

**ANNUAL REPORT  
OF THE INTERNAL AUDIT DEPARTMENT  
OF ZAVAROVALNICA TRIGLAV  
ON INTERNAL AUDITS  
FOR 2011**

Report issued on: 28 February 2012

Recipients of the report: Management Board  
Audit Committee  
Supervisory Board  
General Meeting of Shareholders

Maja Romih  
Director of Internal Audit Department

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## 1 PURPOSE OF THE REPORT

Pursuant to Article 165 of the Insurance Act and Article 27 of the Internal Audit Department Rules of Zavarovalnica Triglav, the Internal Audit Department (hereinafter also IAD) shall prepare an Annual Internal Audit Report and submit it to the Management Board and the Supervisory Board. In turn, the Management Board shall inform the General Meeting of Shareholders on the content of the report and the opinion of the Supervisory Board on the report.

The Internal Audit Department also prepares:

- detailed reports on individual internal audits conducted which are submitted to the Management Board and the management of the insurance company;
- quarterly reports on internal audits submitted to the Management Board and the Audit Committee; and
- semi-annual reports on internal audits submitted to the Management Board, the Audit Committee and the Supervisory Board.

The purpose of drafting the Annual Internal Audit Report for 2011 is to present the Management Board, the Audit Committee, the Supervisory Board and the General Meeting of Shareholders with:

- information on the work of the IAD and the implementation of planned internal audit activities in the reporting period;
- a summary of significant findings of internal auditors resulting from internal audits conducted in the reporting period; and
- an assessment of the adequacy of resources for the work of the IAD in the reporting period.

The report contains all the information required by Article 165(2) of the Insurance Act.

## 2 OVERVIEW OF THE WORK OF THE IAD AND THE IMPLEMENTATION OF PLANNED INTERNAL AUDIT ACTIVITIES

In 2011, the IAD carried out activities based on the adopted plan of action for the IAD, particularly the Annual Work Programme of the Internal Audit Department of Zavarovalnica Triglav for 2011 which was adopted by the Management Board on 14 December 2010 and approved by the Supervisory Board on 23 December 2010. In accordance with internal audit professional guidelines and good practice in this field, the IAD conducted regular and extraordinary internal audits and carried out other auditing activities which are a mandatory component of internal audit in accordance with the aforementioned guidelines.

In the reporting period, the IAD conducted:

- **31 regular internal audits** (out of 31 audits planned), of which 21 audits were related to the business operations of the Company and 10 audits were carried out in other companies of the Triglav Group. The IAD has already published its final reports on 29 audits; for one audit, a draft audit report has been issued, while one audit is still ongoing and will be finalised in the first half of 2012;
- **1 extraordinary internal audit** related to the business activities of the Company (for which the IAD has already issued the final audit report);
- **other internal audit activities:**

- the IAD carried out informal advisory activities, particularly in relation to the drafting and update of internal acts of the insurance company;
- the IAD monitored the implementation of recommendations of both internal and external auditors;
- the IAD submitted quarterly or semi-annual reports to the Management Board, the Audit Committee and the Supervisory Board on its activities, on conducted internal audits and resultant findings and on the implementation of recommendations of internal and external auditors;
- an annual IAD work plan for 2012 was drawn up;
- the IAD carried out activities aimed at assuring and improving the quality of the work of the IAD, that are described in more detail below.

In the Internal Audit Department Quality Assurance and Improvement Programme for 2010 and 2011, the IAD defined a list of activities aimed at improving the quality of operation of the IAD. The programme was submitted to the Management Board on 27 July 2010 and to the Supervisory Board on 30 August 2010. In 2011, the most significant activities carried out by the IAD were the following:

- on the basis of a questionnaire, the IAD performed an evaluation of the quality of its activities in 2010 as perceived by its auditees; the results of the evaluation and the measures taken to correct deficiencies were presented in the IAD annual report for 2010;
- the IAD reformed the structure of reports on IAD activities both for reports on individual internal audits as well as for quarterly, semi-annual and annual reports;
- the IAD continued with the development of an internal audit manual which will contain a detailed description of work methods of the IAD and will serve as a basis for future establishment of software support for the IAD;
- a seminar for internal auditors employed in companies of the Triglav Group was organised in order to foster the exchange of experience and good practice amongst internal auditors;
- the IAD prepared a sample of rules governing the operation of internal audit departments in other companies of the Triglav Group which was submitted to internal auditors of subsidiary insurance companies for review and coordination.

Taking into consideration the personnel issues described in Chapter 4 of this report, the IAD is of the opinion that the planned internal audit activities in 2011 were implemented adequately.

