

**ANNUAL REPORT
OF THE INTERNAL AUDIT DEPARTMENT
OF ZAVAROVALNICA TRIGLAV, d.d.,
ON THE INTERNAL AUDIT
FOR 2013**

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1 PURPOSE OF DRAFTING THE REPORT

Pursuant to Article 165 of the Insurance Act and Article 27 of the Rules on the operations of the Internal Audit Department of Zavarovalnica Triglav, d.d., the Internal Audit Department (hereinafter referred to as 'Department') must draft an annual report on the internal audit, and submit it to the Management Board and Supervisory Boards. The Management Board must then inform the General Meeting of Shareholders about this report and the opinion of the Supervisory Board on the report.

The Department also drafts more detailed reports on individual internal audits carried out for the Management and Supervisory Boards of the insurance company, and periodic (quarterly, biannual) reports on internal audits for the Management Board, Audit Committee and the Supervisory Board.

The purpose of drafting the Annual Report on the Internal Audit for 2013 is primarily to inform the Management Board, Audit Committee, Supervisory Board and General Meeting of Shareholders about:

- the work of the Department and the implementation of the planned internal auditing activities in the period in question;
- a summary of important findings of internal auditors based on internal audits in the period in question;
- the assessment of the suitability of the Department's resources in the period in question.

The report includes all information stipulated by the second paragraph of Article 165 of the Insurance Act.

2 REVIEW OF WORK OF THE INTERNAL AUDIT DEPARTMENT AND IMPLEMENTATION OF PLANNED INTERNAL AUDIT ACTIVITIES

In 2013, the Internal Audit Department carried out activities on the basis of the adopted plans for the Department's operations, primarily on the basis of the annual work programme of the Internal Audit Department of Zavarovalnica Triglav, d.d. for 2013 which was adopted by the Management Board on 13 December 2012 and approved by the Supervisory board on 20 December 2012. In compliance with the rules on internal auditing and guidelines of best practice in this field, the Department implemented regular and extraordinary internal audits and some other internal auditing activities.

In the period in question, the Department implemented the following:

- **25 regular internal audits** from a total of 27 planned audits, i.e. 18 audits in the fields of the insurance company's operations and 7 in other companies of the Triglav Group:
 - the Department has already issued final reports on 22 audits and a draft report on 1 audit;
 - in 2014, the Department is continuing the implementation of 2 audits which it was unable to implement or complete by the end of 2013, particularly due to the implementation of additional auditing procedures in several other internal audits where risks greater than

originally assessed during the planning for 2013 were detected; following the agreement with the management of the audited fields, the Department fully transferred 2 audits in 2014;²

- **1 extraordinary internal audit** in the field of the insurance company's operations, for which the Department has already issued the final report.

¹ In 2014, the Department continues the implementation of the internal audit of corporate governance (implemented in Zavarovalnica Triglav and in other insurance companies of the Triglav Group) and the internal audit of the information protection management system. Both unfinished audits were included by the Department in its annual work programme for 2014.

² The Department fully transferred to 2014 the internal audit of the project management process and the internal audit of the field of resolving claims in Triglav Pojišt'ovna, Brno. Both audits were included by the Department in its annual work programme for 2014.

In the period in question, the Department also carried out numerous **other internal auditing activities**:

- informal counselling activities, especially relating to drafting or updating internal acts of the insurance company and realising the recommendations of internal and external auditors;
- monitoring the realisation of the recommendations of internal and external auditors;
- planning the work of the Department in 2014;
- periodic reporting to the Management Board, Audit Committee and the Supervisory Board on the work of the Department, internal audits implemented and their results, and on the realisation of the recommendations of internal and external auditors;
- tasks of ensuring and improving the quality of operations of the Department and internal audit departments in other companies of the Triglav Group, within which the Department:
 - began revising the Charter and Rules for the operations of the Department in order to define the rules on internal auditing in the insurance company more systematically and comprehensively;
 - revised salary ratios between employees of the Department;
 - revised procedures for issuing reports on internal audits and procedures for informing the heads of the audited fields or recommendation holders with their responsibility to eliminate violations, irregularities and deficiencies established, and reporting on it;
 - in cooperation with the Department for organisation development and business process management, it prepared process schemes for the operational processes of internal auditing, and initiated the development of the system of performance indicators and efficiency of the Department's operations;
 - offered assistance to internal audit departments in other companies of the Triglav Group:
 - in the preparation and implementation of measures for the realisation of recommendations provided by quality assessments of their operations in 2012;
 - in planning work in 2014;
 - carried out a seminar for internal auditors in other companies of the Triglav Group for the purpose of exchanging experience and best business practice among internal auditors.

