

# Strengthening of Internal Control Systems and Internal Audit in the Philippine Government

**PAGBA 2<sup>nd</sup> Quarterly Seminar Workshop  
September 5, 2014**

---

DEPARTMENT OF BUDGET AND MANAGEMENT



# Outline

- **Internal Control Systems (ICS)**
  - ✓ Overview and Objectives of NGICS
  - ✓ Internal Control:
    - Legal Bases and Responsibility for Internal Control
    - Definition, Objectives and Benefits
    - Elements, Concept and Limitations
    - Components
- **Internal Audit (IA)**
  - ✓ The PGIAM
  - ✓ Definition and Legal Bases
  - ✓ Functions of IAS/IAU
  - ✓ Organization of IAS
  - ✓ Types of Audit
  - ✓ Accomplished ICS/IA Activities
  - ✓ Next Steps





## NATIONAL GUIDELINES ON INTERNAL CONTROL SYSTEMS



Department of Budget and Management  
REPUBLIC OF THE PHILIPPINES

# Overview of NGICS

- Contains fundamental principles, policies and general standards to guide agencies in developing, implementing and monitoring their respective ICS
- Update and further broaden public sector understanding of internal control processes



# Legal Bases for Internal Control

- Philippine Constitution of 1987
- Administrative Code of 1987
- Presidential Decree (PD) 1445, s. 1978
- Administrative Order (AO) No. 119, s. 1989
- Memorandum Order No. 277, s. 1990
- Article 9 (Public Procurement and Management of Public Finances), Chapter II (Preventive Measures) of the United Nations Convention Against Corruption



# Responsibility for Internal Control

- **Section 124 of PD 1445** – it shall be direct responsibility of agency head to install, implement and monitor sound system of internal control
- **Section 1, Chapter 1, Subtitle B, Book V of the Administrative Code of 1987** – all resources of govt shall be managed, expended or utilized in accordance with law and regulations and safeguarded against loss or wastage through illegal or improper disposition to ensure efficiency, economy and effectiveness in govt operations; responsibility to take care such policy is faithfully adhered to rests directly with chief or head of agency concerned
- **Section 1 of AO 119 dated March 29, 1989** – responsibility for fiscal operations of offices and agencies of govt to reside primarily with respective Heads of each office, agency, GOCC and LGU; each and every office, agency, corporation and local government unit is mandated to strengthen its ICS and/or organize systems and proceed in coordination with DBM



# Definitions of Internal Control

- ***Section 123 of PD 1445, as amended*** - Plan of organization and all coordinated methods and measures adopted to:
  - safeguard assets
  - check accuracy and reliability of accounting data
  - encourage adherence to prescribed managerial policies



# Definitions of Internal Control

- **Section 32, Title 2, Volume III of the GAAM - Plan of organization and all methods and measures** adopted to ensure that:
  - resources are used consistent with laws, regulations and policies
  - resources are safeguarded against loss, wastage and misuse
  - financial and non-financial information are reliable, accurate and timely
  - operations are economical, efficient and effective



# Definitions of Internal Control

## *International Organization of Supreme Audit Institutions (INTOSAI) –*

- **Integral process** that is effected by entity's management and personnel, and **designed to address risks**
- Provides reasonable assurance that in pursuit of entity's mission, following objectives are achieved:
  - ✓ executing orderly, ethical, economical, efficient and effective operations
  - ✓ fulfilling accountability obligations
  - ✓ complying with applicable laws and rules
  - ✓ safeguarding resources against loss, misuse and damage



# Objectives of Strong ICS

- Safeguard government assets
- Check accuracy and reliability of accounting data
- Ensure economical, efficient, effective and ethical operations
- Comply with laws and regulations
- Adhere to managerial policies

**Source:** *NGICS, pp. 10-14*



# Benefits of a Strong ICS

- Stronger accountability
- Economical, efficient, effective and ethical, **(4 Es)** operations
- Improved ability to address risks to achieve general control objectives
- Better systems of responding to needs of citizens
- Better quality of outputs and outcomes
- Effective governance

