

MESSAGE FROM THE BOARD AUDIT AND COMPLIANCE COMMITTEE CHAIRMAN



EDGAR A. CUA
DIRECTOR

The Board Audit and Compliance Committee (Committee) of the Philippine National Bank (PNB) is a standing Committee of the Board of Directors. It has prepared this annual report on its activities with the purpose of evaluating its operations and organization in 2016, highlighting the main incidents that have arisen with respect to the specific functions it has been assigned.

Functions of the Committee

The Committee shall discharge its functions with complete independence, as follows:

- Assist the Board of Directors in the performance of its oversight responsibility relating to financial reporting process, systems of internal control, audit process and monitoring of compliance with applicable laws, rules and regulations;
- Provide oversight functions over internal and external auditors and ensure that the internal and external auditors act independently from each other;
- Provide oversight over compliance functions and/or oversee the compliance program;
- Review the quarterly, semi-annual, annual and any periodic financial statement signed by the CEO and CFO prior to submission to the Board, focusing particularly on: a) Any change/s in accounting policies and practices; b) Major judgmental areas; c) Significant adjustments resulting from the audit; d) Going concern assumptions; e) Compliance with accounting standards; and f) Compliance with tax, legal, regulatory and stock exchange requirements;
- Monitor the annual independent audit of PNB's financial statements, the engagement of the External Auditors and the evaluation of the External Auditor's qualifications, independence and performance;
- Monitor the compliance by PNB with legal and regulatory requirements, including PNB's disclosure controls and procedures

Organization and Responsibilities

The Committee is composed of three (3) members, who are all Independent Directors (ID). The Committee members are highly qualified business professionals with excellent educational credentials. In August 2016, the Committee members attended a seminar on Corporate Governance as part of their continuing training. The Committee members collectively hold a broad range of expertise and related banking experiences that provide value to the strengthening and upholding good governance practices in the Bank.

The Committee operates under a written Charter adopted by the Board of Directors. The Charter empowers the Committee to:

- Have explicit authority to investigate any matter within its terms and reference, full access to and cooperation by Management and full discretion to invite any Director or Executive Officer to attend its meetings, and adequate resources to enable it to effectively discharge its functions.
- Have the sole authority to select, evaluate, appoint, dismiss, replace and reappoint the External Auditors (subject to stockholder ratification) based on fair and transparent criteria such as (i) core values, culture and high regard for excellence in audit quality; (ii) technical competence and expertise of auditing staff; (iii) independence; (iv) effectiveness of the audit process; and (v) reliability and relevance of the external auditor's reports. The BACC shall set compensation of the external auditor in relation to the scope of its duties and approve in advance all audit engagement fees and terms and all audit related, and tax compliance engagements with the External Auditors. It may recommend to the Board of Directors to grant the President authority to negotiate and finalize the terms and conditions of the audit engagement as well as the audit fees, and sign, execute and deliver the corresponding contract and all non-audit engagement with the External Auditors subject to the confirmation/approval of the BACC members.
- Have the authority, to the extent it deems necessary or appropriate, to retain special legal, accounting, or other consultants to advise the Committee. The Bank shall provide funding, as determined by the Committee, for payment of compensation to the External Auditors and to any advisors employed by the Board Audit and Compliance Committee.
- Form and delegate authority to subcommittees, comprised of one or more members of the Committee, as necessary or appropriate. Each subcommittee shall have the full power and authority of the Committee.
- Ensure that a review of the effectiveness of the institution's internal controls, including financial, operational and compliance controls, and risk management, is conducted at least annually.
- Establish and maintain mechanisms by which officers and staff may, in confidence, raise concerns about possible improprieties or malpractices in matters of financial reporting, internal control, auditing or other issues to persons or entities that have the power to take corrective action. It shall ensure that arrangements are in place for the independent investigation, appropriate follow-up action and subsequent resolution of complaints.

The Committee shall review and assess the adequacy of its Charter annually and recommend any proposed changes for approval of the Board of Directors. The latest revision of the Committee Charter was in June 2016.