In June 2013, the Department began providing **internal audit services in two insurance companies of the Triglav Group**³ which had established the internal auditing function within the scope of their operations, but had been facing many HR-related problems in this field:

- the company Triglav Osiguranje, Banka Luka, does not employ an internal auditor, due to the small scale of the operations; therefore, it has been providing internal audit activities by outsourcing internal audit services at Zavarovalnica Triglav;
- the internal auditor employed at the company Triglav Pojišt'ovna, Brno, has been on parental leave since 2013; therefore, the company's management decided to replace this employee for the period of leave by outsourcing internal audit services at Zavarovalnica Triglav.

The Department had not planned to provide such services in its annual work programme for 2013. However, in mid-2013, it employed one additional person to ensure the suitable scope and quality of these services for both companies by reallocation from the Subsidiary Management Division. The person is professionally qualified to perform internal audit activities and has already within the scope

³ Internal audit services in the companies Triglav Osiguranje, Banja Luka, and Triglav Pojišt'ovna, Brno include the implementation of internal audits (except so-called 'cosourcing' audits already included by the Department in the planned regular internal audits – generally one audit in each of the two companies) and other internal auditing activities in accordance with the annual internal auditing programme adopted by the management and supervisory bodies of these two companies.

of employment at the Department for operative management of affiliated implemented the internal audit services in Triglav Osiguranje, Banka Luka. The Department is continuing to provide such services in 2014, and thus the anticipated scope of these services in 2014 was included in its annual work programme for 2014.

The Department assesses that it successfully carried out the planned and unplanned internal audit activities to the planned extent in 2013.

3 SUMMARY OF IMPORTANT FINDINGS BASED ON INTERNAL AUDITS IMPLEMENTED

In implementing internal audits, the Internal Audit Department is especially focused on verifying and assessing the suitability and efficiency of the functioning of internal control systems in the insurance company, which must ensure that:

- risks are suitably recognised and managed;
- accounting information and information for decision making and operations is correct, reliable and prompt;
- employees act in accordance with statutory provisions and other regulations, standards and guidelines, and in accordance with the internal rules which regulate the insurance company's operations;
- funds are used economically and efficiently, and are suitably protected;
- programmes and plans are implemented, and objectives attained;
- the insurance company constantly improves the quality of its operations.

The Department regularly reports in writing to the responsible heads of the audited fields and recommendation holders on individual internal audits carried out in the insurance company, and informs the Management Board of these reports. On the basis of the Department's recommendations, the responsible heads of the audited fields and recommendation holders must take suitable measures or carry out suitable activities within the deadlines set to eliminate the violations, irregularities and deficiencies established, and report on this to the Department. On this basis, the Department periodically monitors the realisation of the recommendations provided and reports on this to the Management Board, Audit Committee and the Supervisory Board. It also monitors, and reports on, the realisation of the recommendations of external auditors.

On the basis of internal audits and the monitoring of the realisation of recommendations in 2013, the Department assesses that **the functioning of the internal control systems in the insurance company overall is suitable⁴ and improving**, but that there are still possibilities to improve the functioning of these systems in individual fields of the insurance company's operations.

