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Revision Date	Rev. No.	Issue Date	Revision History	Prepared by:	Reviewed and Approved by:
	0	July 01, 2013	Initial Issue	Ms. Lenima B. Judan	PPMC Board of Directors pursuant to Board Resolution 2013-7-145
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			Include in the Introduction page, "This Internal Audit Manual has been reviewed by both PPMC Board Audit and Risk Oversight Committee and BCDA Internal Audit Service Office and was approved by the PPMC Board of Directors on July 01, 2013 as per Board Resolution No. 2013-7-145"		

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Ms. Rubilyn P. Cabiles	Hon. Florante S. Gerdan
Signature over Printed Name of the Internal Auditor	Signature over Printed Name of the President and CEO

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INTRODUCTION

Internal audit, a component of the internal control system, is a strategic function in ensuring good corporate governance throughout the bureaucracy and it is recognized that a well-resourced and effective internal audit function can play a key role in the governance arrangements. By providing assurance on the effectiveness of an agency's internal control environment and identifying opportunities for performance improvement, internal audit can make a valuable contribution to achieving the corporate objectives and help manage risks.

The Internal Audit Service Office (IASO) of Poro Point Management Corporation (PPMC) is an office under the Board Audit and Risk Oversight Committee tasked to ensure the implementation of adequate and effective Internal Audit System. The Commission on Audit (COA) in its 2008 Annual Audit Report to PPMC recommended the creation of an Internal Audit Service Office pursuant to Administrative Order No. 70 which was issued to strengthen the internal control system of government offices. The Internal Audit Service Office and the Board Audit and Risk Oversight Committee were created in year 2010. Approval for the creation of the latter was contained in PPMC Board Resolution No. 2010-10-086 dated October 4, 2010.

The purpose, authority and responsibility of the internal audit activity is defined in the Internal Audit Charter, which was approved by the PPMC Board of Directors on July 2, 2012 per PPMC Board Resolution No. 2012-7-41.

This Internal Audit Manual has been reviewed by both PPMC Board Audit and Risk Oversight Committee and BCDA Internal Audit Service Office and was approved by the PPMC Board of Directors on July 01, 2013 as per Board Resolution No. 2013-7-145

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1. PURPOSE OF THE PPMC IASO MANUAL

The PPMC IASO Manual (IA Manual) shall define the policies and procedures that govern the conduct of internal auditing. It shall describe the underlying principles, policies, standards, procedures and processes in the performance of internal audit activity by the PPMC IASO. The concepts and pronouncements of the Philippine Government Internal Audit Manual (PGIAM) and the Attributes and Performance Standards of the International Standards for the Professional Practice of Internal Auditing have been considered in the IA Manual.

Specifically, the purpose of the IA Manual is to:

- a. Provide guidance on all relevant aspects of the internal audit function, including standards and procedures to be followed and adhered to;
- b. Prescribe the standard operating procedures and processes in the performance of internal auditing in PPMC;
- c. Promote the highest level of professional competence in the IASO; and
- d. Provide a basis for measuring audit performance.

The Manual shall be updated and revised/amended when necessary.

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2. THE PPMC IASO CHARTER

2.1 MISSION STATEMENT

The mission of the Internal Audit Service Office is to add value and help improve and accomplish PPMC’s vision and mission by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

2.2 POLICY STATEMENT

The PPMC recognizes the important role of internal audit in adding value to and improving the operations of the company. It shall help strengthen, maintain and support the Internal Audit Service Office as an independent staff unit under the PPMC Board of Directors through the Board Audit and Risk Oversight Committee. The function of the IASO shall be in accordance with the policies established by the provisions of Republic Act No. 3456, as amended by Republic Act No. 4177, otherwise known as the “Internal Auditing Act of 1962”, and its implementing regulations.

2.3 CREATION

The need for internal audit services as a tool for achieving efficient and effective administration and performance of agency affairs and functions has been recognized as early as 1962 when R.A. 3456 was enacted.

The IASO was created in compliance with Administrative Order (A.O.) No. 278 dated April 28, 1992 as amended by A.O. No. 70, dated April 14, 2003.

A.O. No. 70 was issued to strengthen the internal control systems of the government offices, agencies, government-owned and/or controlled corporations, including government financial institutions, state universities and colleges and local government units by creating an Internal Audit Service in their respective offices.

Further, the creation of the IASO is in compliance with the recommendation of the Commission on Audit (COA) to organize an Internal Audit Office as mentioned in the 2008 Annual Audit Report of PPMC. The Bases Conversion and Development Authority (BCDA) approved the funding of the said position in year 2010.

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2.4 INDEPENDENCE

In performing its responsibilities, the IASO must be independent, in fact and perception, of the activities audited. This independence is essential to freely, and objectively carry out the mission of the Office. Independence permits internal auditors to render an impartial and unbiased judgement essential to the proper conduct of the audits.

The internal auditors shall be free of influence by any element in the company, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of an independent and objective mental attitude necessary in rendering reports.

The internal auditors shall not engage in any activity which they would examine, review and appraise in the course of performing their functions or which may be construed to impair their objectivity.

Internal audit shall serve as an advisory function and not a line or operating function. It is not concerned with participation in, authority over or pre-action in the approval of operations or transactions. Being an advisory unit and in consonance with the provision of Administrative Order No. 278, dated April 28, 1992, the IASO shall be prohibited from performing the following functions, which impair independence and objectivity:

1. Pre-audit of vouchers and countersigning of checks;
2. Inspection of deliveries, although the IASO may, as part of its examination, observe the inspection of deliveries and conduct separate inspection as determine in the course of audit engagements;
3. Preparation of Treasury and bank reconciliation statements;
4. Drafting, developing, installing and operating controls, systems and procedures. In exceptional cases, the IASO may, however, assist by way of giving suggestions and recommendations;
5. Conduct physical inventory. The IASO, however may view the plans in advance and observe and test-check the accuracy of counting and summarizing;
6. Maintaining property records; and
7. All other activities related to operation.

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2.5 AUTHORITY

In the discharge of its functions, the IASO shall have the authority to freely review and appraise any and all policies, plans, regulations and procedures and, at all reasonable time, to have access and freely examine records, books, vouchers, files and property of the company which are deemed relevant to the activity under review.

Restriction to these accesses imposed by any employee or Department Head, which prevents the IASO from performing its duties, will be reported immediately to the Board Audit and Risk Oversight Committee, based on circumstances as determined by the Head of the Internal Audit.

2.6 SCOPE OF WORK AND RESPONSIBILITIES

The audit scope will be based on the offices' assessment of risk. Audit coverage should focus on high-risk areas and give review of risk management procedures, internal control systems, information systems and governance processes. This work also involves periodic testing of transaction, best practice reviews, requirements and measures to help prevent and detect fraud.

The activities performed by the IASO shall include but not restricted to:

1. Ascertain whether the system established provides reasonable assurance that the corporate objectives and goals will be met efficiently and economically.
2. Ascertain the extent of compliance with established policies, and applicable laws, rules and regulations which could have a significant impact on operations.
3. Ascertain the extent to which the assets and other resources of the agency are accounted for and safeguarded from losses of all kinds.
4. Reviews and evaluates the soundness, adequacy and application of accounting, financial and other operating controls and promoting the most effective control at reasonable cost.
5. Reviews operations or programs to ascertain whether or not results are consistent with established objectives and goals and whether or not such programs are being carried out as planned.

