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PURPOSE

The purpose of Internal Audit in MERALCO is to provide risk-based and objective assurance, advice and insight designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The nature of assurance service involves the objective examination of evidence for the purpose of providing an independent assessment on governance, risk management performance, and control processes for the organization. The examples may include the following:

- a. Formal assurance engagements - *financial, operational or performance, compliance and system security audits*
- b. Special assurance engagements - *due diligence and fraud engagements*

The nature of consulting services is advisory in nature and are related to internal client service activities. The nature and scope of advisory services are agreed with the client, without the internal auditor assuming management responsibility. The examples of advisory services include, but are not limited to the following:

- a. Formal consulting engagements - *advisory, facilitation, training, fact finding and verification services requiring an independent and objective perspective from outside of the requesting unit.*
- b. Informal consulting engagement - *counsel, advice*

AUTHORITY

The chief audit executive and staff of the internal audit department are authorized to:

- Have unrestricted access to all functions, records, property, and personnel for the specific purpose of the audit.
- Have a full and free access to, and communicate and interact directly with the Audit Committee, including in private meetings without management present.
- Allocate resources, set frequencies, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of personnel in units of organization where they perform audits, as well as other specialized services from within or outside the organization.

The chief audit executive and staff of the internal audit department are not authorized to:

- Perform any operational duties for MERALCO or its affiliates.
- Initiate or approve accounting transactions external to the internal audit department.

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- Direct the activities of any organization employee not employed by the internal audit department, except to the extent such employees have been appropriately assigned to auditing teams or otherwise assist the internal auditors.

RESPONSIBILITY

The chief audit executive and staff of the internal audit department have responsibility to

- Develop a flexible annual audit plan based on a prioritization of the audit universe using risk-based methodology, including inputs from senior management and the Board. Submit that plan to the Audit Committee for review and approval.
- Implement the annual audit plan, as approved, including as appropriate any special tasks or projects requested by management and the Audit Committee. Any significant deviation from the approved annual audit plan will be communicated to senior management and the Audit Committee through periodic activity reports.
- Maintain a professional audit staff with sufficient knowledge, skills, and experience and professional certifications to meet the requirements of this Charter.
- Evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control process coincident with their development, implementation, and/or expansion.
- Issue periodic reports to the Audit Committee and management summarizing results and audit activities.
- Conduct the appropriate follow-up on engagement findings and recommendations which shall remain in an open issues file until cleared.
- Consult and validate audit findings with management.
- Keep the Audit Committee informed of emerging trends and successful practices in internal auditing.
- Provide a list of significant measurement goals and results to the Audit Committee.
- Assist in the investigation of significant suspected fraudulent activities within the organization and notify management and the Audit Committee of the results.
- Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the organization at a reasonable over-all cost.
- Communicate to senior management and the Audit Committee the internal audit activity's quality assurance and improvement program, including results of on-going internal assessments and external assessments conducted at least every five (5) years.

ACCOUNTABILITY

The chief audit executive, in the discharge of his/her duties, shall be accountable to management and the Audit Committee.

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- Provide an annual assessment on the adequacy and effectiveness of the organization's process for controlling its activities and managing its risk in the areas set forth under the mission and scope of work.
- Report significant issues related to the processes for controlling the activities of the organization and its affiliates, including potential improvements to those processes, and provide information concerning such issues through resolution.
- Periodically provide information on the status and results of the annual audit plan and sufficiency of department resources.

INDEPENDENCE AND OBJECTIVITY

To provide for independence of the internal audit department, its personnel report to the chief audit executive, who reports functionally to the Audit Committee and administratively to the Chief Executive Officer in a manner outlined in the above section on Accountability. It shall include as part of its reports to the Audit Committee, a regular report on internal audit personnel.

The internal audit activity shall remain free from interference by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of a necessary independent and objective mental attitude.

Internal auditors shall have no direct operational responsibility or authority over any of the activities audited. Accordingly, they shall not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair internal auditor's judgment, including:

- Assessing specific operations for which they had responsibility within the previous year.
- Performing any operational duties for Meralco or its affiliates.
- Initiating or approving transactions external to the internal audit office.
- Directing the activities of any Meralco employee not employed by the internal audit, except to the extent that such employees have been appropriately assigned to auditing teams or to otherwise assist internal auditors.

Internal auditors shall exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors shall make a balance assessment of all the relevant circumstances and not be unduly influenced by their own interests or by others in forming judgments.

The chief audit executive shall confirm to the Board, at least annually, the organizational independence of the internal audit activity.

QUALITY ASSURANCE AND IMPROVEMENT PROGRAM

Internal audit will maintain a quality assurance and improvement program that covers all aspects of the internal audit activity. The program will include an evaluation of the internal audit's conformance with the Standards and an evaluation of whether internal auditors apply

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The IIA's Code of Ethics. The program will also assess the efficiency and effectiveness of the internal audit and identify opportunities for improvement.

The chief audit executive will communicate to senior management and the Audit Committee on the Internal Audit's quality assurance and improvement program, including results of internal assessments (both ongoing and periodic) and external assessments conducted at least once every five years by a qualified, independent assessor or assessment team from outside.

PROFESSIONALISM AND STANDARDS OF PRACTICE

The Internal Audit and its activities shall adhere to the mandatory elements of The Institute of Internal Auditors' International Professional Practices Framework, including the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics for Internal Auditors, the International Standards for the Professional Practice of Internal Auditing (*Standards*), and the Definition of Internal Auditing which is adopted verbatim in the general objective statement under this Charter.

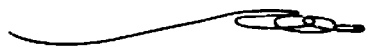
The chief audit executive will report periodically to senior management and the Audit Committee regarding the internal audit's conformance to the Code of Ethics and the *Standards*.



Helen T. de Guzman
Chief Audit Executive



Oscar S. Reyes
President & CEO



Ret. Chief Justice Artemio V. Panganiban
Chairman, Audit Committee