

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.

(e) Where no review was conducted during the year, an explanation why not. (updated – 2015)

Not applicable. Review was conducted in 2015.

**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
	<p>The Internal Audit Group (IAG) is headed by the Chief Audit Executive (CAE) reporting directly to the Board Audit and Compliance Committee (BACC). The Internal Audit functions include assessment of internal controls and the recommendations to implement constructive measures to ensure adequate control. It is also tasked to support the Bank’s risk management activities and corporate governance initiatives. The functions and responsibilities of the Internal Audit Group and the Chief Audit Executive is covered by the audit charter and Internal Audit Manual which is revised and approved by the Board annually.</p> <p>The major functions that IAG performs are:</p> <ol style="list-style-type: none"> <li>1. Develop an audit charter, approved by both senior management and the BACC, for the internal auditing activity.</li> <li>2. Develop, along with management, an organization model that can be used to map major processes/operations for the purpose of identifying the organization’s auditable units.</li> <li>3. Develop a risk assessment methodology for the auditable entities identified in the model of major processes/ operations.</li> <li>4. Develop an audit plan based on the risk assessment and requests from management and get it approved by the Board.</li> <li>5. Work with senior management and the BACC to establish a reporting relationship that will ensure that audit recommendations receive appropriate attention.</li> <li>6. Establish a Quality Assurance and Improvement Program (QAIP) for the internal auditing activity that provides assurance that the internal auditing activity: (a) performs in accordance with its charter; (b) adheres to the standards and the Code of Ethics; (c) operates in an effective and efficient manner; and (d) is perceived by the Board and management as adding value and improving an organization’s operations.</li> <li>7. The internal audit function shall be established centrally by the parent bank (PNB) and shall have authority over the group (PNB and its Subsidiaries). PNB IAG shall define the internal audit strategies, methodology and scope for PNB and its BSP-supervised domestic and overseas subsidiaries and branches.</li> <li>8. For BSP-supervised subsidiaries with established internal audit functions, the internal audit of said entities shall closely coordinate with PNB IAG to ensure consistent adoption of audit methodologies and alignment of strategies and scope.</li> </ol>	In-house	Dioscoro Teodorico L. Lim	Functionally reporting to the Board through the BACC and administratively to the President

- (b) Do the appointment and/or removal of the Internal Auditor or the accounting /auditing firm or corporation to which the internal audit function is outsourced require the approval of the audit committee?

Yes. The BACC Charter states, among others, that as part of the oversight function of the Bank's Internal Auditor, the BACC is:

*"Responsible for the establishment of the Internal Audit Group and the appointment and replacement of the Chief Audit Executive (who will report directly to the BACC functionally) including annual performance review of the CAE, accepting the resignation and/or dismissal subject to due process."*

- (c) Discuss the internal auditor's reporting relationship with the audit committee. Does the internal auditor have direct and unfettered access to the board of directors and the audit committee and to all records, properties and personnel?

Yes. The IAG Charter states that:

*"The Chief Audit Executive (CAE) shall report directly/functionally to the Board Audit and Compliance Committee (BACC) and may report administratively to the President and Chief Executive Officer."*

IAG shall have free and unrestricted access to the BACC and any other member of the Board of Directors as needed to fulfil its responsibilities.

Authority is granted for full, free and unrestricted access to any and all of the Bank's, its affiliates and subsidiaries' records, physical properties, and personnel relevant to any function under review. All employees are requested to assist IAG in fulfilling their staff function.

Documents and information given to internal auditors during a periodic review will be handled in the same prudent and confidential manner as by those employees normally accountable for them."

- (d) Resignation, Re-assignment and Reasons

Disclose any resignation/s or re-assignment of the internal audit staff (including those employed by the third-party auditing firm) and the reason/s for them. (updated – 2015)

Name of Audit Staff	Reason
In summary, there were 24 additional auditors (18 newly hired and 6 transferees from other departments) while 10 auditors retired/resigned in 2015.	Turnover of auditors is considered a "normal attrition" scenario in a banking environment.