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6. Ascertain whether the systems adopted are functioning as intended and that the corporate objectives and goals have been achieved.
7. Performs functions of a protective nature, such as prevention and detection of fraud or dishonesty, review of cases involving misuse of agency properties and checking of transactions with outside parties.
8. Evaluates the quality of performance of groups/individual in carrying out their assigned responsibilities.
9. Acts as witness in the conduct of annual physical inventory or in the event of a transfer or turn-over of assets involving change of ownership.
10. Reviews operating systems and recommends corrective actions.
11. Establishes monitoring activities for the purpose of evaluating the levels of compliance on audit recommendations.
12. Performs such other related duties and responsibilities as may be assigned or delegated by the Board Audit and Risk Oversight Committee and the PPMC Board or as may be required by law.

2.7 SPECIAL ASSIGNMENTS

The IASO may be called upon by the Board Audit and Risk Oversight Committee to perform special assignments but it shall not be made to perform activities which will impair or presume to impair its independence or objectivity.

The IASO shall not be made responsible for or be required to participate in the procedures which are essentially a part of regular operating activities or in operations which are the primary responsibility of another unit in PPMC. It shall not made to involve in day-to-day control procedures. Instead, each office shall be responsible for its own internal control, effectiveness and efficiency. This is to preclude the IASO from evaluating, examining, reviewing or auditing activities of which they took part in.

The IASO, in the conduct of internal audit, should maintain objectivity at all times. If independence or objectivity is impaired in fact or appearance, the details of the impairment should be disclosed to appropriate parties.

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2.8 STANDARDS OF AUDIT PRACTICE

The IASO shall serve the PPMC in a manner that is consistent with the International Standards for Professional Practice of internal Auditing (ISPPA), and with professional standards of conduct such as the Code of Ethics of the Association of Government Internal Auditors, Inc. (AGIA), hereby adopted as follows:

1. Observes the Code of Conduct and Ethical Standards for Public Officials and Employees (Republic Act No. 6713), to uphold the time-honored principle of public office being a public trust;
2. Abide by the Constitution and By-Laws of the Association of Government Internal Auditors, Inc.;
3. Exercise independence, honesty, objectivity, and diligence in the performance of his/her duties and responsibilities;
4. Strengthen and maintain close coordination with all allied agencies and organizations both locally and internationally;
5. Exhibit loyalty to the institution and to the public to whom he/she renders services;
6. Perform internal audit services in accordance with the prescribed standards and procedures;
7. Refrain from entering into any activity which may be in conflict with the interest of the government where he/she belongs or which could prejudice his ability to carry out objectively his/her duties and responsibilities;
8. Not solicit or accept directly or indirectly any gift, gratuity, favor, entertainment, loan, or anything of monetary value from an employee, a client, or a customer of the government where he/she belongs;
9. Be prudent in the use of information acquired in the course of his/her duties. He/she will not use any information for personal gain, for building or destroying public image of any official or employee, nor shall make any premature disclosure of information which might lead to speculations;
10. Exercise all reasonable care in presenting audit findings in order to obtain sufficient factual evidence to warrant such observation. He/she discloses all material facts, which, if not revealed,

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could either distort the report of the results of operations under review or conceal unlawful practices; and

11. Continuously improves proficiency, efficiency, effectiveness and quality of his/her services.

2.9 RECORDS OWNERSHIP AND RETENTION

Audit report and audit working papers shall be considered property of the IASO. These should remain under the control of the IASO and should be accessible only to authorized personnel.

Heads of Departments may request access to audit working papers. These requests for access shall be subject to the approval of the Board Audit and Risk Oversight Committee.

Audit reports and working papers shall be retained and stored in hardcopies and in electronic form. Hard copies should be stored in a steel cabinet with safety lock.

3. THE PPMC INTERNAL AUDIT SERVICE OFFICE

3.1 THE ROLE OF INTERNAL AUDIT

The operation of the IASO is primarily directed at improving the internal control of the corporation. Under the Committee of Sponsoring Organization (COSO) Framework, internal control is broadly defined as a process affected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following internal control categories: (1) Effectiveness, efficiency, economy and ethicality of operations; (2) Reliability and accuracy of financial, managerial and operational reporting; and (3) Compliance with applicable laws, regulations, regulations and contractual obligations; (4) Achieving operational objectives and goals; and (5) Safeguarding of assets against loss, wastage or misuse.

The overall objective of the internal audit function is to provide PPMC management with an independent assessment of the quality of the internal controls and administrative processes and to convey recommendations for further improvements.

The Internal Auditor's judgment will be required in applying this information to specific audit assignments. This manual should provide guidance, but it should not inhibit professional judgment, practicality and innovative auditing.

The role of the IASO is anchored on the strategic plan of PPMC.

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3.2 OBJECTIVES

The IASO is guided by the following objectives:

1. To assist the Board Audit and Risk Oversight Committee in accomplishing its statutory and fiduciary responsibilities with regards to the implementation of adequate and effective system of internal control that will help achieve PPMC corporate goals and objectives.
2. To ensure the effectiveness, efficiency, economy and ethicality of operations, reliability and integrity of financial and operational information, the extent to which assets are safeguarded, adherence to managerial policies, and compliance with applicable laws, rules, regulations and contractual obligations.

3.3 INTERNAL AUDIT OPERATING POLICY

3.3.1 NATURE

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a disciplined approach to evaluating and improving the effectiveness of its risk management, control and governance processes.

The IASO activities are to be performed in a manner which provides reasonable assurance that audit work conforms to the *Standards for the Professional Practice of Internal Auditing*, the PPMC Internal Audit Charter, and effectiveness and efficiency procedures designed to control audit work.

3.3.2 ACTIVITY

The activity of internal auditing is primarily one of information gathering, review, analysis, evaluation, appraisal and testing of the degree of compliance with and the adequacy of managerial systems and controls put in place to mitigate risks that exist in achieving corporate objectives.