**Source:** NGICS, p. 2



# Elements of Internal Control

- **Plan of Organization** - organizational structure and staffing complement for organization to carry out functions (*Sec 38.a, Title 2, GAAM Volume III*)
- **Coordinated Methods and Measures** – control processes implemented which form part of the normal recurring operations of an organization; guide actions at all levels and ensure that activities performed within standards (*NGICS, pp. 22-23*)



# Sample of Control Methods and Measures

- Delegation of authority and supervision
- Segregation of functions for processing, reviewing, approval, recording and custody
- Access to resources and records
- Completeness and integrity of transaction documents and reports
- Verification of transactions
- Reconciliation of records and data

*Source: NGICS, pp. 27-30*



# Concept of Internal Control

## ***Internal Control as an Integral Process***

- Series of actions that occur throughout entity's operations on ongoing basis (*NGICS, p. 8*)
- Built in rather than built on (*INTOSAI Guidelines for Internal Control Standards for the Public Sector*)
- Not stand alone or separate specialized systems within agency (*Sec. 33, Title 2, GAAM Volume III*)

## ***Internal Control is Management Control***

- Utilized by management to regulate and guide operations (*NGICS, p. 9*)
- Helps managers achieve desired results through effective stewardship of public resources (*USGAO Standards for Internal Control in the Federal Gov''*)



# Limitations of Internal Control

- Provide reasonable – NOT ABSOLUTE – assurance to management
- Can be influenced by outside factors which affect ability to meet objectives
- Limitations – error of judgement, negligence, fatigue, attitude

