

**ANNUAL REPORT
OF THE INTERNAL AUDIT DEPARTMENT
OF ZAVAROVALNICA TRIGLAV, D.D.,
ON INTERNAL AUDITING IN 2015**

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Recipients: Management Board
Audit Commission
Supervisory Board
Meeting of Shareholders
Auditor of financial statements

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1 PURPOSE OF THE REPORT

According 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 annual internal audit reports 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 Meeting of Shareholders, 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 field; 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 2015 is to familiarise the Management Board, the Audit Commission, the Supervisory Board, the Meeting of Shareholders 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 statement of independence and impartiality of the Internal Audit Department.

The report includes all information required by Article 165. Paragraph 2, 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 PLANNED INTERNAL AUDIT ACTIVITIES

In 2015, the Internal Audit Department performed activities based on implementation plans adopted by the Department, mostly in respect of the Annual Work Plan of the Internal Audit Department of Zavarovalnica Triglav, d.d., for 2015, which was adopted by the Management Board (of 9 December 2014) in agreed on by the Supervisory Board (of 18 December 2014). In accordance with the rules of the internal audit profession and good practice, 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 **27 regular internal audits** of totally 29 planned audits, and issued final reports. 21 audits were performed in the Insurance Company and 6 audits

were performed in other companies of the Triglav Group or organisations founded by the Insurance Company. One audit, in agreement with the Management Board, was moved to 2016¹, and one audit in the company Triglav Pojišť'ovna, Brno, was not performed, because the company was sold in the middle of 2015.

¹ The Department moved the internal audit of implementing changes of pension plans and managing cover funds for pension insurances to 2016, because the implementation of changes in this filed was delayed due to waiting for the required consent by the competent institutions for the changes of pension plans and the rules on managing the cover funds, which were issued by the competent institutions only in the final quarter of 2015.

In the first quarter of 2015, by issuing the final report, the Department concluded one audit that was initiated in 2014, and in the first quarter of 2016, by issuing the final report, the Department will also conclude one audit that was initiated in 2013.

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 and on implementing the recommendations made by internal and external auditors;
 - Active monitoring of risk managements at establishing the procedures of fiscal verification of invoices or the so-called tax registers;
- Monitoring the implementation of recommendations made by internal and external auditors and the recommendations made by the Fraud Prevention, Detection and Investigation Department²;
- Periodical reporting to the Management Board, the Audit Commission and the Supervisory Board on the work and internal audits performed by the Department, findings of audits, the implementation of recommendations made by internal and external auditors and the recommendations made by the Fraud Prevention, Detection and Investigation Department;
- Planning work of the Department for 2016 based on audit assessments of risks on individual fields of the Insurance Company;
- Internal audit services in two subsidiary insurance companies (Triglav Osiguranje, Banja Luka, and Triglav Pojišt'ovna, Brno – in the last one until it was sold in the middle of the year 2015), due to a lack of internal audit staff in these companies³;
- Assuring and improving quality of work performed by the Department and the internal audit department of other companies in the Triglav Group, mostly including:
 - Participation in internal and external trainings;
 - Regular monitoring of other fields/departments in the Insurance Company and exchange of information within its authorisations;
 - Internal quality assessments of the work performed by Department;
 - Forming internal audit policies in Zavarovalnica Triglav, d.d., preparing internal audit policy samples for the companies of the Triglav Group and renewing process documents of the Department;
 - Providing support to the internal audit department of the company Triglav INT for forming internal audit policies of this company and developing minimum standards in the field of internal audits in the Triglav INT Group;
 - Cooperating with the company Triglav INT in defining the internal audit coordination functions within the Triglav INT Group;
 - Harmonising internal audit policies/rules of companies in the Triglav Group;

² Since 1 January 2015, the Department also monitors the implementation of recommendations made by the Fraud Prevention, Detection and Investigation Department (FPDID) based on targeted reviews and fraud risk assessments performed until the end of 2014, because due to reorganisation, the Fraud Prevention, Detection and Investigation Department that performed targeted reviews and fraud risk assessments was closed.

³ The implementation of internal audit services in the companies Triglav Osiguranje in Banja Luka and Triglav Pojišt'ovna in Brno included both performing internal audits (except co-sourcing audits that are planned by the Department as regular internal audits) and other internal audit activities according to the annual internal audit programme adopted (approved) by the management and supervisory bodies of the two companies. The company Triglav Osiguranje, Banja Luka, has no internal audit staff due to its small scope of business and it hires internal audit services from Zavarovalnica Triglav. The internal auditor of the company Triglav Pojišt'ovna, Brno, was on child-care leave, which is why the company decided to hire internal audit services from Zavarovalnica Triglav during her absence.