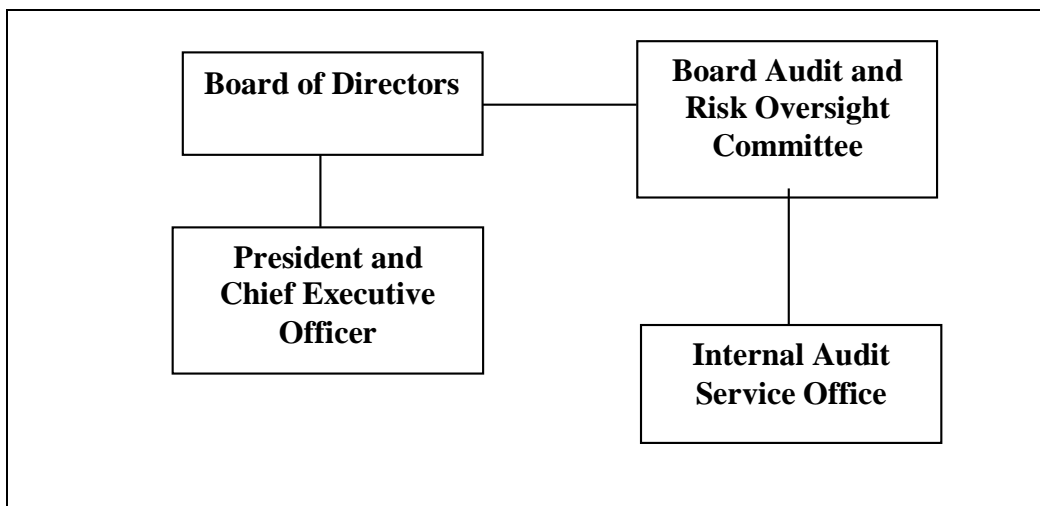
It is a staff advisory function and, therefore, does not exercise authority over other persons in the organization or establish and implement policies and procedures. The internal audit activity is free to review and appraise policies, plans, procedures and other internal controls in any area of the corporation, and to report audit observations and recommendations for improvement to the Board Audit and Risk Oversight Committee. This review and appraisal in no way relieves other persons in the organization of responsibilities assigned to them.

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3.3.3 ORGANIZATION

The IASO is a line function that reports directly to the Board Audit and Risk Oversight Committee of the Governing Board of PPMC, as shown below:



The IASO has an appropriate organizational structure, access to sufficient human resources with the necessary skills and experience and an adequate budget which enables the office to provide the services expected.

3.3.4 PERSONNEL

The IASO shall be staffed with individuals who have the necessary knowledge, skills and core competencies to complete the assigned work. Such persons shall possess professional attributes that qualify them to excel in interpersonal relationships. They shall be inquisitive, self-motivated and have a desire to develop their ability to identify problems and convincingly present recommendations through written reports, oral presentations, and personal discussions.

The table hereunder provides for the qualification standards and functions of each position in the Internal Audit Service Office. It reflects the minimum competency required in the areas of: a) Education; b) Experience; and d) Training that will enable auditors to perform in a competent manner, the functions of the Internal Audit Service Office.

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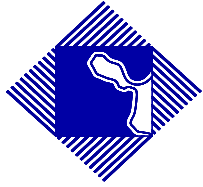
Position	Qualification Standards	Functions
Internal Auditor (Head of Internal Audit)	<ol style="list-style-type: none"> 1. Education: Bachelor's Degree relevant to the job with Masteral Units. 2. Experience: Five (5) years relevant work experience. 3. Training: Forty (40) hours of relevant training. 	<p>Administrative Functions:</p> <ol style="list-style-type: none"> 1. Submits work plans; 2. Submits accomplishment reports; and 3. Submits performance evaluation, targets and ratings of staff. <p>Operational Functions:</p> <ol style="list-style-type: none"> 1. Ensures the implementation of adequate and effective Internal Audit System; 2. Prepares an internal audit plan for the review and approval by the Board Audit and Risk Oversight Committee; 3. Prepares Internal Audit Reports. 4. Establishes the annual goals, objectives and performance targets of the Internal Audit Service Office; 5. Establishes internal auditing standards, guidelines and procedures for the guidance of the internal audit staff; 6. Monitors and evaluates the adequacy and effectiveness of the Corporation's internal control system;

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		<ol style="list-style-type: none"> 7. Receives and reviews report of external auditors and regulatory agencies, where applicable and recommends appropriate compliance measures; 8. Reviews the monthly and annual financial statements of PPMC before submission to the Board; 9. Reviews operating systems and recommends corrective actions; 10. Determines the extent of coordination with the Commission on Audit (COA) to avoid duplication of audit work; and 11. Performs such other duties that are incidental to his/her office or as may be entrusted to him by the Board of Directors.
Internal Audit Assistant (future requirement)	<ol style="list-style-type: none"> 1. Education: Bachelor's Degree relevant to the job. 2. Experience: At least one (1) year relevant work experience. 3. Training: Eight (8) hours of relevant training. 	<ol style="list-style-type: none"> 1. Drafts internal audit plans; 2. Conducts researches to obtain background information on the activities to be audited; 3. Discusses research findings with the Head of the Internal Audit; 4. Drafts report on the results of the audit completed; 5. Assists in the follow-up of actions to

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		<p>determine if audit recommendations have been carried out;</p> <p>6. Assists in the review of monthly and annual financial reports; and</p> <p>7. Performs other official functions that may be assigned.</p>
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3.3.5 AUDIT OBJECTIVE

The objective of internal auditing is to assist management in the effective discharge of their responsibilities by furnishing them with reports setting forth independent and objective analyses, appraisals, recommendations and pertinent comments concerning the activities audited. Internal auditing shall, therefore, be concerned with any phase of government transactions in which it can be of service to management.

In the course of audit examinations, internal auditing shall:

1. Review and appraise the adequacy, soundness, and application of accounting, financial, management reporting and other operating controls and make recommendations for improved practices and techniques where appropriate.
2. Determine that policies and procedures are being interpreted properly and carried out as established, and are adequate and effective, and make recommendations for revision where changes in operating conditions have made them cumbersome, obsolete or inadequate.
3. Determine the reliability, effectiveness and efficiency of procedures designed to ensure the organization is compliant with applicable laws and regulations.
4. Determine whether appropriate procedures exist within operations for self-assessment and continuous improvements.

In carrying out these objectives, the internal auditor's work should be performed with proficiency and due professional care.

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3.3.6 RELATIONSHIP WITH MANAGEMENT

It is the policy of internal auditing to conduct internal audits in a constructive manner. Whenever possible, the assistance of office personnel will be solicited in the planning and performance of the assignment. A spirit of collaborative teamwork between the auditor and those audited will be adhered to.

This attitude shall not alter the fact that internal auditing personnel have full access to all records, personnel, properties, and any other sources of information needed in the performance of an audit. When necessary, special arrangements will be made for the examination of confidential or classified information.

3.3.7 RELATIONSHIP WITH THE COMMISSION ON AUDIT (COA)

The IASO is an integral part of the agency and assists in the management and effective discharge of the responsibilities of the Office without intruding into the authority and mandate of the Commission on Audit (COA) granted under the Constitution. An attitude of cooperation and collaboration best describes the relationship of the IASO and the COA.

The auditors of COA render an opinion as to the fairness of the financial statements. The scope of their examination includes a review of internal controls concerned with the safeguarding of assets and reliability of financial records. On the other hand, the IASO is concerned with a comprehensive continuing program of audits which places emphasis on risk management, control, governance processes and efficient profitable operations.

Coordination of internal audit activities with the COA principally involves checking and working with each other to insure: (1) maximum audit coverage is obtained; (2) there is an exchange of information; and (3) a minimum duplication of effort and expense on routine phases of audit work.

3.3.8 REVIEW, ACKNOWLEDGMENT AND RESPONSE TO INTERNAL AUDIT REPORTS

It is the policy of internal auditing to reach agreement with the affected office concerning the correctness of the facts surrounding the audit findings prior to distribution of the final report.