4 The suitability and efficiency of the functioning of the internal control systems are assessed from the aspect of observing statutory provisions and other applicable regulations, and internal acts, ensuring the efficient work organisation and suitable allocation of powers and responsibilities of employees, the suitability of procedures, and the design and functioning of controls in individual fields of the insurance company's operations, the suitability and efficiency of providing information to, and communicating with, employees, etc. In evaluating the suitability and efficiency of the functioning of internal control systems, the following guidelines were taken into account:

- **very good – the control system is very good in all respects.** Firm internal controls have been established; all key controls function without deviations. The control is optimum;
- **good** – the control system is generally good. The management manages the functioning well, and regularly performs troubleshooting. The responsibilities, authorisations and procedures are well defined, and are only rarely not carried out according to expectations. The control is carried out regularly. The risk is low.
- **suitable** – There are gaps in the control system which do not significantly undermine the insurance company's operations, but require (prompt) action by the management. The responsibilities, authorisations and procedures are usually suitably defined, but are occasionally not carried out according to expectations. The management is aware of monitoring and controlling. Control is carried out occasionally. The risk is medium.
- **poor** (but still conditionally acceptable) – There are some severe gaps in the control system which (may) significantly undermine the insurance company's operations, and must be immediately eliminated by the management. The

The Department also assesses that the Management Board and the management of the insurance company are aware of the potential effects of the violations, irregularities and deficiencies established on attaining the key objectives of the insurance company, and take measures and carry out activities to eliminate them.

The summary of important findings and related recommendations is presented below.

In the fields of developing and concluding insurance, and resolving claims, guidelines for the unification of concluding burglary insurance for jewellery workshops and shops must be provided; guidelines for concluding the insurance of movable property owned by legal entities must be provided, and the possibility of developing a new product for the insurance of movable property owned by legal entities with the general terms and conditions of insurance adjusted to the needs of legal subjects must be studied; additional software controls regarding the automated printout of mandatory clauses in policies, the hierarchy of correction calculation of the basic insurance premium, and alerting to unresolved complaints about insurance concluded must be installed in insurance-concluding; reporting on the actual effects of the introduction of new insurance services (e.g. packages, actions, etc.) in comparison with the effects expected must be improved; the consistency of observing powers and underwriting bases, and the consistency of writing information in insurance policies must be improved; electronic archiving of the accompanying insurance documentation must be improved; regular supervision of the prompt resolution of complaints about insurance concluded must be ensured; in resolving claims, more attention must be paid to the eligibility of claims and the scope of claims; the consistency of writing records about the inspection of damage and marking of the (non-)existence of recourse must be improved, and the promptness of the registration of recourse cases must be ensured; procedures, powers and responsibilities regarding the implementation and recording of fronting transactions must be systematically and comprehensively defined in a suitable internal act; the prompt issue of all documents prepared during the procedures of fronting transaction implementation must be ensured, and suitable supervision of resolving claims and recourses arising from fronting transactions which are resolved by local insurance companies abroad must be established.

In the field of **calculating agents' commissions** (and reimbursing travel expenses to agents and head of groups), a report which will include a comprehensive presentation of the actual effects of the new remuneration system for agents and heads of groups in comparison with the effects expected must be prepared, and on this basis, a proposal regarding the potential additional required modifications of this system must be prepared; a standard form for monthly recording of business trips related to agents' work in the field, and to collecting and submitting underwriting documentation must be prepared, which will be applicable to all regional units and will provide a suitable basis (data) for the calculation and payment of travel expenses; the correct back pay of agents' commissions for terminated insurance must be ensured in the new ITB-Commissioning software support.

In the field of **back-office support for the operations, finance and accounting**, the attainment of the objectives of the project 'Implementation of back-office business support' and the rationality of carrying out activities related to 'physical centralisation' of the back-office business support

responsibilities, authorisations and procedures are not suitably defined and are frequently not carried out according to expectations. Control is rarely carried out, and is left to individuals. The risk is high.

- **insufficient – there are some very severe gaps in the control system (significant non-compliance with external regulations, complete lack of control) which threaten the insurance company's operations and require a comprehensive reorganisation of the insurance company. The control is not carried out. The risk is very high.**

processes within this project must be studied, and a decision on continuing or concluding the project must be made; the record of the target state of back-office business support processes must be re-verified, and if necessary, suitably updated; a more consistent implementation of the procedures of reminding legal entities about outstanding claims on loans, more consistent implementation of assessing/testing the impairment of loans and suitable documenting of procedures conducted must be ensured; the processes/procedures for monitoring and recovering claims for shares from reinsurance claims must be defined in internal acts, and consistent implementation of these procedures must be ensured; the possibility of establishing a central record of insolvency procedures in which the insurance company is involved, and the sensible centralisation of some activities in these procedures must be studied.

