

**ANNUAL REPORT
OF THE INTERNAL AUDIT DEPARTMENT
OF ZAVAROVALNICA TRIGLAV, d.d.,
ON INTERNAL AUDITING
FOR 2017**

Date of issue of the report: 15 March 2018

Recipients of the report: Management Board
Audit Committee
Supervisory Board
General Meeting
Financial statements' auditor

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1 PURPOSE OF THE REPORT

Pursuant to Article 281a of the Companies Act, Article 165 of the Insurance Act, and Articles 41 and 43 of the Internal Audit Policy in Zavarovalnica Triglav, d.d., the Internal Audit Department (hereinafter: the Department) is required to draw up the annual report on internal auditing and submit it to the Management Board, the Audit Committee, the Supervisory Board and the financial statements' auditor, and the Management Board must inform the General Meeting with the Report and with the Supervisory Board's opinion on the Report.

The Department also prepares more detailed reports on specific internal audits performed for the Management Board and the management of the audited areas or the persons in charge of taking measures, as well as periodic (quarterly, semi-annual) internal audit reports for the Management Board, the Audit Committee and the Supervisory Board.

The purpose of drawing up the annual internal audit report for 2017 is to inform the Management Board, the Audit Committee, the Supervisory Board, the General Meeting and the financial statements' auditor:

- on the work of the Department and the implementation of the planned internal audit activities in the reporting period;
- on the summary of significant findings of internal auditors based on the internal audits in the reporting period, including the assessment of the appropriateness and effectiveness of risk management and functioning of the internal control system of the audited areas;
- on the assessment of the adequacy of the resources for the Department operation in the reporting period;
- on the content and findings from the quality assurance and improvement programme of the Department operation;
- on the statement of independence and objectivity of the Department and internal auditors' operation.

The Report includes all the information required under the second paragraph of Article 165 of the Insurance Act and Article 43 of the Internal Audit Policy in Zavarovalnica Triglav, d.d.

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

In 2017, the Internal Audit Department performed its activities on the basis of the adopted plans for the Department operation, mostly on the basis of the Annual Work Plan of the Internal Audit Department of Zavarovalnica Triglav, d.d., for 2017, adopted by the Management Board (on 13 December 2016) with the consent by the Supervisory Board (on 22 December 2016). In accordance with professional rules and good practice guidelines on internal auditing, the Department performed internal audits in Zavarovalnica Triglav (hereinafter the Company) and other subsidiaries in the Triglav Group as well as some other internal audit activities.

In the reporting period, the Department performed/completed:

- all of the **25 planned internal audits** (22 audits in the Company, 3 audits in the subsidiaries in the Triglav Group):
 - for 22 audits the Department issued final reports;
 - for 2 audits the Department issued draft reports;
 - 1 audit is underway and is expected to be completed in the first quarter of 2018;
- **1 extraordinary internal audit** in one of the subsidiaries in the Triglav Group, for which the Department has already issued the final report.

In the reporting period, the Department also performed a series of **other internal audit activities**:

- informal advisory activities, mostly involving consultations and advice relating to the drawing up or updating internal acts of the Company, implementation of business processes, risk management and implementation of recommendations provided by internal and external auditors;
- formal advisory activities relating to the project for the implementation of the new IT system for core business in one of the subsidiaries in the Triglav Group;
- monitoring of the implementation of recommendations provided by internal and external auditors;
- periodic reporting to the Management Board, the Audit Committee and the Supervisory Board regarding the Department operation, the findings of the internal audits and the implementation of recommendations provided by internal and external auditors;
- planning of the Department operation for 2018 based on the risk assessment of the Company's business processes and with due consideration of risks important at the Triglav Group level;
- internal audit services at Triglav Osiguranje, Banja Luka, which does not employ its own internal auditor owing to its small volume of operations;
- tasks related to quality assurance and improvement of the Department and of internal audit departments in the subsidiaries in the Triglav Group, which mostly included the following:¹
 - continuous monitoring performed by the Department Director over the internal auditors' operation (over the implementation of internal audits and other internal audit activities);
 - annual assessment of work of internal auditors and the Department as a whole;
 - monitoring of the Department's key performance indicators;
 - participation in internal and external training courses;
 - keeping updated on the operation of other fields/departments in the Company and exchanging of information within the Department;
 - updating the Internal Audit Policy in Zavarovalnica Triglav, d.d., and preparing Minimum Standards for Internal Auditing in the Triglav Group;
 - revision of the Internal Audit Manual, which is expected to be completed in the first quarter of 2018;
 - overview of the available software solutions to support internal audit process and attending presentations of three solutions;
 - monitoring of the operation of internal audit departments in the subsidiaries in the Triglav Group, advising to the departments and coordinating with them:
 - in the implementation of internal audits and other internal audit activities;

¹ In 2017, the Department performed most of the tasks concerning quality assurance and improvement, except for the activities relating to the introduction of software support to the internal audit process. Somewhat slower than planned, the activities of revising the internal audit manual and overview of internal audit departments' operation in the subsidiaries abroad took place. The non-implemented activities, which are mostly due to more time spent for the implementation of planned internal audits, were included into the Department's annual work plan for 2018.