Where appropriate, corrective action to be taken should be ascertained and included in the report. The Office responsible for the corrective action and the key milestone dates for completion should also be included.

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To assure that agreement is reached as to statements of facts, the audit results to be included in the report are reviewed with the office concerned who later furnished a draft copy of the audit report for review prior to distribution.

After the IASO is satisfied that the audit report is appropriate in the circumstances, final distribution of the report is made. Copies of the report are issued to the appropriate Office.

Audit reports are confidential and therefore have limited distribution. They shall not be reproduced or transmitted to others without the express permission from the Board Audit and Risk Oversight Committee.

3.3.9 FOLLOW-UP ON MATTERS REPORTED BY INTERNAL AUDIT

The appropriate head of departments are responsible for the timely implementation of corrective action for items reported by internal audit, and is to advise the IASO of the status of implementation. If there are delays in implementing corrective action, the IASO should be notified immediately as to the nature and reason for the delay.

The IASO will report to the Board Audit and Risk Oversight Committee any progress on matters previously reported in the audit. Where progress is not satisfactory, the IASO shall consider inviting the responsible office to discuss the matter with senior management and the Board Audit and Risk Oversight Committee.

3.4 INTERNAL AUDIT OPERATING PRINCIPLES

To ensure Internal Auditing meets its goal of effectively serving PPMC, a number of basic operating principles or core concepts have been adopted.

These operating principles are:

1. Value Added Auditing
2. Allocation of Audit Resources to Areas of Risk
3. Individual Professionalism
4. Management's Responsibility for Control
5. Forward Emphasis
6. Objectivity
7. Confidentiality
8. Reasonable Error Level
9. Free Flow of Communication
10. Continual Staff Development
11. Completed Staff Work

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3.4.1 VALUE ADDED AUDITING

Value added auditing seeks to provide management with value-added services by reporting on activities as well as showing through analytical assessments where improvements can be made. Each individual auditor contributes something different, but all contribute toward a common goal. Their efforts must all pull in the same direction, and their contribution must fit together to produce a whole--without gaps, without friction, and without duplication of effort.

Auditing's common goal is to assist management at all levels in the control of the assets and operations for which they are responsible. This is done by providing management with evaluations of the effectiveness of internal controls over accounting, operations, and administrative functions. The auditing function is always to be conducted with the highest standards of business ethics, integrity, and honest dealings in all areas and functions within the company and with all outside parties.

3.4.2 ALLOCATION OF AUDIT RESOURCES TO AREAS OF RISK


One of the *Standards for the Professional Practice of Internal Auditing* states that "The IASO should establish risk based audit plans to determine priorities of the internal audit activity." It is important for internal auditors to remember that the responsibility for the economical and efficient use of resources also applies to the internal auditors themselves.

Internal auditing manpower is a limited resource and, as such, it is critical that such resource be allocated and utilized in a fashion that results in the greatest benefit to the company. In order to effectively allocate auditing manpower over all company assets and operations, the IASO uses an audit risk evaluation approach.

Audit risk is deemed principally to be expenditures or usage of labor, materials, and the custodianship of assets. Determination and quantification of such audit risk is made by line, business process or by audit entity. Audit resources are then allocated in proportion to the peso value of audit risk. Adjustments are made to this allocation based on the judgment and past experience of the IASO.

Under this approach, the audit man-day budget for each audit entity is established. The economic and efficient use of the audit manpower resources dictates that the auditors should put their emphasis in areas of higher peso risk and higher probability of loss.

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3.4.3 INDIVIDUAL PROFESSIONALISM

Modern internal auditing, with its demands for intelligence, creativity, technical competence, and the ability to deal with people at all levels of the company, sets high standards for its practitioners. These standards should never be compromised.

Certain qualities of character are needed to meet the demands made by modern internal auditing. Such qualities include adaptability, understanding, and determination, among others.

The knowledge that audit recommendations are based on facts, and that the facts are placed in their proper perspective, are key traits of professionalism.

The objective evaluation of the materiality of audit findings with no personal ends to achieve, as well as a reputation for being absolutely trustworthy and completely responsible, cap the characteristics of professionalism.

3.4.4 MANAGEMENT'S RESPONSIBILITY FOR CONTROLS

Internal Auditors shall, to the maximum extent possible, have no authority over, or responsibility for, any of the activities audited, and shall not perform accounting or other operational functions outside their office which might require subsequent audit.

Therefore, the IASO neither seeks nor accepts responsibility for line or day-to-day processing functions. It does not wish to place itself in the position of auditing its own performance. Auditing efforts are most effective when they are able to objectively and impartially review, analyze, and interpret information, conditions, procedures, organization and controls.

Controls are primarily the responsibility of management and they are charged with the job of devising, establishing, implementing, and assuring the adequacy, effectiveness and efficiency of controls. Controls should not be implemented simply on the auditor's recommendation.

Controls are instituted to help all levels of management execute their responsibilities in the most effective and efficient manner. Auditing's responsibility is:

1. To review, appraise, test and evaluate the extent of compliance with established controls and procedures.
2. To determine adequacy, effectiveness and efficiency of controls and performance of employees responsible for implementing the controls.

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3. To assist management in developing and establishing controls, especially in and for new systems and situations.
4. To share knowledge regarding controls, weaknesses, and problems resulting from audits, research or ideas.
5. To advise management on the meaning, importance, methodology, techniques and kinds of controls.
6. To recommend when and where controls are needed and evaluate the risk involved in not having them.
7. To determine that proper controls exist in all phases of the Company's activities and that they are effectively administered and implemented.
8. To help management understand that they are primarily responsible for controls and not to depend on Auditing for all control ideas and recommendations.

3.4.5 FORWARD EMPHASIS

In appraising and testing internal controls conceived and implemented by management, Auditing is more concerned with future implications than with the historical record. It is only through placing FORWARD EMPHASIS on findings that internal auditing can be effective in assisting and improving the future performance of management.

When auditors present the number of times items were wrong or did not comply with existing procedure, it is done only as a basis for interpreting recommendations for improvement of future performance. Errors are merely examples of an underlying condition. Internal auditors are more interested in correcting the problem rather than the specific errors.

3.4.6 OBJECTIVITY

In view of the nature of Auditing's role as an independent appraisal activity that functions as a service to management, internal auditors continually strive to be as objective as possible in carrying out responsibilities, and base findings and recommendations on facts rather than impressions.

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3.4.7 CONFIDENTIALITY

The very nature of Internal Auditing, the relationship established between auditor and the auditee, and the type of information frequently provided or uncovered make it **IMPERATIVE** that Internal Auditing continually consider the confidentiality of such information and limit dissemination to a "need-to-know" basis. One indiscretion could compromise Internal Auditing's credibility and undermine its overall effectiveness.

3.4.8 REASONABLE ERROR LEVEL

Any normal business system is not error free. Therefore, a certain level of error may be expected. Only when the error level becomes unreasonably high, develops a trend toward significant increase or has a material financial effect, should internal auditors consider the errors a critical matter and induce management to devote more of their resources to error detection and prevention. Very low error levels could indicate an excessive investment in control.

