risk management and the internal control system in the audited fields;
- the assessment of adequacy of funds for the operation of the Department in the period considered;
- the findings of the internal audit of the quality of operations of the Department;
- the statement of independence and impartiality of the Internal Audit Department and internal auditors.

The report contains all information required by paragraph 2 of Article 165 of the Insurance Act, and Article 42 of the Internal Audit Policy of Zavarovalnica Triglav d.d.

## **2 OVERVIEW OF WORK UNDERTAKEN BY THE INTERNAL AUDIT DEPARTMENT AND IMPLEMENTATION OF THE PLANNED INTERNAL AUDIT ACTIVITIES**

In 2016, the Internal Audit Department performed activities based on the implementation plans adopted by the Department, mostly on the basis of the Annual Work Plan of the Internal Audit Department of Zavarovalnica Triglav d.d. for 2016, which was adopted by the Management Board (on 9 December 2015) and agreed on by the Supervisory Board (of 17 December 2015). In accordance with the rules of the internal audit profession and good practice guidelines, the Department

performed internal audits and other internal audit activities in Zavarovalnica Triglav (hereafter also referred to as the Insurance Company) and other companies of the Triglav Group.

In the period considered, the Department performed **28 regular internal audits** of totally 29 planned audits, and completed 27 of them with the issue of final reports. 25 audits were performed in the Insurance Company and 3 audits were performed in other companies of the Triglav Group. One audit is still in progress and is expected to be completed in the first quarter of 2017<sup>1</sup>, and the Department failed to perform one of the originally planned audits due to sick/maternity leave and was therefore included in its annual work plan for 2017<sup>2</sup>.

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<sup>1</sup> Audit of the procedures for defining and transferring minimal standards of the business functions to the subsidiaries.

<sup>2</sup> Audit of the progress of the CRM programme.

In the period considered, the Department performed **no extraordinary internal audits**.

In the period considered, the Department performed **other internal audit activities**:

- Informal counselling activities, including mostly:
  - Counselling and advice-giving on adopting and updating internal documents of the Insurance Company, the improvement of business processes, risk management and on implementing the recommendations made by internal and external auditors;
  - Monitoring of the implementation of recommendations made by internal and external auditors;
  - Periodical reporting to the Management Board, Audit Committee and the Supervisory Board on the work of the department, the findings of internal audits and the implementation of recommendations made by internal and external auditors;
- Planning work of the Department for 2017 based on the audit assessments of risks on individual business areas of the Insurance Company and planning of the strategic activities of the Department for the 2017-2020 period (as part of the preparation of the strategy of the Insurance Company and of the Triglav Group for the 2017-2020 period);
  - Internal audit services in the subsidiary insurance company Triglav Osiguranje, Banja Luka which does not employ its own internal auditor as a result of small scale of operations;
- Assuring and improving quality of work performed by the Department and the internal audit departments of other companies in the Triglav Group, mostly including:<sup>3</sup>
  - Participation in internal and external trainings;
  - Regular monitoring of the functioning of other fields/departments in the Insurance Company and exchange of information within the Department;
  - Upgrading the method of the risk of individual business areas of the Insurance Company in order to draft (multi-)annual plans of work of the Department;
  - Internal audit of the orderliness of work materials;
  - Implementation of internal workshops addressing the orderliness and retention of work and the criteria for the assessment of the internal auditors' work and its remuneration;

The Department assessed that it successfully implemented the planned internal audit activities in 2016.

- Implementing procedures for the selection and hiring of a provider of the quality audit of the Department and engagement in the audit new internal auditor (key findings of the audit are presented in Chapter 5);
- Getting familiar with the changes to the International standards for the professional practice of Internal Auditing that entered into force on 1 January 2017, and with the preparation of changes to the Internal Audit Policy in Zavarovalnica Triglav d.d. (in changing the Policy, the Department will also take into account the proposals of the external auditor of the quality of the Department and the proposed changed Policy will be presented to the Management Board, Audit Committee and the Supervisory Board at the end of March or at the beginning of April 2017):

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<sup>3</sup> In 2016, the Department conducted the majority of the planned tasks related to ensuring and improving the quality of operations of the Department, except for the activities associated with the introduction of the software to support internal auditing, the updating (template) of the report on the implementation of individual internal audits, the preparation of a questionnaire to assess the quality of the individual internal audit implementation (by the area audited) and the preparation of career plans and promotion criteria for internal auditors. The non-implemented activities which are mainly the result of increased scope of sick/maternity leave and slightly increased time consumption for the implementation of planned regular internal audits were included in the annual work plan for 2017.