### **3 SUMMARY OF SIGNIFICANT FINDINGS BASED ON CONDUCTED INTERNAL AUDITS**

When conducting internal audits, the IAD focuses on the verification and evaluation of the adequacy and effectiveness of the internal audit systems of the Company, which must ensure that:

- risks are adequately identified and controlled;
- accounting information and information required for decision-making and day-to-day operation is correct, reliable and timely;
- employees act in accordance with the law and other regulations, standards and guidelines and in accordance with internal regulations governing the business operations of the Company;
- resources are used economically and efficiently and that they are protected appropriately;
- programmes and plans are implemented and targets achieved;
- the Company continuously improves the quality of its operation.

Based on the internal audits conducted in 2011, the IAD is of the opinion that **the functioning of the internal audit systems of the Company** as a whole is **adequate**<sup>1</sup>, but there are nevertheless a number of possibilities to improve the functioning of these systems in individual areas of activity of the Company.

The following section contains a summary of the most significant findings in individual areas of activity of the Company.

In **marketing, underwriting and claim settlement**, the Company should ensure an even stricter adherence to internal acts of the Company, better control over underwritten policies with the sum insured exceeding the retention of the Company and registration of such contracts for reinsurance, better control over the activities of tourist agencies selling travel assistance insurance, better methods for implementing international insurance programmes and reporting on these programmes; furthermore, the Company should be even more consistent in controlling insurance policies and should speed up the resolution of complaints; the process of recovering unpaid premiums needs to be improved and applied more consistently; provisions should be made for more orderly claims documentation and for faster claim settlement; claim reporting processes should be standardised in all claims centres and in the processes of claim appraisal and settlement more attention should be paid to eligibility and the extent of damage.

In **finance and accounting**, certain additional functionalities and controls need to be established in the software support for business processes in the area of finance; the transfer of data on financial investments from sub-ledger records to the general ledger should be automated, control over given guarantees and their record-keeping need improvement; the processes of identifying, collecting and controlling data for the purpose of reporting on business operations of the Group should be improved, so should the processes of mutual coordination in terms of receivables, liabilities, income and expenses/costs between the parent company and the subsidiaries; an appropriate division of tasks in relation to the implementation and control of the financial statements consolidation process should be established.

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<sup>1</sup> The adequacy and efficiency of the functioning of internal audit systems is evaluated in view of adherence to relevant legislation and other regulations and internal acts, provision of an efficient work organisation and an appropriate division of powers and responsibilities of employees, the adequacy of procedures and the design and operation of audits in individual areas of activity of the insurance company, the adequacy and efficiency of information provision and communication with employees etc. The following criteria were used when evaluating the adequacy and efficiency of internal audit systems:

- **very good** – The audit system is very good in every respect. Robust internal controls are established, all key controls are functional and there are no derogations. There is optimum supervision. The risk level is very low.
- **good** – The audit system is good in general. The management controls business operations well and promptly recognises and eliminates deficiencies. Responsibilities, powers and procedures are well defined and are only rarely exercised contrary to expectation. There is regular supervision. The risk level is low.
- **adequate** – There are certain deficiencies in the audit system which do not significantly undermine the business operations of the insurance company, but they nevertheless require immediate action by the management. For the most part, responsibilities, powers and procedures are adequately defined, but are on occasion not exercised according to expectation. There is occasional supervision. The level of risk is medium.
- **poor** (but still conditionally acceptable) – There are serious deficiencies in the audit system that (may) significantly undermine the business operations of the insurance company and must be eliminated by the management immediately. Responsibilities, powers and procedures are not adequately defined and are often exercised contrary to expectation. Supervision is rare and is left to individuals. The level of risk is high.
- **insufficient** – There are very serious deficiencies in the audit system (significant non-compliance with external regulations, complete lack of control) that jeopardise the business operations of the insurance company and require a complete re-organisation of the company. There is no supervision. The level of risk is very high.

In **human resource management**, the system of bonuses for insurance agents should be upgraded; internal acts pertaining to the reimbursement of work-related expenses need to be updated and the process of issuing, filling-out and validating travel orders and travel expense declarations should be improved.

In **IT improvements** are needed in relation to the system of controlling access to IT systems and in relation to periodical reviews and verifications of system access rights; software controls in underwriting and other applications should be improved; an automated and adequately protected transfer of data between different IT systems should be guaranteed; control over back-office processing should be improved, as should the supervision of the work of external IT contractors.

In **project implementation** the processes of planning, monitoring implementation and reporting on the development of projects as well as ensuring appropriate monitoring of mutually related projects/programmes carried out by different task forces should be improved.