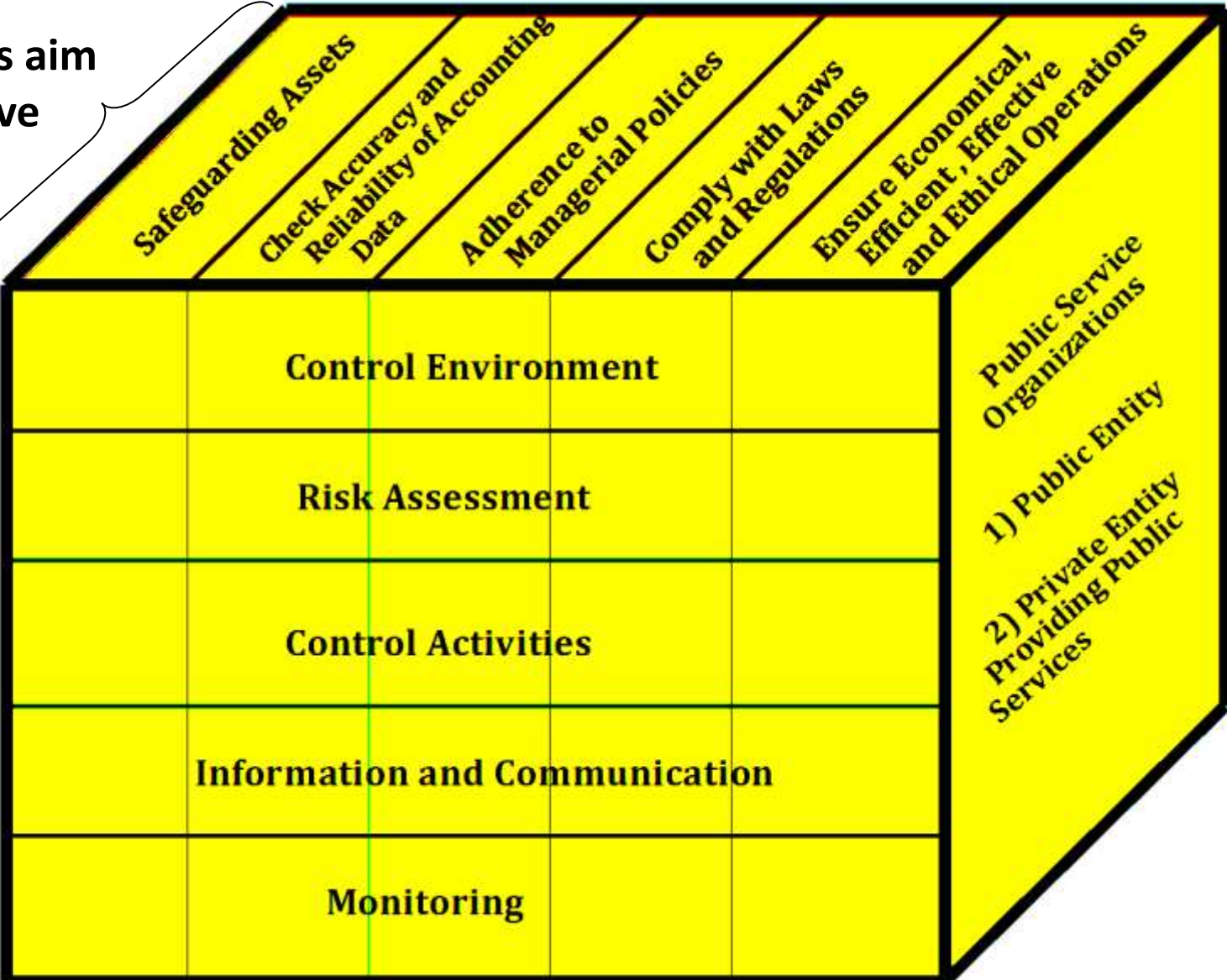
**Source:** NGICS, p. 9



# Components of Internal Control

## Internal Control Objectives

What ICs aim to achieve



Internal Control Components

Needed to achieve control objectives

Source: INTOSAI

# Components of Internal Control

- **Control Environment** - scope and coverage of organization's ICS that impacts on structural and operational framework; integrates all IC components, elements and features; and constitutes essential internal and external aspects (organizational structure, coordinated methods and measures, discipline, attitudes, and managerial policies)

**Source:** NGICS, p. 17





# Components of Internal Control

**Risk Assessment** - overall process of risk identification, analysis and evaluation to ascertain existing and potential risks to the achievement of control objectives and determine appropriate response

**Risk** - effect of uncertainty on objectives

- ✓ **Objectives** – can have different aspects (e.g., financial, health and safety, and environmental goals) and can apply at different levels (e.g., strategic, organization-wide, project, product and process)
- ✓ **Uncertainty** - state, even partial, of deficiency of information related to, understanding or knowledge of, an event, its consequences, or likelihood
- ✓ **Event** - occurrence or change of particular set of circumstances
- ✓ **Consequence** – outcome of **event**

**Source:** NGICS, pp. 29-31



# Components of Internal Control

## **Risk Assessment**

- **Risk identification** - determination of opportunities and threats to achievement of control objectives; generate comprehensive list of risks
- **Risk analysis** - systematic use of information to identify sources and to estimate risk; developing understanding of risk and providing input to risk evaluation and to decisions
- **Risk evaluation** - assessing significance of risk and evaluating likelihood of occurrence

**Source:** *NGICS, pp. 29-31*



# Components of Internal Control

- **Control Activities** - policies and procedures established to address risks and achieve entity's objectives
- **Information and Communication** - go hand in hand and cut across all other internal control components; Relevant information must be communicated throughout agency, as well as to its network of organizations and sectors

**Source:** NGICS, pp. 31-37



# Components of Internal Control

- **Monitoring** – to ensure controls are operating as intended and modified appropriately for changes in conditions; involves assessing whether general objectives of internal control are achieved
  - a. **Ongoing Monitoring** – built into normal, recurring activities of agency/units; performed regularly and on real-time basis, responds dynamically to changing conditions and embedded in agency's operation
  - b. **Separate Evaluation** – covers evaluation of effectiveness of ICS to ensure that internal controls achieve desired results based on predefined methods and procedures

**Source:** NGICS, pp. 37-40





# Philippine Government Internal Audit Manual

## **PGIAM:**

- Assist agencies in establishing internal audit function
- Guide internal auditors review agencies' compliance with laws and policies and performance against agreed-upon objectives, measures and targets





# Philippine Government Internal Audit Manual

## **PGIAM:**

- **PART I (Guidelines)** – outlines basic concepts and principles of internal audit, and policies and standards to guide agencies in organizing, managing and conducting effective internal audit
- **PART II (Practices)** - contains user-friendly tools, techniques and approaches to facilitate the conduct of internal audit activities; serves as a tool kit for Internal Auditors in performance of functions

# What is Internal Audit?

- Evaluation of management controls and operations performance
- Determination of degree of compliance with laws, regulations, managerial policies, accountability measures, ethical standards and contractual obligations
- Involves appraisal of plan of organization and all coordinated methods and measures

