

**INTERNAL AUDIT MANUAL
CHAPTER II–INTERNAL CONTROL SYSTEM AND
INSTITUTIONAL ARRANGEMENTS**

1. Internal Control Framework

Pursuant to DBM CL 2008-5, one of the functions of the IAS in relation to internal control is to conduct appraisal of the organization's internal control system to determine whether internal controls are well designed and properly operated. The Management is the one directly responsible for implementing a sound internal control system. IAS is not responsible for establishing such internal controls.

1.1 Objectives of Internal Control

- A. Safeguard assets
- B. Check the accuracy and reliability of accounting data
- C. Adhere to managerial policies
- D. Comply with laws and regulations
- E. Ensure effective, efficient, ethical and economical operations

1.2 Components of Internal Control**A. Control Environment**

- It is the general framework serving as basis for the other four components of internal control.
- It influences the direction and quality of a company's strategies and outcomes.
- It includes the informal, and often intangible, soft controls, such as ethics, integrity, management practices, discipline, and commitment to competence.
- It also includes laws, rules, regulations and managerial policies currently in place to support good governance and accountability.

B. Risk Assessment

- It is the overall process of identifying, analyzing and evaluating relevant risks to the achievement of the control objectives and determining the appropriate response.
- It is the identification, analysis and evaluation of what could go wrong and how to address it.
- Risk identification process includes identifying the causes and sources of the risk, events, situations or circumstances which could have a material impact upon objectives and the nature of that impact.
- Risk analysis consists of determining the consequences and their probabilities for identified risk events, taking into account the presence and the

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effectiveness of any existing controls. The consequences and their probabilities are then combined to determine the level of risk.

- Risk evaluation involves comparing estimated levels of risk with risk criteria defined when the context was established, in order to determine the significance of the level and type of risk.
- It involves the assessment of operations, controls and internal audit risks.

C. Control Activities

- These are the policies and procedures established to address risks and achieve the company's mandate and objectives.
- Control includes any process, policy, device, practice, or any other action which is intended to modify risk.
- These are the mechanisms that management establishes to ensure that their policies and guidelines are carried out, including the processes identified to address risks.
- These must be appropriate, cost effective, comprehensive, reasonable, and must directly relate to the control objectives and mandate of the company.

D. Information and Communication

- It includes the records system which will ensure the transfer of required information to employees and top management, to the public it serves, to other public service organizations, and to its network of organizations and sectors that need the information.
- Information must be shared in a determined format and communicated in a given time period which enables the parties concerned to fulfill internal control objectives and other responsibilities.

E. Monitoring

- It aims at assessing the quality of the internal control systems' performance over time.
- It is done in various degrees and circumstances to ensure that internal controls continue to be applied at all company unit-levels, and are able to achieve the control objectives.
- There are three (3) ways through which monitoring is accomplished:

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- a. Ongoing monitoring which is ingrained in the daily operations and management of the organization;
- b. Periodic separate evaluation of the internal control's effectiveness in order to achieve the desired results through predefined methods and procedures; and
- c. Combination of ongoing monitoring and separate evaluation.

2. Administrative Relationships

The Management disseminates managerial policies through the issuance of guidelines and standards. They are given to provide guidance to personnel in the proper execution of their individual and unit tasks that collectively contribute to the attainment of the company goals.

To operationalize this particular objective, the Administrative Code of 1987 distinguishes the following administrative relationships pertaining to the manner by which company activities may be controlled, supervised and coordinated.

2.1 Supervision and Control

This includes the authority to act directly whenever a specific function is entrusted by law or regulation to a subordinate; direct the performance of duty; retrain the commission of acts; review, approve, reverse or modify acts and decisions of subordinate officials or units; determine priorities in the execution of plans and programs; and prescribe standards, guidelines, plans and programs.

2.2 Administrative Provision

This is limited to the authority of a department/unit or its equivalent to generally oversee the operations of the company and ensure that they are managed effectively, efficiently, ethically, and economically without interference in day-to-day activities.

2.3 Attachment

This refers to the lateral relationship between a department or its equivalent and the attached agency (if applicable) for purposes of policy and program coordination.

The coordination may be accomplished by having the department represented in the governing board of the attached agency or corporation, either as chairman or as a member, with or without voting rights, if this is permitted by the charter; having the attached corporation or agency comply with a system of periodic reporting which shall reflect the progress of programs and projects and having the department or its equivalent provide general policies through its representative in the board, which shall serve as the framework for the internal policies of the attached corporation or agency.