3.4.9 FREE FLOW OF COMMUNICATIONS

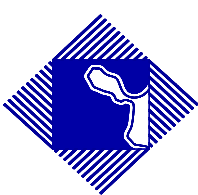
In light of the frequently unstructured, dynamic and demanding assignments performed by the IASO, a team relationship is essential to overall effectiveness. Establishment and maintenance of this team relationship calls for a free flow of both formal and informal communications upward and downward as well as between members of the IASO.

3.4.10 CONTINUAL STAFF DEVELOPMENT

While individual development is essential self-developing, the process is speeded up by:

1. Creating an environment in which it thrives.
2. Offering sufficient challenge, demand, variety and participation to maintain interest at the highest possible level.
3. Providing for quick results in terms of productivity and effectiveness on the job.
4. Requiring a professional approach to the performance of responsibilities.
5. Promoting high performance standards, competitive spirit, and pride in the IASO.
6. Encouraging participation in development activities both outside the Company.

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3.4.11 COMPLETED STAFF WORK

The operating principle of completed staff work requires that every person in the organization perform every task in its own initiative, putting oneself in the position of responsibility and turn over a complete package of work.

This represents the most effective use of staff while rapidly developing their capability to carry out ever-increasing responsibilities. For the operating principle of completed staff work to function effectively, the following must be carefully observed:

1. Know what is wanted or needed (PURPOSE and SCOPE).
2. Tackle the assignment as a whole and accept responsibility for the whole assignment.
3. Coordinate plans with all concerned.
4. Keep the head of office informed.
5. Present a finished package so that the head of office need only approve it to be completed. If staff work is carried out effectively, it may not even be necessary to be there in person to present it. The work should stand alone without further explanation or amplification.

The final test of completed staff work is this - If you were the head of office, would you be willing to sign the work you prepared and stake your professional reputation on it being correct? If the answer is no, the task is not complete.

3.5 FUNCTIONS

Management Audit Division: This section is responsible for conducting separate evaluation on the effectiveness of internal controls management in the operating and support units (business development, airport management, regulatory services, financial management, human resources and administration, infrastructure management, public relations and community development, corporate planning and legal services).

Operations Audit Division: This segment is responsible for the evaluation of the economy, efficiency, effectiveness and ethical conduct of operations including appraisal of operating and support systems.

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Administrative Division: This division is responsible for the efficient flow of documents in the office, takes charge in receiving, filing, safekeeping and disposal of correspondences and communications, and responsible for the general upkeep of the office.

4. AUDIT OPERATIONS, PROCEDURES AND TECHNIQUES

4.1 RISK ASSESSMENT

4.1.1 GUIDELINES OR RISK RANKING CRITERIA

The objective of the risk model is to optimize the assignment of audit resources through a comprehensive understanding of the audit universe and the risks associated with each universe item.

The Audit plan uses an audit risk model to quantify the risk rating of each audit unit. Audits will be scheduled by priority. This represents a departure from past practice which was based on less formal judgment of risk and more on the passage of time since the last audit.

The risk model is based on six factors or elements of risk. They are:

1. Prior audit findings
2. Perceived sensitivity
3. The control environment
4. Confidence in operating management
5. Changes in people or systems, and
6. Complexity.

Each item in the audit universe will be rated on these six (6) factors using a numeric rating of 1 to 3. The ratings are: 1 = "probably not a problem," 2 = "possibly a problem" and 3 = "probably a problem."

The results of these rating judgments are totalled and then multiplied by an audit aging factor. The aging factors used are:

- 100% if a similar audit was completed within 24 months,
- 125% if the audit was completed between 24 and 36 months,
- 150% if the audit was completed between 36 and 60 months,
- 200% if the audit is over 60 months old.

The resulting ratings will range between 6 and 36. Once the ratings are complete, they are sorted into four (4) strata by risk rating.

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The top 10% stratum represents high risk. The next 30% stratum represents sensitive risk. The next stratum, representing 40% of the audit universe, is considered moderate risk. The audit units in the lowest 20% are considered low risk.

The framework for the annual audit plan is then built from samples from these four (4) strata using the following coverage targets. Audit entities considered high risk will be audited 100%. The sensitive risk strata will be audited 50%. A 25% sample will be audited from the moderate risk group, and the low risk group will be audited by selecting a 10% sample. The lower risk groups are sampled to see if the rating process is working and confirm that the levels of risk are appropriately stacked.

While the risk model still requires judgments, the individual ratings are documented and subject to critical review and challenge. The model also promotes uniform definition of each segment's audit universe. Thus, audit risks at each company location can be compared with audit risks at other locations on a subjective basis. This will guide the use and geographic basing of personnel.

Defining the audit universe is the first prerequisite to risk ranking. The audit universe to which this risk assessment will be applied will be determined by the Head of the Internal Audit. Their determination of the audit universe will be based on their knowledge of the company strategic plan and company operations, a review of organization charts and function and responsibility statements of all company organizations, and discussions with responsible management personnel.

Guidelines for the risk ranking criteria are as follows:

1. Prior Audit Findings - Findings in previous audits are one indication of the internal control discipline within an organization. Problems are often characterized by significant control deficiencies, large adjustments, a greater than normal number of findings, and repetitive findings not fixed. Conversely, the lack of findings or timely correction of previous findings indicates control discipline.

2. Sensitivity - This represents an assessment of the inherent risk associated with the unit being rated. It is an assessment of what potentially could go wrong and what the related reaction would be. It could be risk connected with loss or impairment of assets, risk connected with undetected error, risk connected with liability not recognized or not accurately quantified, or risk of adverse publicity, legal liability, etc. The rating of sensitivity also should consider relative size of the universe item, potential exposure and probability.

3. Control Environment - The control environment represents the collective policies, procedures, routines, physical safeguards and employees in place. Essential to a favorable control environment is tone at the top, adherence to documented policies and procedures, reliable systems, prompt detection and correction of errors, adequate staffing and controlled turnover of personnel. Conversely, lack of

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supervision, high error rates, lack of documentation, unmanageable backlogs of work, high turnover, and nonroutine transactions are symptoms of a poor control environment.

4. Comfort with Operating Management - This criterion reflects the confidence that the IASO places in management directly responsible for the audit unit and management's commitment to internal control. Comfort is characterized by factors such as past audit interaction, experience of management in the work environment, and feelings about the quality and level of staffing.

5. Changes in People/Systems - Corporate history indicates that changes impact internal controls and financial reporting. Change usually occurs to effect improvement in the long term, but often has short-term offsets that require increased audit coverage. Changes include reorganizations, business cycle swings, rapid growth, new product lines, new systems, acquisitions and divestitures, new regulations or laws and personnel turnover. Audit units not subject to change require less audit coverage.

6. Complexity - This risk factor reflects the potential for errors or misappropriation to go undetected because of a complicated environment. The rating for complexity will depend on many factors. Extent of automation, complex calculations, interrelated and interdependent activities, number of products or services, the time spans of estimates, dependency on third parties, customer demands, processing times, applicable laws and regulations and many other factors, some not recognized, affect judgments about the complexity of a particular audit.