- Monitoring the operations of internal audit departments of other companies in the Triglav Group and the provision of advice;
  - regarding the implementation of internal audits and other internal audit activities;
  - in the planning of work for 2017;
- implementation of a seminar for internal auditors of the companies in the Triglav Group in order to exchange experience and good practices between internal auditors;
- Other activities that mainly include administrative activities, management of the Department, and participation at board meetings and other meetings, cooperation with the external auditor, participation in the Section of internal auditors within the Slovenian Insurance Association. etc.

The Department assesses that, taking into consideration the available business days, it successfully and to the extent expected implemented the planned internal audit activities in 2016.

### 3 SUMMARY OF IMPORTANT FINDINGS BASED ON THE PERFORMED INTERNAL AUDITS

In performing internal audits, the Internal Audit Department focuses mainly on verifying and assessing the suitability and efficiency of risk management and the performance of the internal control system in the Insurance Company, making sure that:

- Risks are adequately identified and managed;
- Accounting data and data required for decision-making and operational functioning is correct, reliable and timely;
- Employees comply with legal and other requirements, standards and guidelines, and operate in accordance with internal rules of the Insurance Company;
- Resources are used economically, efficiently and with appropriate protection;
- Programmes, plans and objectives are realised;
- The Insurance Company is constantly improving the quality of its operations.

The Department regularly submits written reports to persons responsible for the audited fields or the persons responsible for implementing recommendations from individual internal audits in the Insurance Company, and also informs the Management Board of these reports. These responsible persons have to take measures or perform certain activities for eliminating the identified infringements, irregularities and deficiencies within a given deadline based on the recommendations made by the Department, and report thereon to the Department. Based on this, the Department periodically monitors the implementation of recommendations and reports thereon to the Management Board, the Audit Committee and the Supervisory Board. Similarly, the Department also monitors and reports on the implementation of recommendations made by external auditors.

Based on performed internal audits and monitoring of the implementation of recommendations in 2016, the Department assesses that **risk management and the performance of the internal control system in the audited fields of the Insurance Company are**, on the whole, **suitable and constantly improving**; however, it identified the following possibilities of improvement:

- In the field of developing and undertaking insurances (concluding insurance contracts and resolving claims), closer attention has to be paid to consistent observance of insurance-technical basis and the provision of complete and timely issued/submitted documentation regarding the conclusion of insurance contracts and resolving loss events; to further improve the speed of handling complaints concerning the established insurance; and to examine some possibilities of improving or restricting insurance products or services; to study some potential improvements of the functionalities of the underwriting and associated applications;
- In the field of calculating the insurance technical provisions, some missing internal rules need to be prepared, the control of data quality for the calculation of provisions has to be defined and documented;

- In the field of calculating the required solvency capital, some missing internal rules on the calculation have to be drafted; to ensure suitable staff for the implementation of the calculation procedures and reporting (mainly in the Risk Monitoring and Reporting Department);



- In the field of financial investments, some rules regarding the procedure implementation need a clearer definition; to improve the documenting of some audits of the adequacy of investment policies;
- In the field of real estate management, the processes of real estate management or the scope of powers and responsibilities, tasks, ways of cooperation, information and communication between the Insurance Company and Triglav, Upravljanje nepremičnin, require clearer definition and description; a detailed analysis of the return on investment property is to be made, and measures adopted to achieve their targeted return;
- In the field of recovery and write-off of receivables, the procedures for regular reminding of contractual points of sale are to be established to remind the latter of the receivables associated with the paid but not transferred premiums; more attention needs to be placed on consistent implementation of the subrogation recovery;
- In the field of the purchase of fixed assets, materials and services, the optimization of the procedures of purchasing is necessary as well as comprehensive handling of the existing and potential suppliers, the achievement of (even) better purchasing conditions and a good overview (monitoring and control) of the purchase; to ensure consistent adherence to the rules regarding the determination of parameters for the allocation of the costs of purchase to cost centres;
- in the field of information technology and information systems, a detailed comprehensive strategy of the IT management in the Triglav Group is needed, which will define the targeted portfolio of applications, target information infrastructure, targeted organisation of IT and key supplier management at one spot (in one document); to be more active and uniform in following the technological trends in the field of operating systems, databases, architecture, tools and development standards; to improve the procedures and measures to ensure personal data protection in some information systems; to place more attention to the compliance of the management of access rights and of changes of information systems with the adopted internal rules; to draft a plan of further activities for systematic and efficient data quality management and ensure their implementation; to coordinate or optimize the criteria for the preparation and retention of data back-up in conjunction with the data source owners; to ensure regular monitoring of key suppliers in the area of information technology and information systems;
- in the field of project implementation, more attention is to be paid to the procedures of risk and change management associated with projects, and procedures for monitoring and controlling project implementation.