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- (e) Progress against Plans, Issues, Findings and Examination Trends

State the internal audit's progress against plans, significant issues, significant findings and examination trends. (updated -2015)

<b>Progress Against Plans</b>	The following are the accomplishment rates for 2015:				
		Budget	Actual	Variance	Accomplishment Rate
	Regular Audits	431	432	1	100.02%
	Spot Audits	307	330	23	107.00%
	Confirmation of Balances	525	554	29	106.00%
<b>Issues<sup>6</sup></b>	None				
<b>Findings<sup>7</sup></b>	94.8% resolution rate				
<b>Examination Trends</b>	<ul style="list-style-type: none"> <li>Regular Audits-</li> </ul>				

<sup>6</sup> "Issues" are compliance matters that arise from adopting different interpretations.

<sup>7</sup> "Findings" are those with concrete basis under the company's policies and rules.

	<ul style="list-style-type: none"> <li>• Spot Audits</li> <li>• Confirmation of Balances</li> <li>• Special Audits/Fraud Investigations/Request for Audit</li> </ul> <p>The results of our internal control review and evaluation on operations of the bank units disclosed that the internal control environment of the Bank is considered effective as the units' ratings remained concentrated at Low Risk.</p>
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(f) Audit Control Policies and Procedures

Disclose all internal audit controls, policies and procedures that have been established by the company and the result of an assessment as to whether the established controls, policies and procedures have been implemented under the column "Implementation." (updated – 2015)

Policies and Procedures	Implementation
Internal Audit Charter	<p>Implemented. Based on the assessment of an independent validator, IAG "Generally Conforms" to the International Standards for the Professional Practice of Internal Auditing, the Code of Ethics, and the Definition of Internal Auditing.</p> <p>In 2015, the IAG likewise performed Self-Assessment and had assessed itself as "Generally Conforms" to the Standards, the Code of Ethics, and the Definition of Internal Auditing. Furthermore, the Self-Assessment will be subject to an independent validation by and an external party outside the Bank. Target date of completion is March 2016.</p>
Board Audit and Compliance Committee Charter	
Audit Risk Assessment	
Audit Planning and Monitoring of Accomplishment	
Pre-Engagement Activities	
Audit Fieldwork and Reporting of Results	
Audit Client Satisfaction Surveys	
Audit Sampling Methodology	
Audit Working Paper Preparation	
Audit Risk Rating System	
Internal and External Quality Assessment Reviews	
Monitoring of Outstanding Audit Issues	
Fraud Investigations	
Professional Development	
Consulting Activities	
Insourced Activities	
Performance Measures	

(g) Mechanisms and Safeguards

State the mechanism established by the company to safeguard the independence of the auditors, financial analysts, investment banks and rating agencies (example, restrictions on trading in the company's shares and imposition of internal approval procedures for these transactions, limitation on the non-audit services that an external auditor may provide to the company):

Auditors (Internal and External)	Financial Analysts	Investment Banks	Rating Agencies
Internal Auditors' performance is governed by the provisions of the International Standards for the Professional Practice of Internal Auditing and BSP prescribed standards and regulations, particularly on rotation of auditors.	<p>The credit rating agencies, investment banks, institutional and other potential investors request for data and information prior to their scheduled meetings with the Bank's senior officers.</p> <p>Information provided to them is cut-and-dried data that have already been previously disclosed to the Philippine Stock Exchange and to the public.</p> <p>No write-ups, analyses, opinions and judgments are included in the information provided to these agencies.</p>		
Auditors are bound to carry out their functions in accordance with the Employee Discipline Policies and Procedures/Code of Conduct.			
Auditors shall not install nor develop policies and procedures, prepare reports, or execute activities that fall within the scope of its review.			
The Board Audit and Compliance Committee (BACC) shall have the sole authority to select, evaluate, appoint, dismiss, replace and re-appoint 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			