**Source:** PGIAM, p. 5





# Legal Bases for Internal Audit

- **RA 3456 (Internal Auditing Act of 1962), as amended by RA No. 4177** – first mandated creation of Internal Audit Service (IAS)
- **PD 1** - abolished IAS but functions were merged with Management Division (MD) of Financial and Management Service (FMS) of Depts
- **Administrative Code of 1987** – re-established IAS in DPWH, included internal audit function under DOF-CFMO





# Legal Bases for Internal Audit

- **AO 119, s. 1989** – mandated government entities to strengthen their ICS and organize systems and procedures in coordination with DBM
- **MO 277, s. 1990** – directed DBM to promulgate necessary rules, regulations and circulars for strengthening ICS of government agencies, GOCCs and LGUs
- **AO 278, s. 1992 & AO 70, s. 2003** – provided authority for creation of IAS and its functions, duties and activities



# Legal Bases for Internal Audit

- **DBM Budget Circular 2004-4** – highlighted policy guidelines in organization, staffing of IAS
- **DBM-CSC Joint Resolution No. 1, s. 2006** – provided for creation of IAS/IAU with its functions in line with EO 366
- **DBM Circular Letter No. 2008-5** – provided guidelines in organization of IAS and clarified its functions, and rank and salary grade of head of IAS
- **DBM Circular Letter No. 2008-8** – provided that IAS to be composed of (1) Management Audit Division and (2) Operations Audit Division



# Functions of IAS/IAU

- Advise DS/HoA or Governing Body/Audit Committee on matters relating to management control and operations audits
- Conduct management and operations audits of Dept/Agency/GOCC/GFI functions, programs, projects, activities with outputs, and determine degree of compliance with mandate, policies, government regulations, established objectives, systems and procedures/processes and contractual obligations

**Source:** DBM Circular Letter No. 2008-05



# Functions of IAS/IAU

- Review and appraise systems and procedures, organizational structures, asset management practices, financial and management records, reports and performance standards of department proper, bureaus and regional offices
- Analyze and evaluate management deficiencies and assist top management by recommending realistic courses of action (what not how)

**Source:** *DBM Circular Letter No. 2008-05*



# Which Agencies May Organize IAS/IAU

- Departments
- Agencies attached to a department for policy and program coordination
- GOCCs/GFIs

**Source:** DBM Circular Letter No. 2008-05



# Organization of IAS

- Service-level headed by a Director IV in Departments
- With **2 Divisions**:
  - **Management Audit Division** – evaluate achievement of control objectives to include safeguarding of assets, checking accuracy and reliability of accounting data, adherence to managerial policies, compliance with laws, rules and regulations
  - **Operations Audit Division** – evaluate extent of compliance and ascertain effective, efficient, ethical and economical execution of operations