In the field of **strategic planning and controlling**, a suitable manner of in-depth analyses of individual types of costs must be established; following the completion of the project 'Data warehouse', the roles, competences, responsibilities and tasks of individual departments and organisational units in the implementation of the reporting system for the needs of business decisions, as well as types of reports, their duration, recipients of reports, etc. must be defined.

In the field of **IT**, formal terminology and the classification (structure) of IT assets, which will be harmonised with the system of accounting and reporting, must be prepared; guidelines for preparing the plan of IT assets must be prepared, and at least quarterly operational plans for implementing individual activities must be prepared in cooperation with holders of planning needs (business fields and departments); on the basis of the preparation of a comprehensive technological and cost analysis of the required production hardware architecture to support key information systems, negotiating positions for future purchases of hardware must be prepared, and a comprehensive technological and cost analysis of various options for developing information infrastructure must be prepared at regular intervals (along with updating IT strategy); an analysis of the contractor, an exclusion risk assessment and a study of the economic viability of the exclusion must be included in the decision-making process on the internal/external implementation of IT services; a comprehensive report on operational risk management in the insurance company which arise from the development and use of information systems must be drafted; safety standards for managing mobile and multifunction devices which will be based on the defined risks of using such devices must be set; the process of managing regular and extraordinary/urgent modifications must be improved, and options to introduce a systemic audit trail must be studied; all the equipment in 'safe cells' must be fitted with suitable inventory numbers (labels), a suitable inventory of this equipment must be ensured, and the records of these assets must be harmonised with the actual situation.

In the field of **implementing projects for information system development**, the organisational framework and expert support for project implementation must be improved; the selection of suitable methodology for the development of information systems, and the planning and ensuring of suitable (sufficient and appropriate) staff resources for the preparation of functional specifications must be given more attention; a monitoring system of ownership costs and benefits of information systems must be established; the results (products) of such projects (e.g. source code of applications, accompanying documentation, etc.) must be formally defined, and the procedures for their storage and maintenance must be improved; all incomplete and missing accompanying documentation for the project of the development of the IT-Build information system must be suitably updated, completed or prepared in accordance with realistic possibilities; an assessment of the possibilities and costs of processing the data model and applications of the IT-Build information system must be prepared to replace non-numerical keys with numerical ones, with sensible consideration of the long-term positive effects on the usage of disk space, system resources and the speed of the IT-Build information system operation; the possibility of replacing our own persistence framework (interface) with a widely used persistence framework must be studied within the development of the IT-Build information system; suitable maintenance agreements must be concluded for applications whose development within the IT-Build programme projects⁵ has already been completed.

In the field of **purchasing and the contract management system**, prior to deciding on the further partial automation of procedures in the purchasing process, a comprehensive analysis of this process must be carried out, which, in addition to the process and document flow, should include the control flow of transaction data and a proposed plan for the further automation of the entire purchasing

⁵ The programme is an agglomeration (portfolio) of interconnected projects.

process; based on the systematic and comprehensive inventory of the situation regarding contract management, suitable guidelines for the unification and improvement of contract management must be prepared, and their implementation ensured.

In the field of **property management**, on the basis of the adopted strategic decisions regarding the organisation of the management process of property owned by Zavarovalnica Triglav and the reorganisation of the operations of Triglav nepremičnine, a more detailed plan for the implementation of these decisions must be prepared, which will more precisely define the activities and measures required to attain the strategic objectives, persons responsible and deadlines for implementing these activities.

In the field of **risk management**, the implementation of the risk management policy must be reported in detail to the Management Board within the framework of regular biannual reporting on the work of the Risk Management Department, so that the activities already realised and those to be implemented will be displayed in a systematic manner, including the persons responsible for implementing individual activities.