- Providing assistance or advice to internal audit departments of other companies in the Triglav Group:
 - On performing internal quality assessments of their work;
 - On performing internal audits and other internal audit activities;
 - On developing work plans for 2016;
- Organising a seminar for internal auditors of the companies in the Triglav Group with the intention of exchanging experiences and good practices between internal auditors;
- Implementing procedures for choosing and hiring a new internal auditor;⁴
- Other activities that mostly include:
 - Administrative activities, management of the Department, and participation at board meetings and other meetings;
 - Cooperation at preparations of the Insurance Company for implementing the Solvency 2 requirements;
 - Participation in filling in the quarterly questionnaires of the Insurance Supervision Agency in connection with the implementation of Solvency 2 requirements;
 - Cooperation in preparing comments to suggested regulations prepared by the Insurance Supervision Agency based on the new Insurance Act (ZZavar-1);
 - Participation in work groups of the Slovenian Audit Institute and the Slovenian Insurance Association for developing a document for efficient internal auditing in insurance companies.

The Department assessed that it successfully implemented the planned internal audit activities in 2015.

3 SUMMARY OF IMPORTANT FINDINGS BASED ON 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 suitably recognised 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 performance.

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

⁴ Due to the development of information technology and the connected risks for the Insurance Company and other companies of the Triglav Group, and for ensuring suitable long-term staff solutions, the annual work programme of the Department for 2015 also included hiring an additional internal auditor for the field of information systems. The selection process was concluded at the beginning of March 2015 and the internal auditor started his job in the middle of June 2015.

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 Commission and the Supervisory Board. Similarly, the Department also monitors and reports on the implementation of recommendations made by external auditors and the Fraud Prevention, Detection and Investigation Department.

Based on performed internal audits and monitoring of the implementation of recommendations in 2015, 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**, but there is still some room for improvements of the system, which are presented hereafter. The Management Board and the heads of business fields are aware of the possible impact of the identified infringements, irregularities and deficiencies on achieving key objectives of the Insurance Company, which is why they take measures and perform activities for eliminating infringements, irregularities and deficiencies.

In the field of **the preparations of the Insurance Company for implementing the requirements of the Solvency 2 directive**, the majority of activities were performed in time until the end of 2015, and some activities for ensuring complete compliance with the mentioned directive and the implementation regulations based on this directive have to be concluded by the end of March 2016.

In the field of **developing and undertaking insurances and resolving claims**, closer attention has to be paid to proper observance of insurance-technical provisions and ensuring completely and duly completed documentation for undertaking insurances and resolving loss events; the response time for submitting insurance documents and resolving complaints has to be further improved; insurance premium balance procedures have to be fully implemented; loss events that include sensitive personal data have to be consistently identified; the way of giving explanations to customers regarding complaint resolving procedures and decisions has to be improved; the implementation of risk analyses/assessments based on customer complaints and/or the way they are being resolved has to be improved; some possibilities for improving the functionality of undertaking applications have to be considered.

In the field of **calculating agents' and agencies' commissions**, the plan for unifying the procedures for calculating commissions has to be duly implemented and the performance of software support for calculating commissions has to be improved; the procedure of concluding contracts with agencies has to be improved; a complete supervision over calculating commissions has to be ensured; and it would also make sense to consider further centralisations of the procedures for calculating commissions.

In the field of **provisioning**, the provisioning procedures for annuity claims (with clearly defined rules on dealing with annuity claims and their provisioning, and with an improved software support in this field) have to be improved; the procedures for registering provision changes due to the development of software support or other circumstances have to be adjusted.

In the field of **marketing and corporate communication**, the methodology for evaluating sponsorship applications has to be formally defined, and the control over the implementation of sponsorship and donation contract provisions or preventive funds contracts has to be further improved.

In the field of **back-office support for business, financial and accounting activities**, in the context of achieving better efficiency of implementing procedures, the possibility of introducing/supplementing some automatic foundations has to be considered; the documentation of suitability assessments of investment policies has to be improved; the automatization of controlling authorisations for implementing financial investments has to be ensured (within the introduction of the new software support for investment management).

In the field of **strategic planning and controlling**, the roles, authorisations, responsibilities and tasks of individual departments and organisational units have to be appropriately defined in the context of reporting for decision-making purposes; the necessary number of internal staff for providing high-quality and efficient management of all phases of developing and maintaining the data warehouse has to be considered and all necessary measures have to be taken.