**Source:** DBM Circular Letter No. 2008-05 & PGIAM, pp. 57-61

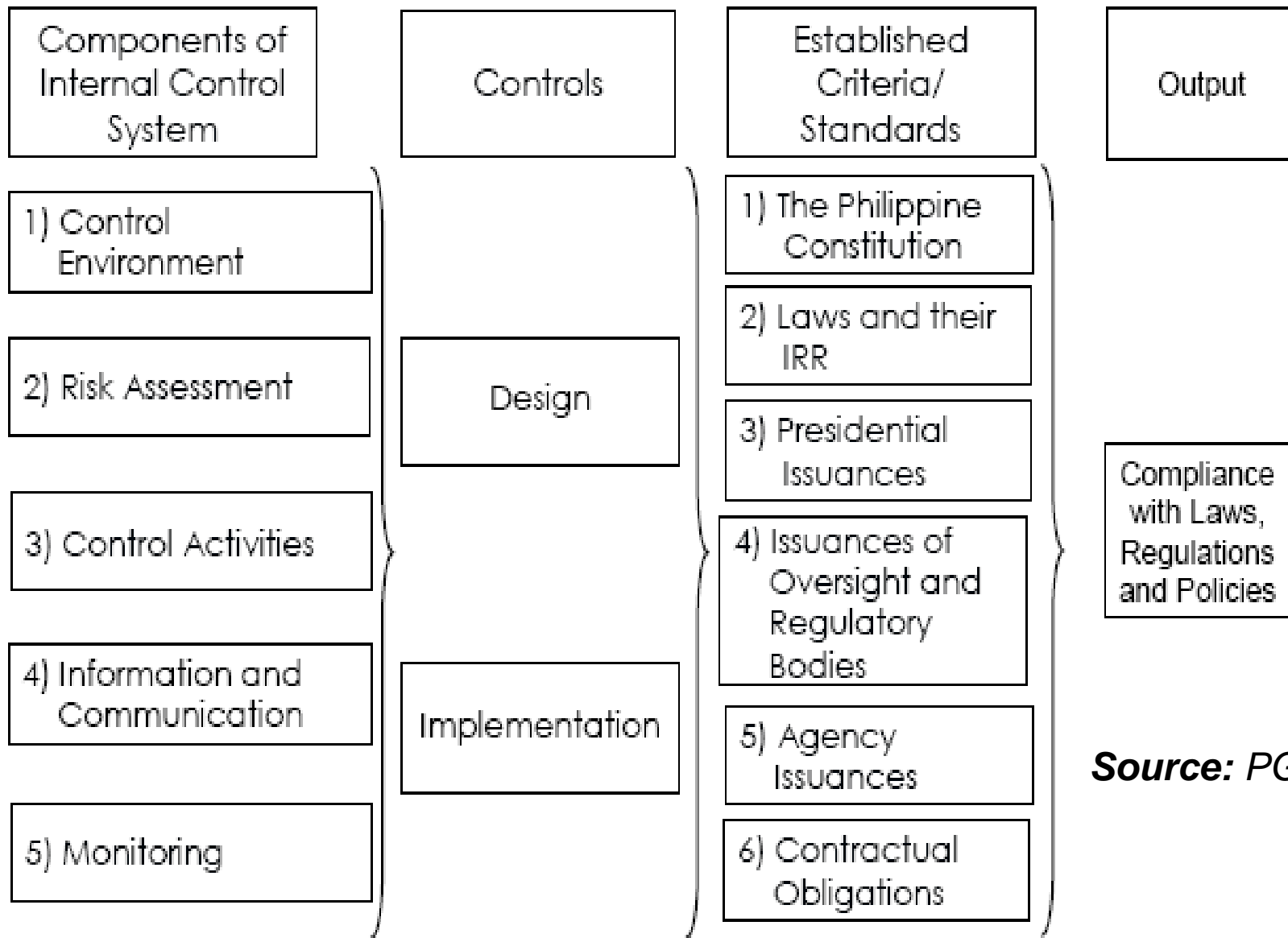


# Types of Audit

**Compliance audit** – evaluation of degree of adherence with laws, regulations, managerial policies and operating procedures, including compliance with accountability measures and ethical standards and contractual obligations

