

**ANNUAL
INTERNAL AUDIT REPORT
FOR 2014
BY INTERNAL AUDIT SERVICE
OF ZAVAROVALNICA TRIGLAV d.d.**

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Recipients: Management Board
Audit Committee
Supervisory Board
Shareholders' Meeting

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CONTENT

1. PURPOSE OF THE REPORT
2. OVERWIEV OF THE INTERNAL AUDIT SERVICE WORK AND THE IMPLEMENTATION OF THE PLANNED INTERNAL AUDIT ACTIVITIES
3. SUMMARY OF SIGNIFICANT FINDINGS BASED ON CONDUCTED INTERNAL AUDITS
4. ASSESSMENT OF THE ADEQUACY OF RESSOURCES FOR THE WORK OF THE INTERNAL AUDIT SERVICE

1 PURPOSE OF THE REPORT

Pursuant to Article 165 of the Insurance Act and Article 27 of the Internal Audit Service Rules of Zavarovalnica Triglav d.o.o., the Internal Audit Service (hereinafter the Service) shall prepare an Annual Internal Audit Report and submit it to the Management Board and the Supervisory Board, the Management Board shall inform the Shareholders' Meeting about the content of this Report and about the Supervisory Board's opinion of the Report.

The Internal Audit Service also prepares detailed reports on individual implemented internal audits for the Management Board and the management of the audit departments or for the persons responsible for taking measures; and quarterly and mid-annual reports on internal audit for the Management Board, the Audit Committee and the Supervisory Board.

The purpose of this Internal Audit Report for 2014 is mostly to present the Management Board, the Audit Committee, the Supervisory Board and the Shareholders' Meeting with:

- the information on the work of the Service and the implementation of the planned internal audit activities within the reporting period;
- a summary of significant findings of internal auditors on the basis of internal audits conducted within the reporting period;
- an assessment of the adequacy of resources for the Service operation during the reporting period.

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

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

In 2014, the Internal Audit Service carried out activities based on the adopted action plan for the Service, particularly on the basis of the Annual Work Programme of the Internal Audit Service of Zavarovalnica Triglav 2014 that was adopted by the Management Board on 10 December 2013 and approved by the Supervisory Board on 19 December 2013. In accordance with the internal audit professional guidelines and good practice in this field, the Service conducted regular and extraordinary internal audits and carried out some other internal audit activities.

In the reporting period, the Service conducted:

- 24 regular internal audits out of 26 planned audits, of which 18 audits within the insurance company, 5 audits in other companies from the Triglav Group, 1 audit within the Company as well as in the subordinated insurance companies;
 - the Service already issued final reports for 23 audits;
 - the Service issued a draft report for 1 audit;
 - according to an agreement reached with the management of audit departments, 2 audits were transferred to 2015 and included in the Service's annual plan of work for 2015;¹

¹ The following activities were carried over to 2015:

- an internal audit of the changes introduced in the pension plans and pension insurance cover funds management - the changes were introduced slowly because the authorised institutions did not issue the necessary approvals of the pension plan modifications and rules on cover fund management on time;

- **1 extraordinary internal audit** in one of the companies from the Triglav Group for which the Service has already issued a final report.

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- the internal audit of operation of software support Adlnsure in the company Triglav Pojišt'ovna, Brno, since the introduction of this software support was not concluded by the end 2014 (in agreement with the management of the company, the operation of this support and the provision of data for the preparation of accounting statements of the company for 2014 will be audited by an external auditor of the company).

The Service carried out several **other internal audit activities** in the reporting period:

- informal advisory services, mostly related to the preparation or updating of internal acts of the Company and the implementation of recommendations of internal and external auditors;
- monitoring of the implementation of recommendations of internal and external auditors;
- planning the work of the Service in 2015 on the basis of the audit assessment of risk in business lines of the Company;
- periodical reporting to the Management Board, the Audit Committee and the Supervisory Board on the work of the Service, the implemented internal audits and their outcomes and the implementation of recommendations of internal and external auditors;
- internal audit services in two affiliated insurance companies (Triglav Osiguranje, Banja Luka, and Triglav Pojišt'ovna, Brno) because of temporary problems with human resources in the field of internal audits in these two companies;²
- insuring and improving the quality of work of the Service and internal audit offices in other companies from the Triglav Group that mostly included:
 - the preparation of new drafts of basic acts of the Service (Declaration and the Rules of the Service) that will be supplemented by the Service with the rules on coordination and coherent work of internal audit services in the Triglav Group in order to define the internal audit rules in the Company and in the Triglav Group in a more systematic and coherent way;
 - the improvement of the planning procedures and the implementation of internal audits and reporting on internal audits;
 - assistance to internal audit services in other companies from the Triglav Group with:
 - the preparation and implementation of measures to execute recommendations issued at the assessment of quality of operation in 2012, in order to standardise the operation of internal audit services within the Triglav Group;
 - setting up the operation plan for 2015;
 - the implementation of a seminar for internal auditors from the Triglav Group companies to enable them to exchange their experience and good business practices;
 - participation at in-house and external trainings;
- other activities that mostly included:
 - participation at collegiate bodies and other meetings;
 - participation at the preparations of the Company to Solvency 2 requirements;
 - participation at the preparation of comments to the proposed Insurance Act (ZZav-1);
 - participation at a round table of the Bank Association of Slovenia on cooperation between the functions of internal audit and compliance department;
 - preparation of an article on internal audit of corporate management for a professional magazine SIR*IUS that is published by the Slovenian Institute of Auditors

