

**ANNUAL REPORT
OF THE INTERNAL AUDIT DEPARTMENT
OF ZAVAROVALNICA TRIGLAV, D.D.,
ON INTERNAL AUDITING
FOR THE YEAR 2018**

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Recipients: Management Board
Audit Committee
Supervisory Board
Shareholders' Assembly
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 of Zavarovalnica Triglav, d.d., the Internal Audit Department (hereinafter: the Department) must compile an annual report on internal auditing and submit it to the Management Board, the Audit Committee, the Supervisory Board and the financial statements' auditor, whereas the Management Board must inform the Shareholders' Assembly with this Report and with the Supervisory Board's opinion on the Report.

The Department also prepares more detailed reports on individual internal audits performed for the Management Board and the management of the audited areas, i.e., persons responsible for measure taking, as well as periodic (quarterly, semi-annual) reports on internal auditing for the Management Board, the Audit Committee and the Supervisory Board.

The purpose of the Annual Report on internal auditing for the year 2018 is to inform the above mentioned stakeholders on:

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

The Report contains all information required under the Paragraph 2, Article 165 of the Insurance Act and Article 43 of the Internal Audit Policy of Zavarovalnica Triglav, d.d.

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

In 2018, the Internal Audit Department was performing activities according to adopted plans for the Department's operations, predominantly based on the Annual Work Plan of the Internal Audit Department of Zavarovalnica Triglav, d.d., for the year 2018, adopted by the Management Board (on 12 December 2017) with the consent of the Supervisory Board (of 21 December 2017). In accordance with professional rules and best practice guidelines on the internal auditing, the Department was carrying out internal audits in Zavarovalnica Triglav (hereinafter the Company) and other companies in the Triglav Group, along with several other inter audit activities.

The Department carried out **28 planned internal audits**, namely 3 audits that remained unfinished from 2017 and all of 25 audits from the 2018 plan. 23 audits were performed in the Company and 5 in the other Triglav Group companies. 26 audits were concluded with publication of final reports, while 2 audits were still underway at the end of the calendar year and are to be concluded in the 1st quarter of 2019.

No **extraordinary internal audits** were carried out in 2018.

The Department also performed a series of **other internal audit activities**:

- formal consulting activities, including:
 - counselling on the implementation of the new IT system supporting the core business and introduction of electronic authorisation of contracts in one of the Triglav Group companies;
 - support to another in-house department in reviewing indirect telephone marketing provided by external contracted partners;
- informal consulting activities, mostly involving consultations and advice relating to drawing up or updating internal acts of the Company, implementation of business processes, risk management and implementation of recommendations issued by internal and external auditors;
- monitoring of the implementation of recommendations issued by internal and external auditors;
- periodical reporting to the Management Board, the Audit Committee and the Supervisory Board on Department's operations, the findings of the internal audits and the implementation of recommendations issued by internal and external auditors;
- planning of the Department's operations for 2019 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 due to small scale of business operations;
- tasks related to quality assurance and improvement of operations of the Department as well as internal audit departments in other Triglav Group companies, which mainly included:¹
 - continuous supervision of work performed by internal auditors by the Department Director;
 - internal quality assessment review of the Department's operations, which mainly included:
 - internal compliance review of the Department's activities with legal regulations, standards and codes regulating the area of internal auditing;
 - assessment of work performed by internal auditors and the Department as a whole by internal audit stakeholders (members of the Management Board, the Audit Committee, the Supervisory Board and directors of organizational units);
 - monitoring of the Department's key performance indicators;
 - participation at in-house and external trainings;
 - keeping updated on the operations of other departments in the Company and exchanging of information within the Department;
 - continuation of revision of the Internal Audit Manual;
 - compilation of user requirements for software support of the internal audit process and collection of detailed information from the software solution providers;
 - monitoring of the operations of internal audit departments in other Triglav Group companies, advising to them and coordinating with them:
 - on the implementation of internal audits and other internal audit activities;

¹ In 2018, the Department completed the majority of the tasks concerning quality assurance and improvement, except for the activities relating to the introduction of software support to the internal audit process, which took longer than planned. Activities are to be continued and have been included in the annual plan for 2019.

- on the implementation of Minimum Standards for Internal Auditing in the Triglav Group;
- on the planning of activities for the year 2019;
- review of the operations of the internal audit department in one of the subsidiaries abroad;
- organising a conference for internal auditors within the Triglav Group;
- other activities, mostly including administrative activities and management of the Department, cooperation with the external auditor, etc.

As Department Director, I estimate that in 2018, with due consideration of the available number of work days, the Department performed the planned internal audit activities successfully and in expected extent.

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 adequacy 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 financial 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 operations of the Company;
- the assets are used economically, efficiently and are properly protected;
- the programmes, plans and objectives are achieved;
- the Company continuously improves the quality of its operations.

The Department regularly reports, in writing, to the managers in charge of audited areas, i.e., the recommendations addressees, on the findings of internal audits performed in the Company, and informs the Management Board on the reports as well. Based on the Department's reports, the managers in charge of audited areas or recommendations addressees must adopt adequate measures and implement proper activities to correct any detected violations, irregularities and deficiencies within the agreed deadlines, and report to the Department accordingly. 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 issued by external auditors.