*Source: PGIAM, p. 9*





**Source: PGIAM, p. 9**

## Compliance Audit Flow Diagram



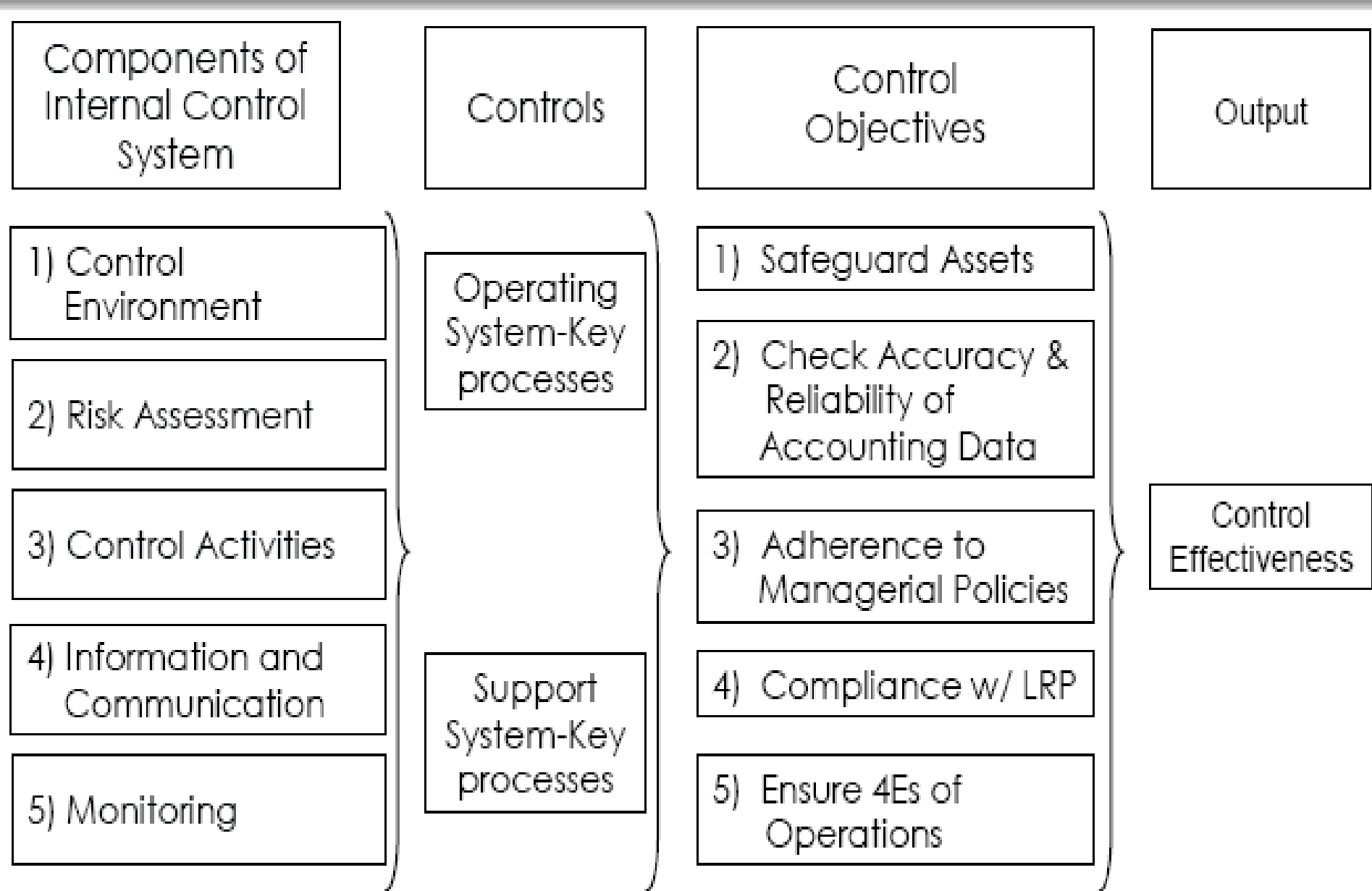


# Types of Audit

**Management audit** – evaluation of effectiveness of ICs adopted in operating and support services units/systems, determine whether it achieves control objective over specific period of time; review and appraisal of systems and processes, organizational structure and staffing, operations and management practices, records, reports and performance standards of agencies/units covered