The refinement of the risk rating model will remain an ongoing priority of Internal Auditing. The objective of the IASO is to assign audit resources in the optimum manner to audits with the greatest risk, savings, or recoveries.

4.2 PLANNING

4.2.1 STRATEGIC PLANNING

PPMC's internal audit activities start with the development of a Strategic Plan which identifies the key audit strategic direction of the IASO for a three-year period.

A. Steps in Strategic Planning:

1. Conduct Baseline Assessment (BA) of the Internal Control System. This is carried out by performing activities such as administering internal control questionnaires/checklist and verifying the results; using flowchart/narrative notes, conducting walkthrough and test of controls. The objectives of the baseline assessment are to:

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- a. Get familiar with PPMC’s operations. The IASO gathers and analyzes information on the corporation’s mandate, objectives, strategies, operating and support systems, relevant laws, rules and regulations, and organizational performance. This involves a table review of the pertinent materials such as previous audit reports.
- b. Identify and document the five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication and Monitoring.
- c. Review key control processes and performance of operating and support systems. The objective of the review is to document controls in key processes of operations within the agency that are critical to the achievement of the control objectives. This is to determine adequacy of internal control and identify gaps, deficiencies or breakdown for potential inputs to the baseline assessment report.

The criteria for the selection of critical processes can include the following:

- A process with an output that is an input to a major final output;
 - A process that makes up significant control procedures; and
 - A process where the financial value of inputs are high.
- d. Gather sufficient information on potential audit areas to be included in the strategic plan.
2. Consider control significance, materiality level and control risk of key processes. This involves the following steps:
 - a. Assess the significance level taking into account qualitative factors, including cumulative effects of errors, legal and regulatory requirements;
 - b. Assess the materiality level taking into account quantitative factors and nonfinancial items that, independent of the amount, may impact on the achievement of the control objectives.
 - c. Identify controls in the potential audit areas.
 - d. Conduct risk assessment on the identified material and significant controls where there may be high risk of impact on key processes of operating and support systems.
 - e. Determine those controls that are vulnerable to be omitted, being improperly implemented or bypassed.

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3. Assess Internal Audit risks

Internal audit risks are those risks or factors which may affect the conduct of the audit and may have an impact on the planned results without neglect and inspite of the exercise of due diligence, e.g., sudden change in political leadership/administration, replacement of the principal, natural calamities, judicial findings and decisions which may affect audit objectives.

Assessment of internal audit risks involves the following steps:

- a. Risk identification
 - Choose the risk identification method/s or technique/s to be used;
 - Identify risk sources and events; and
 - Identify the causes of the risk.
- b. Risk analysis
 - Choose the risk analysis method/s or technique/s to be used;
 - Determine the consequences for the identified risks;
 - Determine the probabilities for the identified risks;
 - Identify the factors that could affect the consequences and probability; and
 - Determine the level of the risks.
- c. Risk evaluation
 - Compare the estimated levels of the risks with the risk criteria; and
 - Determine whether or not the risk or its magnitude is acceptable or tolerable.

4. Formulate Strategic Plan

The IASO prepares the proposed three-year direction of the internal audit activities for approval by the Board Audit and Risk Oversight Committee.

Steps in the formulation of the Strategic Plan:

- a. Analyze the results of the baseline assessment report;
- b. Evaluate the result of the assessment of the significance and materiality and the risk involved in the identified controls that may impact on the achievement of control objectives, if omitted, improperly implemented and/or bypassed; and
- c. Evaluate the result of the assessment of internal audit risks.

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B. Components of the Strategic Plan

1. IASO Objectives

This section provides a statement of the broad audit objectives and directions for internal audit over a three-year period, including the limitations. It focuses on both audit and management goals and is consistent with organization/sector policies and guidelines.

2. Methodology

This section outlines the approach in developing the plan, consisting of the conduct of the baseline assessment of the internal control system, consideration of the control significance and materiality and control risk of key processes in the operating and support systems, assessment of internal audit risks, and consultation with the principal.

3. Organizational Strategic Environment

This section identifies issues and trends relevant to the company which may impact on the achievement of the corporate objectives. Such issues could come from a number of sources including:

- Governance, organizational structure, roles and accountabilities;
- Policies, objectives, and strategies that are in place to achieve the company's objectives;
- Capabilities, understood in terms of resources and knowledge;
- Information systems, information flows and decision making processes;
- Relationships with, and perceptions and values of, stakeholders;
- Organization's culture;
- Standards, guidelines and models adopted by the organization;
- Form and extent of contractual relationships;
- Social and cultural, political, legal, regulatory, financial, technological, economic, natural and competitive environment, whether international, national, regional or local; and
- Key drivers and trends having impact on the objectives of the organization.

4. Fraud and Errors

Fraud encompasses an array of irregularities and illegal acts characterized by intentional and unintentional deception. It can be perpetrated to the detriment of the company and by persons outside, as well as inside, the organization.

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The functional units, not the IASO, are responsible for the deterrence and detection of fraud and error. The IASO, however, may determine whether or not:

- The organizational environment fosters control consciousness;
- Realistic organizational goals and objectives are set;
- Written policies (e.g., code of conduct) exist that describe prohibited activities and the action required whenever violations are discovered;
- Appropriate authorization policies for transactions are established and maintained;
- Policies, practices, procedures, reports, and other mechanisms are developed to monitor activities and safeguard assets; and
- Communication channels provide management with adequate and reliable information.

5. IASO Management Strategies

This section describes the IASO's three-year management strategy to achieve its broad audit objectives considering the emerging trend in the sector.

The strategies, detailed into plans and approaches, shall:

- Address short and long term direction focused on the audit needs of the sector; and
- Describe the capabilities and resources, both dictated by the assessment of internal controls.

Examples of management strategies include:

- Changes in work practices and enhancement of audit methodologies to ensure that internal audit meet the needs of its public and delivers value for money;
- Review of the internal audit professional development program to address new trends in audit;
- Development or introduction of new audit technology;
- Benchmarking exercises or external reviews, as may be deemed appropriate;
- Introduction of secondment programs aimed at augmenting the capacity of the IASO; and
- Skilled and experienced staffing resources to deliver the internal audit annual work plan.

6. IASO Work Strategies and Audit Coverage

This section describes the major focus of the audit function and any audit related activity over the three-year period; and any change that is required to ensure that the audit plan and other activities

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remain relevant to the strategic direction of the company. The section clarifies the audit coverage, as follows:

- The focus of the audit prioritized from the baseline assessment of the internal control system, consideration of the control significance and materiality and control risk of key operating and support processes, and assessment of internal audit risks.
- The audits proposed to be conducted over a three-year period categorized into compliance, management and operations audits, containing the following: audit area; site; and priority.
- Rationale on the greater need for compliance, management or operations audit.

7. Allocation of Audit Resources

This section details the relative allocation of financial and human resources between audit, audit support and any audit related activity over the life of the plan, including the previous year, for comparative purposes.