The Service estimates that in 2014 it managed to implement the planned and not planned internal audit activities fully and successfully.

² The internal audit services in the companies Triglav Osiguranje, Banja Luka, and Triglav Pojišt'ovna, Brno include internal audits (except from the so called "cosourcing" reviews that are included in the planned regular internal audits – usually 1 audit in each company), as well as other internal audit activities in line with the annual internal audit reports that are adopted (approved) by the management and supervisory bodies in these two companies. The company Triglav Osiguranje, Banja Luka, does not have an employed internal auditor, therefore since 2010 the company has been contracting internal audit services from Zavarovalnica Triglav, one internal auditor of Triglav Pojišt'ovna, Brno has been on an maternity leave since June 2013, therefore the management decided to contract internal audit services from Zavarovalnica Triglav during her absence.

3 SUMMARY OF SIGNIFICANT FINDINGS BASED ON CONDUCTED INTERNAL AUDITS

When conducting internal audits the Internal Audit Service mostly focuses on the verification and evaluation of the adequacy and effectiveness of the internal audit systems of the Company which must insure 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.

The Service regularly informs in writing the responsible heads of audit departments or the authors of the recommendations about individual implemented internal audits in the Company and it presents the reports to the Management Board as well. The responsible heads of the audit departments or the persons responsible for the recommendations are obliged to adopt adequate measures or implement adequate activities within the agreed deadlines in order to eliminate the breaches, irregularities and deficiencies on the basis of the Service's recommendations and report on their activities to the Service. Based on their reports the Service then periodically monitors the implementation of the presented recommendations and reports to the Management Board, the Audit Committee and the Supervisory Board. It equally monitors and reports on the implementation of recommendations of external auditors.

Based on the internal audits and the monitoring of the implementation of the recommendations in 2014, the Service concludes that **the functioning of the systems of internal audit of the Company and the risk management within the Company's operation** as a whole is **adequate³ and is constantly**

³ 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, the provision of an efficient work organisation and 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 general. 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 recognised 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. The management is aware of the importance of monitoring and supervision. 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 immediately by the management. 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.

improving, but there are nevertheless a number of possibilities to improve the functioning of these systems in individual areas of activities of the Company. The management and the heads of business departments are aware of the possible impact of the breaches, irregularities and deficiencies on the key objectives of the Company and are adopting measures or implementing the activities to eliminate them.

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- **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 reorganisation of the company. There is no supervision. The level of risk is very high.

The following section contains a summary of significant findings and related recommendations.

In **corporate management of the Company and its subsidiaries** it is necessary to clearly define the system of management of subsidiaries and improve the management of these companies; to analyse the allocation of management and supervision functions within individual subsidiaries and to act upon the results of these analyses; to strengthen the role of audit committees in subsidiaries and make their work more successful and efficient and to clearly define the role or powers of posted workers.

In **the preparation process of the Company to meet the requirements of Solvency II**, more detailed action plans must be prepared for some of the more demanding activities and consistent implementation and monitoring of the implementation of these plans should be provided; the powers and responsibilities and the implementation methods to be carried out in subsidiaries must be defined clearly in order to insure compliance with the Directive's requirements in due time at the level of the Triglav Group.

In **development, underwriting and claim settlement** it is necessary to improve classification and allocation of goods vehicles and working vehicles in tariff guides for the third party liability insurance and hull insurance; to study the possibility of implementing broad scope market activities for sales promotion of animal insurance policies and for presenting the possible modification in these insurance policies; to formally define the limits for automated entry in life insurance; to focus even more on the timely submission of offers for the acceptance in life insurance to an insurance company that are collected by contractual partners; to improve the monitoring procedures and recovery of open claims against contractual partners for cash resources from insurances; to shorten the process of handling of complaints about the insurances; to study some possibilities to improve the functionality of applications for underwriting; to focus more on the underwriting procedures and claims management; to adopt a decision on an adequate tool for the assessment of damages in goods vehicles and working vehicles insurances; to study the possibility to connect the claims management activities in a support centre and management of the same property damages in regional points of sale in order to ensure consistent inclusion of costs of support services among recourse claims.