**Source:** PGIAM, pp. 9-10





## Management Audit Flow Diagram

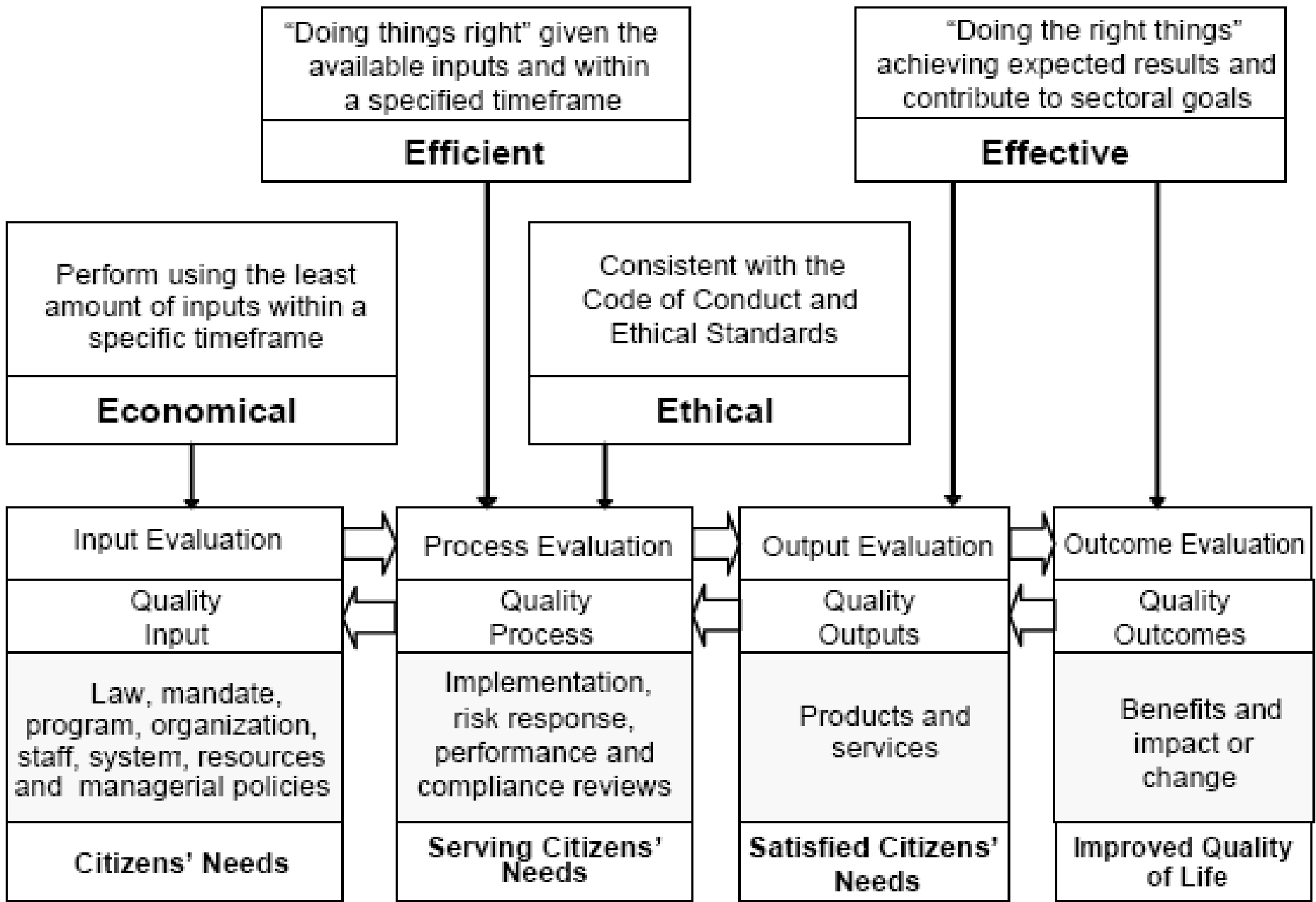
Source: PGIAM, pp. 9-10

# Types of Audit

**Operations audit** – evaluation of outcome, output, process and input to determine whether government operations, including management and personnel structure in programs/projects are effective, efficient, ethical and economical; organization, programs, and projects involves an evaluation of whether or not expected results were achieved and targets were attained

**Source:** PGIAM, pp. 12-13





**Operations Audit Flow Diagram**

*Source: PGIAM, pp. 12-13*

# Sample Internal Control/ Internal Audit Findings

- Report of Cash Collections and Deposits was only signed by the Collecting Officer and not by the Chief of the Cash Unit
- File of Order of Payment by Cash Unit is incomplete
- Official receipts listed in Report of Cash Collections and Deposits are not sequential



# Sample Internal Control/ Internal Audit Findings

- No policy to safeguard issuance of checks such as prohibition of signing of checks in advance and maintenance of file of names and specimen signatures or initials of persons authorized to approve transactions
- Separation of cash custodian and signing of checks functions was not observed
- Cash reports are prepared monthly instead of daily as required by COA
- No periodic training on cash management control, cash flow and other relevant trainings being provided to personnel concerned
- No policy on rotation of staff in Cash Unit