In the field of **subsidiary management**, the implementation of suitable activities to eliminate violations, irregularities and deficiencies established during internal audits in subsidiaries must be ensured in cooperation with the management of subsidiaries. The possibilities of improving the internal control system's operation in subsidiaries where the Department has carried out internal audits in cooperation with internal auditors in these companies or independently (some of the aforementioned possibilities refer to individual companies, and not all companies where audits were implemented) are summarised below:

- in the field of concluding insurance, more consistent observation of underwriting bases and other internal acts, and the suitable allocation of powers must be ensured; and the procedures for resolving complaints about insurance concluded must be improved;
- in the field of finance and accounting, the procedures for monitoring payments and recovering claims must be improved; the rules on concluding contracts and monitoring the implementation of contracts on the recovery of claims and contracts on the reprogramming of claims must be formalised; the adopted criteria for approving loans must be consistently observed when granting loans; the possibility of automating the implementation of certain procedures in the management process of loans granted must be studied; the real values of insurance received for the repayment of claims must be assessed; and the criteria for preparing corrections to the values of claims and writing off claims must be formalised.
- in the field of IT and information systems, the separation of incompatible functions, or at least replacement controls to supervise the implementation of operational tasks in production information systems must be ensured; the procedures of periodic auditing and formal confirmation of rights to access information systems must be established; the rules of remote access must be formalised, and suitable supervision of remote access to information system must be ensured; the procedures for managing modifications to information systems, and control procedures in data transfer from old to new information systems must be improved.
- the procedures of property management must be improved; suitable records of existing internal acts and their managers must be established; suitable records of contracts and their managers must be established; a suitable system of archiving business documentation must be established, etc.

In order to establish efficient internal control systems in insurance subsidiaries in the Triglav Group, the insurance company continued in 2013 with the activities of transferring the minimum standards of internal control systems to all insurance companies of the Triglav Group.

4 ASSESSMENT OF THE SUITABILITY OF RESOURCES OF THE INTERNAL AUDIT DEPARTMENT

The Management Board provides the Internal Audit Department with suitable conditions for work from the aspect of organisational independence and the scope of the Department's resources, which enables employees of the Department to carry out internal auditing activities independently and impartially.

On 1 January 2013, the Department employed nine persons, and on 31 December 2013, it employed ten persons. As mentioned in Chapter 2, the increase in the number of employees refers to the additional employment of an appropriately qualified person in June 2013 by reallocation from the Subsidiary Management Division, primarily in order to provide internal auditing services in two insurance companies of the Triglav Group (Triglav Osiguranje, Banja Luka, and Triglav Pojišt'ovna, Brno) which had established the internal auditing function within its operations, but had been facing HR-related problems. The person is appropriately qualified to carry out internal auditing activities and had already implemented internal auditing services in the aforementioned companies during their employment at the Subsidiary Management Division. The Department could not have anticipated this employment when planning its activities for 2013. The reinforcement of staff will also contribute to closer cooperation with internal audit departments in other companies of the Triglav Group.

Of all employees, seven persons have at least one professional title awarded by the Slovenian Institute of Auditors after they successfully concluded their studies in the field of auditing and/or a similar profession:

- 2 persons hold professional titles "experienced internal auditor" and "certified auditor";
- 4 persons hold the professional title "experienced internal auditor";
- 1 person holds the professional title "experienced internal auditor of information systems".

The Department enables all employees to receive a suitable scope of professional education and training. In 2013, employees attended formal education within and outside the insurance company, and also devoted part of their time to informal education in the form of reading professional literature.

The number and structure of employees of the Department and their qualifications generally facilitate the suitable fulfilment of the planned internal auditing activities in an individual year on the assumption that the Department does not face unplanned lengthy sick leaves, maternity/parental or other extraordinary leaves of absence and/or requires greater extent of the implementation of unplanned tasks.

The Management Board also enables the Department to acquire assistance from appropriately qualified experts within or outside the insurance company if employees of the Department do not have sufficient special knowledge and skills required to implement internal audits and/or other internal auditing activities. Thus in 2013, the Department implemented three internal audits in the field of IT and the implementation of information system development projects with assistance from external experts. The anticipated scope of assistance (45 counselling days) was included in the work programme of the Department for 2013.

Due to the development of IT and information systems, as well as related risks in the operations of the insurance company and other companies in the Triglav Group, the Department included the additional employment of one person with the professional title "experienced auditor of information systems" or other comparable title (probably in autumn 2014) in its annual work programme for 2014 in order to ensure suitable staffing in the long term.