8. Performance Measures

This section lists the performance measures of the IASO that are used to measure the performance of internal audit and any change in measures or targets over time.

9. Review of the Strategic Plan

This section describes the timeframe and arrangements for the review and update of the plan. The plan covers a three-year rolling period and needs to be reviewed iteratively. It is developed by the IASO and approved by the Board Audit and Risk Oversight Committee.

4.2.2 ANNUAL WORK PLANNING

An Annual Work Plan (AWP) contains the prioritized audit areas from the Strategic Plan and approved by the Board Audit and Risk Oversight Committee which will be focused on during a one-year period, the type and approach of the audit, and the timelines of the same.

The AWP include areas for management audit and operations audit. The basic frame of reference is the strategic objectives established by PPMC and the weight of the expected results from the audit area. If failure to deliver expected results is attributed to a control deficiency in the system, there is a need to conduct a management audit.

Steps in prioritizing potential audit areas:

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- a. Validate the Baseline Assessment Report.
- b. Update consideration of the control significance and materiality and control risk assessment.
- c. Update the internal audit risk assessment.
- d. Prioritize the potential audit areas.

In the preparation of AWP, the IASO takes into consideration previous audit follow-up reports in order to validate the implementation/non-implementation by the units concerned of the approved actions and recommendations. The steps involved are as follows:

- a. Validate the report of the non-implementation/inadequate implementation of preventive/corrective actions.
- b. Validate the report of justification for the non-implementation/inadequate implementation of actions.
- c. Validate the recommendation for possible legal/management action for the non-implementation/inadequate implementation of preventive/corrective actions.

4.2.2.1 AUDIT OBJECTIVES AND PLANNING

To uniformly document the audit planning process, an audit objective and planning checklist will be completed before each audit begins. The Head of the Internal Audit will be responsible for the timely completion of the checklist.

The checklist has been designed to document the following planning information:

1. Reviewing prior audit work papers, prior audit scope and audit reports, and determining specific follow up steps required.
2. Reviewing prior audit time versus findings and conclusions on controls, and determining the impact on the current audit.
3. Assessing current audit risk, and identifying current audit concerns.
4. Coordinating the audit with outside auditors, and determining the effect of their work on current audit scope.
5. Establishing specific audit objectives.
6. Estimating the time and resources necessary to meet the audit objectives.
7. Developing and approving the detailed audit program.

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8. Communicating with all who need to know about the audit.
9. Documenting the rationale for selecting audit entrance- and exit-level management to make sure that the management level selected has the authority to implement the agreed corrective actions.
10. Communicating with management of the unit to be audited regarding the audit objectives, and obtaining their comments and suggestions to facilitate positive audit results.
11. Revising the detailed audit program, if appropriate, to reflect the results of communications with management of the location to be audited, or to reflect the results of the on-site survey.

4.3 AUDIT APPROACHES

Audit approaches or methodology is the framework or outline of a process which provides guidance and control to help ensure the audit objectives are achieved. The IASO uses the following audit approaches in conducting internal audit work activities.

4.3.1 RISK-BASED AUDIT

Risk-based audit methodology focuses on areas of highest risk, thus, it adds greatest value to the company.

Internal control system helps management manage or control the degree of business risk inherent in any business operation. Internal control is a risk management process. Risk is dependent upon people, organization, climate, characteristics, situational pressures, and conditions of opportunity.

Risk-based audit methodology procedures:

1. The IASO determines the key risks or objectives.
2. Identify limits of risk used by management to controlling the processes designed to achieve the objectives.
3. The Internal Auditor conducts initial survey and form hypothesis regarding how well the risk appears to be controlled.
4. Verify through the most cost-effective means the validity of the hypothesis.
5. Report results.

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4.3.2 CONTROL SELF-ASSESSMENT (CSA)

Control Self-Assessment is a relatively new method for examining and evaluating the company's system of internal control. It is an amalgam of traditional internal auditing concepts, risk analysis, and self-assessment approaches.

CSA has the following elements:

1. Front-end planning and preliminary audit work.
2. The gathering of a group of people into a same time/same place meeting, study of relationships among elements of information.
3. Structured agenda which the facilitator uses to lead the group through an examination of the process's risk and controls.
4. Reporting and the development of action plans.

CSA basic philosophy is that control is the responsibility of all employees in the organization. The people who work within the process, including employees as well as the managers of the process, are asked for their assessments of risks and controls in their process.

4.4 TYPES OF AUDIT

1. **Internal Control Audits.** The objective of internal control audits is to apprise management of how adequately a particular system of internal control provides reasonable assurance that objectives are achieved.
2. **Operational/Management Audits.** Stating the obvious, operational audits are audits of operations. They focus on the ability of an organization to achieve its business objectives in the areas of efficiency and effectiveness.
3. **Compliance Audits.** Compliance audits are largely focused on apprising management of the degree of compliance with established policies, laws, procedures, regulations, contractual provisions, etc.
4. **Fraud Audits** (forensic auditing or investigative auditing). Where fraudulent activity is present or suspected, specialized audit activities may be performed to assist management in detecting or confirming the presence and extent of fraud and in providing necessary evidence for legal purpose.

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4.5 INTERNAL AUDIT PROCESSES

4.5.1 Audit Assignment

The Audit Assignment prepared by the Head of the Internal Audit, initiates the start of internal audit activities. It is to be completed before any audit work is done. The IASO assigns the audit name and number, provides direction as to what the audit's objectives are and any special concerns or considerations, determines the audit period, and assigns audit personnel and time budget.

The estimated time budget is initially obtained from the annual audit plan. Any proposed changes to the budgeted hours based upon preliminary work such as review of prior work papers, discussions with the auditee, etc., are requested through revisions.

4.5.2 Auditee Notification

The IASO issues an Audit Notice for the conduct of internal audit work and request documents needed for the initial review of the processes and procedures of the Auditee.

4.5.3 Conduct of the Preliminary Survey

In the Preliminary Survey, the auditor gathers relevant information about the unit in order to obtain a general overview of operations. He/she talks with key personnel and reviews reports, files, and other sources of information.


4.5.3.1 Familiarization

The IASO gathers and analyses information in the agency's mandate, objectives, strategies, operating and support systems functions and structures, relevant laws, rules and regulations, corporate performance and previous audit reports.

Primary source of information about the agency can be obtained through the following documents:

- Internal policies;
- Approved budgets and monitoring reports;
- Audited financial statements;
- Operating procedure manuals, departmental manuals;
- Organization charts and flow charts of processes;
- Annual reports; and
- And other related reports.

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4.5.4 Audit Program Preparation

The audit program should be prepared after the completion of the preliminary survey. The audit program is a detailed plan for the work to be performed during the audit. A well-constructed program is essential to completing the audit project in an efficient manner.

A well-constructed program provides:

1. A systematic plan for each phase of the work that can be communicated to all audit personnel concerned.
2. A means of self-control for the audit staff assigned.
3. A means by which the Head of the Internal Audit can review and compare performance with approved plans.
4. Assistance in training inexperienced staff members and acquainting them with the scope, objectives, and work steps of an audit.
5. The basis for a summary record of work actually performed.
6. An aid to the Head of the Internal Audit making possible a reduction in the amount of direct supervisory effort needed.
7. Assistance in familiarizing successive audit staff with the nature of work previously carried out.