The Management Board and the heads of functional areas are aware of the potential impacts of identified infringements, irregularities and deficiencies on the achievement of key objectives of the Insurance Company and adopt the measures or carry out activities for their elimination. Although delays in the implementation of some recommendations continue to occur, the speed of the implementation of recommendations in 2016 compared to the previous years improved, and the number of outstanding recommendations at the end of 2016 compared to the previous year decreased. The proportion of outstanding overdue recommendations with respect to all outstanding recommendations also dropped.

More important opportunities for improving risk management and internal control systems **in the subsidiaries** which the department identified when performing internal audits in these companies or by monitoring performance and results of internal audit services in these companies are presented below:

- In the field of undertaking insurance, more consistent observance of insurance-technical basis and other internal documents of individual companies is to be ensured; the implementation of procedures for assessing and assuming risks need to be improved; the procedures for controlling and resolving complaints have to be improved, training of agents has to be improved, in the processes of the assessment of claims and their liquidation more attention has to be paid to the preparation of better documentation and assessment of the eligibility of claims and determining the amount of claims;
- In the field of back-office support to operations, finance (investment management) and accounting activities, the processes of monitoring payments and the recovery of claims arising from premiums and subrogations have to be improved; the criteria for value adjustments and write-off of receivables have to be consistently observed; the investment policies have to also define realistic short-term target exposure or adopt adequate measures related to investments aiming at better alignment of the actual exposure with the defined long-term target exposure; the improvement of the processes of recording business events;
- In the field of marketing communications, the procedures for granting sponsorships, donations and funds for prevention need to be formalised; the processes of purchasing and recording of advertising materials need to be improved and adequate control over the use of these materials has to be put in place;
- In the field of information technology and information systems, the separation of incompatible functions has to be provided or at least compensatory controls to supervise the implementation of operational tasks in the production information systems; the procedures of the management of access rights and changes as well as the measures of personal data security in information systems have to be improved; periodical testing of the continuity of the key information systems have to be provided.

In order to constantly improve risk management through the functioning of internal control systems in the companies of the Triglav Group, the Insurance Company continued to transfer uniform minimal standards of performing business functions to its subsidiaries also in 2016.

#### **4 ASSESSMENT OF THE ADEQUACY OF FUNDS FOR THE WORK OF THE INTERNAL AUDIT DEPARTMENT**

The Management Board provides suitable working conditions to the Internal Audit Department, both in the terms of organisational independence and the volume of funds for the functioning of the Department, which enables the employees of the Department to perform internal audit activities independently and impartially.

The number and structure of employees in the Department and their competences usually enable a suitable implementation of planned annual internal audit activities, with the assumption that the Department does not face unplanned longer sick leaves, child-care leaves or other exceptional absences and/or increased volume of the performance of unplanned additional tasks.

In 2016, the Department had 11 employees; however, due to long-term sick leave of two of the employees, 10.5 persons were actually active employees. When planning its activities for 2016, the Department did not envisage this scope of absence (planned sick leave amounted to 79 days; and

realised sick and maternity leave 185 days). Despite all this, it managed to carry out the majority of all planned activities, which is also presented in Chapter 2.

Of all employees, 8 have at least one professional title in the field of audits and related fields awarded by the Slovenian Audit Institute or comparable foreign institutions:

- 2 employees have the professional titles “Certified Internal Auditor” and “Authorised Auditor”;
- 4 employees have the professional titles “Certified Internal Auditor”;
- 1 employee has the professional titles “Certified Information Systems Auditor”, »CISA<sup>4</sup>« and “CGEIT<sup>5</sup>”;
- 1 employee has the professional title “CISA”.