- in the planning of work for 2018;
- overview of the operation of internal audit departments in three subsidiaries abroad;
- conducting professional traineeship for internal auditors from certain subsidiaries in the Triglav Group;
- organising a conference for internal auditors within the Triglav Group;
- other activities, mostly including administrative activities and management of the Department, participation in committees and other meetings, cooperation with the external auditor, participation in the Section for Internal Auditors and the Key Function Committee at the Slovenian Insurance Association etc.

As Department Director, I estimate that in 2017, with due consideration of the number of available business days, the Department was successful in implementing the planned internal audit activities to the extent expected.

3 SUMMARY OF SIGNIFICANT FINDINGS BASED ON PERFORMED INTERNAL AUDITS

When conducting internal audits, the Internal Audit Department focuses mainly on checking and assessing the appropriateness and effectiveness of risk management and functioning of the internal control system established in the Company in order to assure that:

- the risks are properly identified and managed;
- the accounting information and the information needed for decision-making and operational functioning is correct, reliable and timely;
- the employees act in accordance with legal and other regulations, standards and policies as well as in line with internal rules regulating the operation of the Company;
- the assets are used economically, efficiently and are properly secured;
- the programmes, plans and objectives are achieved;
- the Company continuously improves the quality of its operation.

The Department regularly reports, in writing, on the findings of internal audits performed in the Company to the responsible managers of audited areas or the recommendations addressees, and informs the Management Board on the reports as well. Based on the Department's reports, the responsible managers of audited areas or recommendations addressees must adopt corresponding measures and implement proper activities within the agreed deadlines to eliminate the identified violations, irregularities and deficiencies, and report to the Department thereon. Based on the above, the Department periodically monitors the implementation of the issued recommendations, and reports to the Management Board, the Audit Committee and the Supervisory Board thereon. It also monitors and reports on the implementation of the recommendations provided by external auditors.

Based on the internal audits performed and the monitoring of the implementation of the recommendations in 2017, the **Department deems that, overall, risk management and functioning of the internal control system of the audited areas in the Company are appropriate and continue to improve**, but it identified the following significant opportunities for improvement:

- in the field of implementing own risk and solvency assessment (ORSA process), a more active inclusion of all Company's business areas into the ORSA process is needed; reporting to the Supervisory Board on the ORSA process results needs to be established;

- in the field of calculating the capital adequacy at the Triglav Group level, the rate of exchanging certain data between the departments involved in the procedures for calculating the capital adequacy must be improved; additional controls to provide quality data on real estate needed to calculate the capital adequacy are required;
- in the field of insurance development and implementation (sales, underwriting and claims handling), certain possibilities to improve insurance products and services should be considered; certain possibilities to improve the functionality of the insurance software should be considered; when concluding insurance policies and handling claims, more attention should be paid to consistent compliance with the insurance terms and conditions as well as with work instructions, providing full and well-completed documentation and prompt implementation of procedures; the speed of handling objections to concluded insurance policies should be further increased; life insurance endowment management should be improved; supervision over the work of the external sales network should be improved;
- in the field of planning and implementing reinsurance, consistent observance of legal provisions regarding the components of the reinsurance protection programme is required; more systematic and transparent archiving of key documentation should be ensured; new reinsurance software (with all planned functionalities) should be implemented as soon as possible;
- in the field of financial investment management, the traceability of transaction approval should be improved; methodology for determining and monitoring exposure limits towards alternative investments should be drawn up;
- in the field of subsidiary management, procedures for transferring minimum standards of business functions operation into subsidiaries and the procedures for monitoring the implementation of such standards should be improved;
- in the field of informatics and IT systems, more attention should be paid to the compliance of access rights management and change management with the adopted internal rules and good practice; records of the purchased and installed IT licences should be improved;
- in the field of project management, more attention should be paid to timely change management (the management of project changes as well as the management of organisational, process and staffing changes needed in the future); upon the completion of IT development and implementation projects, quality technical documentation must be ensured;
- in the field of marketing communication, responsibilities and criteria for the selection and distribution of promotional and prevention products should be clearly defined; more concrete instructions for managing potential conflict of interest in purchasing and distribution of such products should be provided;
- in the field of data quality management, the plan of data quality management activities should be updated and its implementation ensured; the possibility of harmonising methodologies for process modelling and data flow as well as the possibility to improve automation of data quality management procedures should be considered.