Activities for the calendar year 2016

The Committee held 13 meetings during the year. Accomplishments and action plans are monitored to ensure the full discharge of all its functions. For the calendar year 2016, the Committee:

- Reviewed and discussed the unaudited consolidated quarterly financial statements and the audited consolidated annual financial statements of the Bank, including management's significant judgments and estimates. While the Committee has the responsibilities and powers as set forth in this Charter, it is not the duty of the Committee to determine that PNB's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of Management and the External Auditors;
- Assessed the independence and effectiveness of the external auditors, tax preparers and consulting companies, and endorsed them to the Board of Directors;
- Reviewed the scope of work and fees of the external auditors, tax preparers and consulting companies, assessed their independence and effectiveness, and endorsed them to the Board of Directors;
- Reviewed the performance of the Internal Audit Group and Global Compliance Group. In the first quarter of 2016, the Internal Audit Group was subjected to an External Quality Assessment (EQA). SGV & Co. was engaged to conduct the independent external validation of the Internal Audit Group's self-assessment of its conformance with the International Standards. SGV concurred with the results of the self-assessment and confirmed that the Internal Audit activity "Generally Conforms" with the International Standards. Also, during the third quarter of 2016, the LT Group, Inc. (LTG), the Bank's immediate parent company, acquired the services of SGV & Co. to diagnose the current maturity level and future state of the Internal Audit function of LT Group, Inc. and its selected entities, which included PNB. The results of the current and future state assessment classified PNB Internal Audit Group as "Leading" in terms of maturity level.

- Reviewed and approved the annual plans and programs of the Internal Audit Group and Global Compliance Group for 2016, and the audit plan of the external auditors for the consolidated financial statements of the Bank for the period ending December 31, 2016;
- Reviewed the results of audits and recommendations of the internal and external auditors and their assessment of the Company's internal controls and the overall quality of the financial reporting process;
- Reviewed the monthly reports of the Internal Audit Group and Global Compliance Group, ensuring that management takes timely and appropriate corrective actions, including those involving internal control and compliance issues;
- Reviewed the enhancements on anti-money laundering controls and processes, including the major projects launched by the Internal Audit Group that automated the Group's end-to-end processes, promoting greater effectiveness and productivity. Internal Audit Group and Global Compliance Group are focused to support the Bank's cybercrime prevention and cyber-security preparedness programs, through attendance in several cybercrime prevention trainings and seminars.
- Performed self-assessments and reviewed the overall effectiveness of the Committee as against its Charter, following the guidelines set by the Securities and Exchange Commission;
- Enhanced the Committee Charter by adopting leading good governance practices.
- Reviewed and approved the Revised Internal Audit Group Manual, which covered significant enhancements in the Internal Audit Group and the Committee Charters to align with regulatory requirements, Risk Assessment Methodology, and various audit procedures.
- Reviewed significant updates in the Compliance Programs of PNB Parent Bank, its Subsidiaries and Affiliates including foreign branches.

Based on the stated responsibilities, authority and activities, the Board Audit and Compliance Committee recommended to the Board of Directors the approval of the Audited Consolidated Financial Statement of the Bank for the year ended December 31, 2016 and their consequent filing with the Securities and Exchange Commission and other regulatory bodies.

The Chief Audit Executive rendered an independent, objective assurance to the Committee, the Board of Directors and the Senior Management that, based on the overall activities performed by the Internal Audit Group, the Bank's risk management system, internal control systems and compliance with policies, procedures and relevant laws and regulations is Satisfactory. Furthermore, the results of the internal control review and evaluation on operations of the bank units, lending units, domestic and foreign branches and subsidiaries and information systems audited disclosed that the internal control environment of the Bank is considered effective as the units' ratings profile remained concentrated at Very Low to Low Risk. **This is supported by the comprehensive compliance systems effectively implemented enterprise-wide wherein there were no material deviations noted by the Chief Compliance Officer.**

With the robust governance of the Board and the unwavering support of Senior Management, the Committee is greatly confident that strong oversight on the establishment, administration, and assessment of the Bank's systems of risk management, control and governance processes provides reasonable assurance that Philippine National Bank's internal control environment remains effective and dynamic, able to support the business model and ensures the attainment of its business plans.



EDGAR A. CUA
Board Audit and Compliance Committee Chairman

MESSAGE FROM THE BOARD OVERSIGHT COMMITTEE (Domestic and Foreign Offices/Subsidiaries) CHAIRMAN

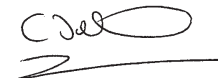


CHRISTOPHER J. NELSON
DIRECTOR

The main duties and responsibilities of the BOC – Domestic and Foreign Offices/Subsidiaries are:

1. To provide oversight on the business plans, initiatives, operations, risk and regulatory compliance of the domestic subsidiaries and foreign offices to include foreign branches, subsidiaries, marketing desk offices and representative offices;
2. To review periodically the actual performance of the domestic and foreign offices/subsidiaries in relation to its approved quantitative and qualitative plans as well as in relation to its strategic objectives and business priorities; conduct periodic financial performance and management profitability reviews which includes the evaluation of the Bank's short-term, medium-term and long-term strategic plans and key activities. Be informed of market and economic developments of the foreign office/subsidiary, in coordination with the respective entity's Board of Directors, other Board Committees and Senior Management Group Heads that provide oversight support to the foreign offices
3. To supervise the formulation of policy guidelines and procedures to ensure the quality of compliance and risk management of the different business legal vehicles by focusing on key risk areas that require direction by the Board and Implementation of timely effective corrective actions
4. To review business models/licenses, product programs, operations policy and procedures manuals, IT systems and developments, major marketing tie-ups/programs of the foreign offices; and
5. To review and evaluate qualification of key officers recommended to be hired or appointed for the foreign offices as well as those nominated to positions requiring the appointment of their Board of Directors.