In the field of **computing and information systems**, a consistent implementation of the plan of stabilisation measures for operational purposes of the non-life insurance information system has to be provided, and a systematic development of new functionalities and elimination of errors/shortcomings of this system has to be ensured, and a suitable training of employees for enabling further developments and maintenance of this system has to be considered; the introduction of the (uniform) system for managing changes of information systems has to be continued and some change management procedures have to be improved (especially the procedure of approving, testing and documenting changes); owners and operators of key information resources of the network infrastructure have to be clearly defined, the degree of risk of these resources has to be identified, and regular monitoring of the list of authorised users of these resources and their user rights has to be provided; formal rules on managing exceptional information events or incidents have to be adopted; a more effective network monitoring and controlling has to be provided; the technical documentation of some information systems has to be updated for the purpose of maintaining/upgrading these systems.

In the field of **project implementation**, closer attention has to be paid to procedures of risk managements and project changes, change management procedures resulting from project implementation, and the procedures of monitoring and controlling project implementation.

In the field of **management of subsidiaries**, closer attention has to be paid to a better harmonisation between the Department for Management of Subsidiaries and the company Triglav INT, and more detailed rules for all the participants in the process of concluding contracts on providing services and charging services to subsidiaries have to be prepared.

Later in this report, we summarise some additional opportunities for improving risk management and the operation of internal control systems **in subsidiaries** where the Department, in cooperation with internal auditors of these companies or independently, performed internal audits (the stated opportunities relate to individual companies where audits were performed):

- In the field of developing and undertaking insurances and resolving claims, closer attention has to be paid to proper observance of insurance-technical provisions and other internal rules of individual companies, procedures of risk assessment and risk taking have to be improved, the procedures of controlling and resolving complaints have to be improved, a suitable delimitation of authorities has to be ensured, training of agents has to be improved, and a closer attention has to be paid to preparing better documentation and assessments of eligibility for damages in the process of application, assessment and liquidation of claims, and determining the amount of claims;
- In the field of back-office support for business, financial and accounting activities, the procedures of monitoring payments and the recovery of claims have to be improved and the measures for value adjustments and waivers have to be strictly complied with;
- In the field of computing and information systems, the procedures of managing access rights for accessing information systems and the procedures of managing changes of information systems have to be improved, the technical documentation of some information systems has to be

updated for the purpose of maintaining/upgrading these systems, and a plan for preventive measures for reducing the risk of malicious applications has to be adopted.

With the intention to establish efficient internal control systems in subsidiaries of the Triglav Group, in 2015, the Insurance Company continued with the activities for transferring uniform minimum standards for internal control systems to all insurance companies of the Triglav Group.

4 ASSESSMENT OF ADEQUACY OF OPERATION FUNDS OF THE INTERNAL AUDIT DEPARTMENT

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

On 1 January 2015, the Department had 10 employees, and on 31 December 2015, 11 employees. As mentioned in Chapter 2, the increase of the number of employees refers to an additional employment of an internal auditor for the field of auditing information systems. The selection procedure was concluded at the beginning of March 2015 and the internal auditor started his job in the middle of June 2015.

Among 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”;
- 1 employee has the professional titles “Certified Internal Auditor” and “Auditor”;
- 3 employees have the professional title “Certified Internal Auditor”;
- 1 employee has the professional titles “Certified Information Systems Auditor”, “CISA⁵” and “CGEIT⁶”;
- 1 employee has the professional title “CISA”.

The Department enables all employees to receive suitable professional education and training. In 2015, the employees participated in internal and external trainings, and they also gained new knowledge through non-formal education by reading professional literature.

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 needs for performing unplanned additional tasks. If the employees of the Department do not have the 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 2015, the Department thus, in assisted by external professionals, performed one internal audit in the field of computing. The anticipated scope of assistance (10 counselling days) was included in the annual work plan of the Department for 2015.

⁵ CISA – Certified Information Systems Auditor

⁶ CGEIT – Certified in the Governance of Enterprise IT

5 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 the context of organisational independence and operation funds 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 fields, 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 fields and functions in the Insurance Company;
- The Audit Commission and the Supervisory Board, which reinforces the Department's independence from the Management Board.

All internal auditors that performed internal audits in 2015 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.⁷

⁷ The head of the Department, together with the Management Board, has to inform the Audit Commission 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.