In **market communication** it is necessary to improve internal reporting on used financial funds for implementation of market activities; to improve the procedures and the records of take-over and allocation of promotion and prevention products.

In **background support in business operation, finances and accounting** it is necessary to study the possibility of simplification, harmonisation and centralisation of payment transactions procedures and cash-flow recording; to prepare an action plan to improve the programme support of the financial investment management; to transfer the methodology of the planned return on investment to all subsidiaries and set up supervision of the items used by these subsidiaries for the preparation of the ROI plans.

In **the prevention of money laundering and financing of terrorism** it is necessary to clearly define and allocate powers, responsibilities and tasks of the authorised persons in the insurance company and in its subsidiary Triglav INT to ensure the implementation of measures for detecting and preventing

money laundering and financing of terrorism in subsidiaries in third countries and to clearly define cooperation, information sharing and reporting on the implementing activities among them.

In **management of authorisations and rights to access information sources** it is necessary to focus more on the issue of applications for the implementation of changes or for withdrawal of general and/or professional authorisations and access rights to information sources; to ensure consistent implementation of periodic checks of access rights to information sources; to study the possibility of connecting applications and registers of data on human resources, authorisations and access rights to information sources.

In **IT and IT systems** it is necessary to prepare an action plan to improve the system of information protection in information systems; to prepare technical grounds (guidelines) for the conclusion of contracts in the field of development/purchase of information system: to regularly study possible risks/threats of the use of mobile and on-line applications and to update security mechanisms/algorithms of these applications if necessary and to ensure the implementation of independent security checks of these applications.

The following sections include the summaries of some opportunities for improving the operation of systems of internal control in **subsidiaries** in which the Company carried out internal audits in cooperation with internal auditors of these subsidiaries or on its own (the opportunities listed refer to individual subsidiaries in which the audits were carried out):

- in development, underwriting and claim settlement it is necessary to ensure consistent application of internal acts of individual companies, to ensure adequate allocation of powers, to shorten the process of submitting the application for life insurance by the agents and agencies to the insurance company, to improve the procedures of strict register of receipt books at recovery of the first premium of life insurances, to improve the control of cancelled insurance policies, to pay more attention to active communication with clients in the processes of evaluation and claim settlement, to claims documentation, to the eligibility of claims and the scope of damage, to consistent implementation of inventory check and documentation of modification in loss reserves and the control of the implementation of contractual repairs;
- in background support of business operation, finances and accounting it is necessary to improve the processes of monitoring payments and recovery of claims and to attribute more attention to consistent implementation of compensations of premiums due with liquidated damages;
- in IT and IT systems it is necessary to insure separation of incompatible functions or at least adequate substitute control of the implementation of operation in the production-information systems, to improve the processes of management of access rights, to set up processes of periodic check-ups of access rights to information systems and to improve the processes of management of modified information systems.

In 2014, the Company continued transferring common minimum standards of internal controls to all insurance companies within the Triglav Group in order to set up effective internal control systems in subsidiaries.

4 ASSESSMENT OF THE ADEQUACY OF RESSOURCES FOR THE WORK OF THE INTERNAL AUDIT SERVICE

The Management Board is providing the Internal Audit Service with appropriate work conditions in terms of organisational independence and the amount of funds for the operation of the Service. This enables the employees at the Service to implement internal audit activities independently and impartially.

In 2014, there were 10 persons employed in the Service. Of all these employees, 7 persons have at least one of the professional titles awarded to persons having successfully completed training in the field of auditing and related field by the Slovenian Institute of Auditors:

- 2 persons have 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".

The Service planned to increase the number of employees by one person with a professional title "verified information system auditor " or with a comparable professional title because of the development of IT, IT systems and related risks in the operation of the Company and of other companies within the Triglav Group and in order to ensure the sufficient number of staff in a long run. The employment process is still taking place and will be completed by the end of March 2015.

The Service offers all employees a sufficient amount of education programmes and training courses. In 2014, all employees participated in formal in-house and external training courses, while part of their activities consisted of informal education in the form of reading research literature.

The number and structure of employees in the Service and their qualifications enable the Service to fully implement planned internal audit activities in an individual year provided that the Service is not faced with unplanned long-term sick leaves, maternity/parental leaves or other unexpected absences and/or provided that it is not faced with bigger amount of unplanned necessary tasks. In the event that the employees in the Service do not possess special knowledge or skills that are needed for the implementation of internal audits and/or other internal audit activities, the Management Board enables the Service to obtain assistance form internal or external experts with suitable qualifications.