The Management Board and the management of the audited areas are aware of the potential impact of identified violations, irregularities and deficiencies on the achievement of key objectives of the Company and have adopted appropriate measures or have been performing appropriate activities to eliminate them. In 2017, the rate of implementing the recommendations provided by internal and external auditors improved compared to the previous years, which resulted in a significant decrease of open recommendations (from 104 to 70) and open overdue recommendations (from 32 to 11).

Below we enumerate significant opportunities to improve risk management and functioning of the internal control system in the subsidiaries, which the Department identified during internal audits in the subsidiaries or while monitoring the operation and findings of internal audit departments of the subsidiaries (the listed opportunities apply to individual subsidiaries that were subject to audit):

- in the field of insurance implementation, more consistent compliance with the insurance terms and conditions as well as with other internal acts of individual subsidiaries should be provided, with the need to renew the internal acts to a certain extent; underwriting procedures should be improved; procedures for insurance policies control and handling objections to concluded policies should be improved; competence of insurance salespersons should be improved; supervision over the work of the external sales network should be improved; more attention should be paid to the organisation of claims documentation, the assessment of claims justification and the determination of claims amounts; complaint handling procedures should be improved;
- in the field of back office division, finance and accounting, procedures for monitoring payments and recovery of accounts receivable from premiums and subrogation should be improved; procedures and controls of the sales network commissions should be improved; procedures and controls in the implementation of payment transactions should be improved; more attention should be paid to timely/prompt recording of business events and allocation of costs to business activities;
- in the staffing, legal and general field, procedures and controls in the calculation of salaries and other employment benefits should be improved; the system of internal act management should be improved; procedures for archiving business documentation should be improved;
- in the field of informatics and IT systems, segregation of duties or at least proper additional controls should be provided in order to supervise the implementation of operational tasks in production IT systems; procedures for access rights management and change management should be improved; measures for physical security of IT infrastructure should be improved; periodical testing of disaster recovery plans for key IT systems should be ensured;
- in the field of project management, more attention should be paid to the risk and change management procedures in projects;
- in the field of marketing communication, responsibilities and criteria for the selection and distribution of promotional and prevention products should be clearly defined, proper documentation of approval procedures for sponsorships and donations should be provided.

With the aim of continuous improvement of risk management and functioning of the internal control system in the subsidiaries in the Triglav Group, the Company continued to transfer uniform minimum standards of business functions operation into subsidiaries also in 2017.

4 ASSESSMENT OF THE ADEQUACY OF RESOURCES FOR THE DEPARTMENT OPERATION

In 2017, the Internal Audit Department had eleven (11) persons employed, and due to the whole-year maternity leave of one (1) person, there were ten (10) persons active, which had been taken into account by the Department when planning its activities for 2017.

Eight (8) of the employees holds at least one of the professional certificates awarded by The Slovenian Institute of Auditors or equivalent professional institutions abroad following completed education in auditing and/or related disciplines:

- two (2) persons hold the professional certificates of “certified internal auditor” and “authorised auditor”;
- four (4) persons hold the professional certificate of “certified internal auditor”;
- one (1) person holds the professional certificates of “certified information systems auditor” (issued by The Slovenian Institute of Auditors), “CISA²” and “CGEIT³”;
- one (1) person holds the professional certificate of “CISA”.

The number and qualification of the internal auditors usually allow for the completion of the planned internal audit activities in each year (specifically risk-based internal audits), assuming that the Department is not faced with longer unplanned sick leaves, maternity/parental leaves or other extraordinary absences.

If the internal auditors lack certain expertise or skills needed for the implementation of internal audits and/or other internal audit activities, the Management Board allows the Department to seek assistance from properly qualified experts outside or inside the Company. In 2017, the Department did not make use of any services by experts outside the Company, but it performed an internal audit of marketing communication in cooperation with the Compliance Department, with a view of checking (in addition to other issues) the appropriateness of managing conflict of interest in purchasing and distribution of marketing communication products.

The Company enables the internal auditors to receive an appropriate extent of professional education and training. In 2017, the internal auditors attended formal education sessions within and outside the Company, and spent part of their time for informal education by reading professional literature and exchanging knowledge within the Department.

Due to the progress in information technology, IT systems and related risks in the Company’s operation and subsidiaries in the Triglav Group, and in order to provide a proper long-term staffing, the Department foresaw an increase in the number of employees in the 2018 annual work plan by one person with the professional certificate of “certified information systems auditor” or adequate professional certificate (expected to be employed in autumn of 2018).

As Department Director, I estimate that the Management Board provides appropriate conditions and resources for the Department operation. The conditions allowing for an independent and impartial operation of the Department and internal auditors are presented in more detail in Section 6.