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<sup>4</sup> CISA – Certified Information Systems Auditor

<sup>5</sup> CGEIT – Certified in the Governance of Enterprise IT

The Department enables all employees to receive suitable professional education and training. In 2016, the employees attended formal internal and external trainings, and they also gained new knowledge through non-formal education by reading professional literature.

If the employees of the Department do not have specific knowledge or skills required for performing internal audits or other internal audit activities, the Management Boards enables the Department to acquire suitable assistance of internal or external qualified professionals. In 2016, the Department did not make use of the services of external experts.

## 5 FINDINGS OF THE EXTERNAL AUDIT OF THE QUALITY OF PERFORMANCE OF THE INTERNAL AUDIT DEPARTMENT

In its work, the Internal Audit Department is bound by the International Standards of professional practice in Internal Auditing (hereinafter referred to as the Standards). They require that the external assessment of the compliance of the Department with the Standards is to be carried out by a qualified independent reviewer at least once every five years. The five-year period within which the external assessment is to be provided expires at the end of 2017<sup>6</sup>; however, the Department included the assessment already in the annual work plan for 2016.

DELOITTE REVIZIJA, d.o.o. was selected to perform the external assessment (hereinafter referred to as the external reviewer). The review was conducted in the period 28 November to 31 December 2016, and it primarily assessed the performance of the Internal Audit Department in the January 2015 - November 2016 period.

The external assessor established that **the operations of the Internal Audit Department are compliant with the International standards for the professional practice of Internal Auditing in all material aspects**, and made some recommendations regarding further development and introduction of global best practices into the Department's operations.

The Department took into account the majority of these recommendations when planning the activities of quality assuring and improving of the Department for 2017, the other will be considered when planning internal audit activities for future (multi)annual period. The Department will report on the implementation of the recommendations within its periodic internal audit reports.

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<sup>6</sup> Previous external assessment of the compliance of the Department with the International standards for the professional practice of Internal Auditing was performed in 2012 by Vezjak svetovanje d.o.o., which assessed that the Department was compliant with the Standards in all material aspects.

## 6 STATEMENT OF INDEPENDENCE AND IMPARTIALITY OF THE INTERNAL AUDIT DEPARTMENT AND INTERNAL AUDITORS

As mentioned in Chapter 4, the Management Board provides suitable working conditions to the Internal Audit Department, both in terms of organisational independence and the volume of funds necessary for the functioning of the Department, which enables the employees of the Department to perform internal audit activities independently and impartially.

The Department is organised as an independent organisational unit within the Insurance Company that is directly subordinated to the Management Board and functionally and organisationally separated from other organisational parts of the Insurance Company. The Department is independent in defining the areas, objectives and scopes of internal audits. The Department reports on its operations, findings of internal audits and the implementation of recommendations directly to (in writing and orally):

- the Management Board, which enables the Department to stay independent from other business areas and functions in the Insurance Company;
- The Audit Committee and the Supervisory Board, which reinforces the Department's independence from the Management Board.

All internal auditors that performed internal audits in 2016 have signed a statement confirming their independence and impartiality in performing these audits.

The duties of the head of the Department and other internal auditors in connection with ensuring independence and impartiality, avoidance of the conflict of interests, and reporting on any circumstances that may weaken the independence and impartiality of the Department or internal auditors are defined in the Internal Audit Policy of Zavarovalnica Triglav, d.d.<sup>7</sup>

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<sup>7</sup> The head of the Department, together with the Management Board, has to inform the Audit Committee and the Supervisory Board of possible limitations of funding for implementing internal audit plans based on risks. Internal auditors have to notify the head of the Department on any circumstances that may cause a conflict of interests and thus weaken their independence and impartiality, and the head of the Department informs the Management Board, the Audit Commission and the Supervisory Board. The circumstances that cause a conflict of interests include:

- Performing any development or operative tasks, decision-making regarding the activities and/or directing the activities of employees in the audited fields, especially within two years before performing audit tasks in these fields;
- Family relationships with employees in important or sensitive positions within the audited fields or the Insurance Company in general;
- Any material gains in connection with the performance of the audited fields or the Insurance Company in general;
- Offered or received rewards or other benefits from the employees of the Insurance Company or third persons which appear to be offered or given with the intention of weakening the impartiality of the head of the Department and/or the internal auditors.