In **marketing communication**, rules should be drafted for awarding sponsorship funds and donations; the transparency of awarding such funds needs to be improved and stricter control over the fulfilment of obligations by sponsorship recipients is needed; software support for awarding sponsorship funds and donations should be improved and a registry of given and received gifts as well as an appropriate system for evaluating the efficiency of procurement in the area of marketing communications should be set up.

In **fraud prevention, detection and investigation**, an analysis (assessment) of the risk of individual types of fraud in the Company should be conducted; the registries of key fraud indicators and key internal audits for the timely prevention and detection of fraud need to be completed and software support for a more efficient and automated prevention, detection and investigation of fraud should be established; the system of monitoring the implementation of recommendations given by the Prevention, Detection and Investigation of Fraud Department needs to be standardised.

In **management of subsidiaries**, the implementation of all relevant activities for the elimination of violations, irregularities and deficiencies detected in internal audits in subsidiaries concerned must be ensured in cooperation with the management of the respective subsidiaries. The following section summarises the possible improvements to the functioning of the internal audit system in the subsidiaries of the Triglav Group where the IAD conducted audits either independently or in cooperation with internal auditors employed by the subsidiaries (some of the possible improvements are only related to individual companies and not to all audited companies):

- in marketing, underwriting and claim settlement, stricter adherence to the internal acts of individual companies and an appropriate division of powers is required; the control of strict record-keeping on all issued documents and the control of insurance policies should be improved; improvements are also needed in relation to the resolution of complaints and the recovery of unpaid premiums and subrogated receivables; companies need to ensure a better reinsurance process, more orderly claims documentation and more efficient claim settlement and subrogation procedures;
- in finance and accounting, payment monitoring processes and the recovery of unpaid premiums should be improved;
- in IT the separation of incompatible functions must be ensured; periodical reviews and formal verifications of IT system access rights must be established; regular controls of access to personal data of business partners are required; control processes in relation to the transfer of data from

old to new IT systems should be improved, as should the supervision of the work of external IT contractors;

- improvements should also be made to the processes of issuing purchase orders, verifying the regularity of received invoices and to the process of issuing, filling-out and validating travel orders and travel expense declarations.

In order to establish efficient internal audit systems in the subsidiaries of the Triglav Group, the Company continued its activities pertaining to the introduction of unified minimum standards for internal audits in all subsidiaries of the Triglav Group throughout 2011.

In 2011, the IAD submitted regular reports to the Management Board on all internal audits conducted. The Management Board discussed the reports and instructed the heads of the audited departments and the addressees of recommendations to follow the recommendations of the IAD, to eliminate the detected violations, irregularities and deficiencies within the agreed time period and to report to the IAD on their progress. Based on these reports, the IAD regularly monitors the implementation of given recommendations and reports to the Management Board, the Audit Committee and the Supervisory Board. The same monitoring and reporting process also applies to the recommendations of external auditors.

Based on its monitoring of the implementation of recommendations, the IAD is of the opinion that the Management Board and the management of the Company are aware of possible repercussions of the detected violations, irregularities and deficiencies on the Company's attainment of key targets and that they have taken measures and initiated activities for their elimination.

#### **4 ASSESSMENT OF THE ADEQUACY OF RESOURCES FOR THE WORK OF THE IAD**

The Management Board is providing the IAD with appropriate work conditions. The number and structure of employees of the IAD and their qualification level generally enable the IAD to implement the planned internal audit activities in a given year, provided that the IAD is not faced with unforeseen lengthy absences due to sick leave, maternity/parental leave or other unexpected reasons.

As at 1 January 2011, there were 9 persons employed and working actively in the IAD, whereas on 31 December 2011, 10 persons were employed of which one person was on maternity/parental leave, so that 9 persons were working actively in the IAD. The increase in the number of employees at the end of 2011 is the result of an additional position of employment that was created specifically in order to provide a substitute for the person on maternity/parental leave, to facilitate substitution for possible other unplanned absences and to provide adequate staff for the implementation of planned internal audit activities in 2012. In 2011, the IAD was faced with severe difficulty in the implementation of planned internal audit activities particularly due to a high number of extended sick leaves and maternity leaves that had not been foreseen on such a scale when planning IAD activities for 2011 (absences foreseen for 2011 were 45 days, the actual absences amounted to 168 days).

Of all the employees of the IAD, 6 persons have at least one of the professional titles awarded to persons having successfully completed training in the field of auditing and related fields by the Slovenian Institute of Auditors:

- 1 person has the professional titles »verified internal auditor« and »certified auditor«;
- 4 persons have the professional title »verified internal auditor«;
- 1 person has the professional title »verified information system auditor«.

In 2011, the IAD provided all employees with an adequate level of professional training and education. The employees participated in formal in-house and external training courses, while a part of their activities consisted of informal education in the form of reading relevant technical literature.