Based on the internal audits performed and the monitoring of the implementation of the recommendations in 2018, **the Department deems that, overall, risk management and functioning of the internal control system of the audited areas in the Company are adequate and continue to upgrade**, however did recognize the following significant opportunities for improvement:

- in the field of governing the Company and Triglav Group, consideration should be given to adequacy of organizational structure, number and composition of committees; the process of monitoring and reporting on implementation of the Triglav Group Strategy should be clearly defined; efficiency of the governing system of subsidiaries should be further improved;

- in the field of insurance (insurance development, sales, underwriting and claims handling), certain possibilities to improve the functionality of the insurance software should be considered; additional attention should be paid to thorough consideration of the insurance terms, conditions and work instructions when concluding insurance policies and handling claims, as well as to provide full and well-completed documentation and prompt implementation of procedures; consideration should be given to the adequacy of organizational structure in the field of life insurance, due to already implemented and planned changes in the processes; a training plan for the use of new software for life insurance underwriting should be prepared; options for further centralization of claims handling and for establishment of an expert group for specific technical issues should be examined in the field of non-life insurance; technical staff training system and supervision of their work should be improved; the contracts with assistance services providers should be unified to the largest possible extent and, where necessary, price framework for these services should be set;
- in the field of technical provisions for reported claims, more attention should be paid to regular monitoring of unsolved claims in the area of non-life insurance and up-to-date adjustment of the provisions to known facts, and similarly in the area of life insurance for claims that are subject to court procedures;
- in the field of financial investment management, a catalogue of all adopted exposure limits for individual risk types should be compiled and further regularly updated; regular control of the investment management application parameters, used as the basis for investment reports, should be timely assured;
- in the field of purchasing management, options for further centralization of purchasing should be considered; ownership of the supply contract management system should be clearly defined; complete and transparent storage of all contracts and regular annual review of all long-term contracts should be assured; in cases of longer delays in invoice confirmation and liquidation procedures sanctions should be put in place; relevant decisions/measures for improvement of software support for purchase procedures should be adopted;
- in the field of outsourcing relationship management, an exit strategy for the outsourced operation relating to asset management should be prepared (for the case of termination of the contract with the external provider); compliance of contracts for outsourced and partly outsourced operations with internal policies should be examined and where necessary relevant supplements to contracts should be agreed with contract partners;
- in the field of fixed assets management, control procedures over implementation of the contract with the company Triglav, Real Estate Management need to be defined; single and transparent way of managing investment projects should be established; system for recording maintenance works in progress should be established; action plan for completion of implementation of software support for real estate management should be prepared;
- in the field of sponsorship management, sponsorship methodology and transparency of evaluation of sponsorship requests should be further improved;
- in the field of IT management and IT systems, a formal strategy of information security needs to be prepared, as well as an action plan for its implementation; optimal concept of firewalls should be defined; guidelines and criteria for cloud service management should be defined and security management controls for cloud services should be improved; adequate monitoring of the project of centralization of IT infrastructure management should be established in a way that it would allow a comparison of effects/benefits and costs of the centralization after completion; method of recording audit trails in the software support for life insurance should be improved; additional

attention should be paid to the compliance of access rights management and change management with the adopted internal rules and best practice;

- 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 personal data privacy, rules for personal identification and rules for handling documents needed for identification should be more systematically defined in the internal acts; systemic solution for implementation of data exchange with external contractors should be set-up; implementation of the new software for data privacy management should be finalized as soon as possible.

The Management Board and the management of the audited areas are aware of the potential impact of detected violations, irregularities and deficiencies on the achievement of the Company's key objectives and have adopted appropriate measures, i.e., have been performing appropriate activities for their remediation. The trend of faster implementation of recommendations which began in 2017 continued in 2018, resulting in significant decrease of open overdue recommendations.

Below we enumerate significant opportunities for improvement of risk management and functioning of the internal control systems **in the subsidiaries**, detected by the Department during internal audits in the subsidiaries or while monitoring the operations and findings of the internal audit departments of the subsidiaries. In general, **the control environment and control procedures are improving**, while the listed opportunities apply to individual subsidiaries that were subject to audits:

- in the field of insurance (sales, underwriting and claims handling), additional attention should be paid to thorough consideration of the insurance terms, conditions and work instructions when concluding insurance policies and handling claims, as well as to provide full and well-completed documentation and prompt implementation of procedures; procedures for insurance policies control and handling objections to concluded policies should be further improved; competence of sales staff and the supervision over the work of the external sales network should be improved; more attention should be paid to regular monitoring of unsolved claims and up-to-date adjustment of the provisions to known facts; recourse handling procedures should be improved;
- in the field of reinsurance, more consistent keeping/archiving of key documentation related to planning and monitoring the reinsurance protection should be ensured; reinsurance cover for some insurance risks which exceed the retention limits should be provided; options for upgrade of software support for reinsurance management should be examined;
- in the field of back office division, finance (investment management) and accounting, procedures for monitoring payments and recovery of receivables from premiums and recourses should be improved; more attention should be paid to thorough respect of authorisations/powers in investment management and traceability of approvals of business 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 process of payroll and other employment benefits should be improved; the system of internal act management should be improved; archiving procedures of business documents should be improved;
- in the field of IT management and IT systems, implementation of measures for improvement of information security should actively continue and more attention should be paid to adoption or upgrades of security policies, adequate segregation of duties, improvement of access rights

management and change management procedures; introduction of software support for network monitoring, improvement of third-party management and improvement of business continuity management;