# Operating Units vs. MD/MU vs. IAS/IAU

Reference	Operating/ Implementing Units	MD/MU	IAS/IAU
<b>Nature and Purpose of Review</b>	<ul style="list-style-type: none"> <li>• Performance review and improvement of operations, processes and activities</li> <li>• Compliance review and improvement of operations, processes and activities</li> </ul>	<ul style="list-style-type: none"> <li>• Review whether ICs are applied at all levels within and across agency and sector</li> <li>• Recommend measures for management improvement</li> </ul>	<ul style="list-style-type: none"> <li>• Appraise whether controls are well designed and properly implemented</li> <li>• Determine adequacy of IC or whether it is achieving objectives</li> </ul>

**Source:** NGICS, p. 41



# Operating Units vs. MD/MU vs. IAS/IAU

Reference	Operating/ Implementing Units	MD/MU	IAS/IAU
<b>Scope, Coverage and Frequency</b>	<ul style="list-style-type: none"> <li>• Performance is reviewed on a regular basis</li> <li>• Operations, processes and activities are periodically reviewed to ensure compliance with current regulations, policies, processes and other requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Organizational structure, manpower, and operations</li> <li>• Existing methods, systems and procedures/ processes</li> <li>• On-going and recurring activities</li> </ul>	<ul style="list-style-type: none"> <li>• Determine extent of compliance</li> <li>• Depends on assessment of risks, effectiveness of on-going monitoring, and adequacy of IC</li> <li>• Takes place “after the fact”</li> <li>• Covers complete cycle of operations to determine control effectiveness over a specific time</li> </ul>

**Source: NGICS, p. 41**





# Operating Units vs. MD/MU vs. IAS/IAU

Reference	Operating/ Implementing Units	MD/MU	IAS/IAU
<b>Actions To Be Taken</b>	<ul style="list-style-type: none"> <li>• Institute process improvements to meet objectives or standards to achieve efficiency and effectiveness in operations</li> <li>• Institute process improvements to achieve compliance with regulations, policies, procedures and other requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Report mgt review results to FMS Head</li> <li>• Submit recommendations for mgt improvement to FMS Head</li> <li>• Conduct trainings on application of improvements</li> <li>• Provide staff supervision over implementation of mgt improvements</li> </ul>	<ul style="list-style-type: none"> <li>• Submit report to HOA or Audit Committee</li> <li>• Advise HOA or Audit Com on matters relating to mgt control and operations audit</li> <li>• Analyze and evaluate mgt deficiencies and assist top mgt by recommending realistic courses of action</li> </ul>

**Source:** NGICS, p. 41



# Internal Audit vs. ISO Audit

## Internal Audit

- Evaluation of management controls and operations performance
- Determination of degree of compliance with laws, regulations, managerial policies, accountability measures, ethical standards and contractual obligations
- Involves appraisal of plan of organization and all coordinated methods and measures

**Source:** PGIAM, p. 5

## ISO Audit

- Assessment of whether or not agency's **quality management system (QMS) conforms** to planned arrangements and requirements of ISO 9001:2008 standards and QMS targets set by organization, and is **effectively implemented and maintained**

**Source:** ISO QMS 9001:2008



# Accomplished ICS and IA Activities

- **Launched PGIAM** in October 2011
- **Forged Agreement with COA** on its assistance in conduct of capacity-building trainings for IAS personnel
- **Developed corps of trainers** from DBM, COA, OP-IAO and Departments/Agencies concerned (i.e., DepEd, DOF, DOH, DOLE, DSWD, CSC, HOR, OMB, Land Bank of the Philippines & PCSO)
- **Prepared PGIAM Trainers' Training Manuals**



# Accomplished ICS and IA Activities

- **Conducted briefings/orientations on NGICS** to various departments/agencies/GOCCs
- **Conducted capacity building trainings on PGIAM/NGICS** to various departments/ agencies/GOCCs
- **Rolled-out NGICS** in **DepEd, DOF, DOH, DOJ** and **DPWH** on limited basis
- **NGICS and PGIAM rolled-out** in **DOLE** (thru ADB TA) and **DSWD** (thru AusAID TA) in 2012, and in **DBM** and **DENR** (thru World Bank TA) in 2013



# Next Steps

- **Continuation of the roll-out of PGIAM** in **17** agencies/GOCCs thru conduct of capacity-building trainings starting on 22 July 2014
- **Completion of organization of IAS/IAU and MD/MU** in departments/agencies/GOCCS concerned



***THANK YOU!***