5 PROGRAMME AND FINDINGS REGARDING QUALITY ASSURANCE AND IMPROVEMENT OF THE INTERNAL AUDIT DEPARTMENT OPERATION

The Internal Audit Department develops/maintains and implements a quality assurance and improvement programme of its operation in order to ensure compliance with the professional and ethical rules of internal auditing (especially with the International Standards for the Professional Practice of Internal Auditing) and in order to improve its performance and effectiveness.

² CISA – Certified Information Systems Auditor

³ CGEIT – Certified in the Governance of Enterprise IT

The quality assurance and improvement programme of the Department operation covers the following activities:

- internal quality assessments including:
 - continuous supervision of the Department Director over the work of internal auditors;
 - interim and annual assessment of the work of internal auditors and the Department as a whole;
 - annual monitoring of the Department's key performance indicators;
 - periodic self-assessment of the Department operation, which has to be performed at least once in the period between two external assessments;
- external quality assessments, which has to be performed at least once every five years by a qualified independent assessor from outside the Company;
- activities for eliminating deficiencies identified during assessments, and other activities for quality improvement.

The latest external quality assessment of the Department operation was performed in 2016 by DELOITTE REVIZIJA, d.o.o., who established that in every important aspect, the Department operated in compliance with the International Standards for the Professional Practice of Internal Auditing, and provided some recommendations for further development and introduction of best global practices into the Department operation. These recommendations were taken into account by the Department when planning its activities for 2017 and 2018.

As Department Director, I estimate that, based on the performed activities of quality assurance and improvement of the Department operation in 2017, which are described in more detail in Section 2, the Department operates in compliance with the International Standards for the Professional Practice of Internal Auditing in every important aspect.

6 STATEMENT ON THE INDEPENDENCE AND OBJECTIVITY OF THE INTERNAL AUDIT DEPARTMENT AND INTERNAL AUDITORS

The Management Board ensures proper working conditions to the Internal Audit Department, in terms of organisational and functional independence, in terms of the resources provided for its operation and in terms of providing access to all records, physical properties and personnel in the Company (including the members of the Management Board, the Audit Committee and the Supervisory Board), thus allowing the internal auditors to perform their activities independently and objectively.

The Department is organised as an independent unit within the Company, which is directly subordinate to the Management Board, and is organisationally and functionally separated from other parts of the Company. The Department independently determines areas, objectives and the scope of internal auditing and is independent in performing and reporting on internal auditing. The internal auditors do not perform any development or operational tasks that might lead to conflict of interest and impair their objectivity, and do not decide on the activities in the areas subject to internal auditing.

The Department determines the areas, objectives and the scope of internal auditing based on the risk assessment of the Company operation and risks important at the Triglav Group level. It reports directly to the Management Board and the Supervisory Board. To this purpose, the Department Director reports on the Department operation, findings of the performed internal audits, implementation of the recommendations and the assessment of appropriateness and effectiveness of risk management and functioning of the internal control system in the audited areas directly (in writing and orally) to:

- the Management Board, thus preserving the independence from other business areas and functions in the Company;
- the Audit Committee and the Supervisory Board, thus strengthening the independence from the Management Board.

The responsibilities of the Department Director and other internal auditors concerning the assurance of independence and objectivity, avoiding conflict of interest and reporting on the occurrence of any circumstances that might impair the independence and objectivity of the Department or internal auditors are defined in the Internal Audit Policy in Zavarovalnica Triglav, d.d.⁴

As Department Director, I hereby declare that the Department in 2017 operated independently and that no circumstances arose in the operation of the internal auditors that might have impaired their objectivity. The statement on the objectivity of the internal auditors is based on the statements signed by all internal auditors.

⁴ Together with the Management Board, the Department Director must inform the Audit Committee and the Supervisory Board on any restrictions regarding:

- the areas, objectives and the scope of internal auditing;
- the access to the records, physical properties and personnel in the Company needed by the internal auditors to successfully and effectively perform their job;
- the resources for the implementation of risk-based internal auditing.

The internal auditors must report on any circumstances that might lead to conflict of interest and thus impair their objectivity to the Department Director, who must in turn inform the Management Board, the Audit Committee and the Supervisory Board thereof. The circumstances that may lead to a conflict of interest are notably the following:

- performing any development and operational tasks, deciding on the activities and/or directing the activities of the employees in the audited areas, especially within two years before the audit performed in such areas;
- family ties to the employees in the audited areas and employees at important or sensitive positions in the Company in general;
- any pecuniary advantage related to the operation of the audited areas and the Company in general;
- rewards, gifts and other benefits offered or received from the employees in the Company or persons outside the Company, which are assumed to be offered or given with the aim of impairing the objectivity of the Department Director and/or internal auditors.