- in the field of anti money laundering and terrorist financing, procedures for clients' identification and acquisition of required data on origin of clients' assets should be improved; responsibilities and tasks of the person in charge of anti money laundering procedures should be clearly defined; more attention should be paid to education of personnel on the topics related to anti money laundering;
- in the field of personal data privacy, rules for personal identification and rules for handling documents needed for identification should be more systematically defined in the internal acts and consistently implemented.

Persons in charge in the subsidiaries have been informed on the findings, whereas implementation of recommendations for improvement of risk management and functioning of internal controls in these companies is being regularly monitored by internal audit departments of these companies.

With the purpose of constant improvement of risk management and functioning of internal control systems in the Triglav Group companies, the Company continued to transfer the common minimum standards of business functions operations (including the internal audit function) into subsidiaries and monitored their implementation also in 2018. Likewise, the Internal Audit Department is placing growing attention to internal audit activities on the Group level.

4 ASSESSMENT OF THE ADEQUACY OF RESOURCES FOR THE INTERNAL AUDIT DEPARTMENT OPERATIONS

On 1 January 2018, the Internal Audit Department had 11 persons employed, and on 31 December 2018 it had 12 persons. The increase in the number of employees by 1 person is related to additional post for an internal auditor in the segment of information systems auditing, whose employment began in mid- November 2018.

9 employees hold 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:

- 2 persons hold the professional certificates of »certified internal auditor« and »authorised auditor« (issued by The Slovenian Institute of Auditors);
- 4 persons hold the professional certificate of »certified internal auditor« (issued by The Slovenian Institute of Auditors);
- 1 person holds the professional certificates of »certified information systems auditor« (issued by The Slovenian Institute of Auditors), »CISA²« and »CGEIT³«;
- 1 person holds the professional certificates of »CIA⁴« and »CISA«;
- 1 person holds the professional certificate of »CISA«.

² CISA – Certified Information Systems Auditor

³ CGEIT – Certified in the Governance of Enterprise IT

⁴ CIA – Certified Internal Auditor

The number and competencies of employed internal auditors generally allow for the completion of the planned internal audits and other internal audit activities, with the presumption that the Department is not dealing with unforeseen long-term sick leaves, maternity/paternity leaves and other exceptional absences of employees.

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 acquire help of adequately qualified experts from inside or outside the Company. In 2018, the Department involved external expert into execution of the internal audit of fixed assets management as help in assessment of adequacy of the procedures in renovation of business offices.

The Company enables the internal auditors to receive an appropriate extent of professional education and training. In 2018, the internal auditors attended formal trainings within and outside the Company, and also spent part of their time for informal education by reading professional literature and exchanging knowledge within the Department.

As Department Director, I estimate that the Management Board provides appropriate conditions and resources for the Department's operations. The conditions allowing independent and impartial functioning 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 OPERATIONS

The Internal Audit Department develops/maintains and implements a quality assurance and improvement programme of its operations 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.

The quality assurance and improvement programme of the Department's operations covers the following activities:

- internal quality assessments including:
 - continuous supervision by 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's operations at least once in the period between two external assessments;
- external quality assessments 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 last external quality assessment of the Department's operations was performed in 2016 by DELOITTE REVIZIJA, d.o.o. It established that the Department operated in compliance with the International Standards for the Professional Practice of Internal Auditing in all significant aspects, and provided some recommendations for further development and introduction of best global practices into the Department's operations, which the Department follows when planning and executing its activities.

As Department Director, I estimate that, based on the performed quality assurance and improvement activities of Department's operations in the year 2018, presented in more detail in Section 2, the Department operates in compliance with the International Standards for the Professional Practice of Internal Auditing in all significant aspects and fulfils the expectations of its stakeholders (members of the Management Board, the Audit Committee, the Supervisory Board and directors of organizational units). However, there are still opportunities for improvement that the Department shall take into account when planning and executing its future activities.

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

The Management Board ensures adequate working conditions to the Internal Audit Department, in terms of organisational and functional independence, in terms of the resources provided for its operations 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 is independent in determining areas, objectives and the scope of internal auditing, performing of work 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's operations 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's operations, findings of the performed internal audits, implementation of the recommendations and the assessment of adequacy 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 of Zavarovalnica Triglav, d.d.⁵

As Department Director, I hereby declare that the Department in 2018 operated independently and that no circumstances arose in the operations 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.

⁵ 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.