The BOC – Domestic and Foreign Offices/Subsidiaries conducts two (2) meetings every month, one for the domestic subsidiaries and another for the foreign offices/subsidiaries.



CHRISTOPHER J. NELSON
Board Oversight Committee – Domestic and Foreign Offices/
Subsidiaries Chairman

The Board Oversight Committee – Domestic and Foreign Offices/Subsidiaries (BOC) was created in the year 2012 by the Board of Directors to provide the required oversight on the domestic and foreign offices/subsidiaries to ensure their profitable operations and long term viability consistent with the bank's strategic goals

The Committee has at least three (3) regular members of the Board of Directors. It may invite Senior Management Group Heads as resource person in any of its meetings to present management reports, clarify matters and provide information on relevant issues to the Committee, as needed.

		<p>regular discussions on the Bank's current risk exposures based on regular management reports and assess how the concerned units or offices reduced these risks.</p> <p>d) Review and revise the plan as needed – The ROC shall evaluate the risk management plan to ensure its continued relevance, comprehensiveness and effectiveness. It shall revisit strategies, look for emerging or changing exposures, and stay abreast of developments that affect the likelihood or harm or loss.</p>
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G. INTERNAL AUDIT AND CONTROL

1) Internal Control System

Disclose the following information pertaining to the internal control system of the company:

(a) Explain how the internal control system is defined for the company:

Internal control system is a process designed and effected by the Board of Directors, Senior Management, and all levels of personnel to provide reasonable assurance on the achievement of objectives through efficient and effective operations; reliable, complete and timely financial and management information; and compliance with applicable laws, regulations, supervisory requirements, and the organization's policies and procedures. The internal control system shall embody management oversight and control culture; risk recognition and assessment; control activities; information and communication; and monitoring activities and correcting deficiencies.

(b) A statement that the directors have reviewed the effectiveness of the internal control system and whether they consider them effective and adequate:

The Bank's overall risk management system, internal control systems and compliance with policies, procedures and regulations have remained satisfactory. PNB has an integrated bank-wide risk management process of comprehensive identification, assessment, mitigation and monitoring of all relevant material risks exposures of the Bank through individual unit's Risk and Control Self-Assessment (RCSA) process. The RCSA is an integral component of Enterprise Risk Management (ERM) and the Internal Capital Adequacy Assessment Process (ICAAP). The Board of Directors and Senior Management are consistent and diligent in the discharge of their oversight and governance functions over the Bank's internal control system through regular monitoring of major issues of the Bank operations. Periodically, appropriate policies and procedures are issued to strengthen controls versus changes in the economic and regulatory environment.

Under the good governance of both the Board and the President/Chief Executive Officer and with the strong support of Senior Management to oversee the establishment, administration, and assessment of the Bank's system of risk management and control processes, PNB's internal control environment has been effective and dynamic to ensure the attainment of its business objectives.

(c) Period covered by the review:

One (1) year.

(d) How often internal controls are reviewed and the directors' criteria for assessing the effectiveness of the internal control system:

Internal controls are continuously monitored and assessed/reviewed annually. The criteria for assessing the effectiveness of internal control system include, among others, the results of internal, external and BSP regulatory examinations, occurrence of fraud/irregularity and RCSA, which are discussed during the monthly meetings of Board Committees. The Chief Audit Executive renders an annual report on the Internal Control Environment of the Bank to the Board through the Board Audit and Compliance Committee (BACC).

(e) Where no review was conducted during the year, an explanation why not.

Not applicable. Review was conducted in 2016.

2) Internal Audit

(a) Role, Scope and Internal Audit Function

Give a general description of the role, scope of internal audit work and other details of the internal audit function.

Role	Scope	Indicate whether In-house or Outsource Internal Audit Function	Name of Chief Internal Auditor/Auditing Firm	Reporting process
The Internal Audit Group is headed by the Chief Audit Executive (CAE) reporting directly to the Board Audit and Compliance		In-house	Dioscoro Teodorico L. Lim	Functionally reporting to the