The program consists of specific directions for carrying out the assignment. It should contain a statement of the objectives of the operation being reviewed. For each segment of the audit, the program should (1) list the risks that must be covered in that segment; (2) show for each risk the controls that exist or that are needed to protect against the indicated risk; (3) show for each of the listed controls the work steps required to test the effectiveness of those controls, or set forth the recommendations that will be required to install needed controls; and (4) provide space for initials of auditor completing the audit step, reference to the related audit work papers, and brief comments.

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4.5.5 Conduct of Entry Conference

After completing the preliminary planning stages of the audit assignment, and prior to commencing the audit fieldwork, the Internal Auditor should meet with the head of office concerned and key supervisory personnel. The opening conference provides the opportunity to begin building good relationships. Points that should be discussed during the opening conference include:

1. Scope and objectives - Review the basic scope and objectives planned for the audit. Outline the general audit work plan. Emphasize that the purpose of the audit is to add value to the organization and assist management by providing analysis, appraisals, recommendations, and information concerning the activities reviewed.
2. Audit findings - Explain how audit findings will be handled, e.g., resolution of minor findings, the discussion of all findings on a current basis to permit the auditee to take timely corrective action, the exit conference at the completion of the field work, the review of the report draft, and the distribution of the formal audit report. Discuss current status of prior audit findings.
3. Audit progress - Establish a clear understanding with audited management about keeping their personnel advised of the audit progress and findings. Determine the frequency of progress updates and management levels to be apprised of audit progress and findings. Consideration should be given to providing the auditee with an audit event timeline. This timeline should include estimated dates of fieldwork, interim meetings, exit meeting, audit report issuance, and follow-up audits.
4. Consulting Activities - Ask for suggestions of problem areas where the auditors can be of assistance to management. Auditors can often be in the position to consult with auditee about “best practices” existing in other functions within the organization. (Careful consideration must be given to any suggestions and requests to insure that there is need of audit attention. Do not become involved in functional or operating activities.)
5. Cooperative administration - Inquire about working hours, access to records, available work area for participating auditors, the auditee’s various work deadline requirements, and any other information which will help schedule the audit activities to fit into the office routine with minimal disruption to the audit management personnel.

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6. Introduction and tour - Arrange to meet other personnel the auditor will be working with during the audit. Also arrange for a familiarization tour of the physical facilities. Effective communication at the beginning of the audit fieldwork can significantly influence the atmosphere in which the entire audit is conducted. It can mean the difference between active cooperation and open hostility. It deserves the auditor's careful attention and best efforts.

4.5.6 Fieldwork

The IASO classifies the audit field work into three (3) categories:

1. System analysis and evaluation. Much of the audit work performed is based on Management's system of internal control. The Internal Auditor begins the evaluation of internal control by reviewing the system documentation and capabilities.

Particular emphasis is placed on the assignment of duties, the approval process, and the reporting structure. This information is obtained primarily through interviews and flowcharts.

The Internal Auditor's opinion regarding the adequacy of internal control has a direct relationship to the amount and depth of transaction testing.

2. Transaction testing. To determine if the reported controls are functioning as intended, the Internal Auditor selects samples of documents and inspects them for compliance with stated procedures and practices. The results of these tests provide the Internal Auditor with a degree of assurance regarding the reliability and adequacy of the controls, and a means of measuring operational effectiveness and accountability.

Through these analyses, the Internal Auditor is able to determine if the auditee is achieving its stated mission. The Internal Auditor documents the test samples and results, both positive and negative, in audit work papers. Audit work papers consist of large quantities of paper files stored in notebooks.

3. Progress reporting. The Internal Auditor meets with the head of office/department during the course of the audit field work to discuss audit progress, audit test results, and conclusions and recommendations. The purpose of these meetings is threefold: to clarify any misunderstandings, enlist management's opinion and support in solving any problems discovered, and to ensure timely implementation of recommendations.

The goal of the Internal Auditor is to discuss with management all significant weaknesses discovered during the course of the audit field work, and to achieve an agreement regarding corrective action to be taken by management prior to the release of the final audit report.

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4.5.6.1 Data Gathering

The IASO gathers information to obtain an overview of the company's operations, practices, and policies. The information gathered is generally from discussions with heads of offices and personnel, and reviews of reports and files maintained in the department/office. The information gathered shall refine the audit objectives and the audit procedures required to accomplish them.

4.5.6.2 Evaluation and Analysis of Gathered Data

Evidential data and information obtained during the course of fieldwork provides the documented basis for the auditor's opinions, observations, and recommendations as expressed in the audit report. The Internal Auditor is obligated by professional standards to act objectively, exercise due professional care, and collect sufficient, competent, relevant, and useful information to provide a sound basis for audit observations and recommendations.

Auditors must obtain all evidence necessary for the effective completion of the audit. The decision on how much evidence is enough and what type to seek requires the exercise of the auditor's judgment based on experience, education, reasoning and intuition. A thorough knowledge of the concepts underlying audit evidence will help the auditor to improve the audit quality and efficiency.

4.5.6.3 Audit Work Paper Review

An important part of the IASO's quality control program is a timely and thorough review of work papers by auditors assigned to each audit. The purpose/objective of audit work paper review is to evaluate the adequacy of audit work performed and to determine if the predetermined audit objectives have been met. The term "audit work paper" in this context applies to both hard copy audit work papers and to electronic work.

Audit work papers must be a set of stand-alone documents from which the reader will be able to identify the actions taken by the auditor(s) to satisfy the objectives of the detailed audit program and prepare the final audit report. A clear audit trail must exist. Documentation of work paper review is the responsibility of the Internal Auditor.

1. Accuracy. The auditor must always keep in mind that the report must be completely factual. Every statement, every figure, and every reference must be based on hard evidence. Statements of fact must carry assurance that the auditor personally observed or validated every fact stated in the report.
2. Clarity. Clarity means conveying to the reader what was in the auditor's mind when the report was written. Lack of clarity in the mind of the auditor is the prime impediment to clear writing.

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If the auditor does not have a firm grasp of the subject, then writing should not begin until more fieldwork or research is performed.

3. Conciseness. Conciseness means cutting out what is superfluous and eliminating what is irrelevant and immaterial. The words, sentences, and paragraphs that do not help the auditor get across the central theme of the report should not be included in the report.
4. Tone. The report should maintain an objective professional tone. The auditor needs to consider the report's effect upon the area that is being reviewed. The report should always avoid the use of slang words and technical terms that would not be familiar to all individuals receiving the report. Use of inflammatory or unnecessarily harsh wording should be avoided.

There may also be occasions where the Internal Auditor should consider an interim review of work papers, especially if some of the auditors assigned are relatively new, or if early in the audit significant findings are reported.

4.5.6.4 Attributes of a Well-Developed Audit Finding

1. Statement of Condition

The condition identifies the nature and extent of the finding or unsatisfactory condition. It often answers the question: "What was wrong?" Normally, a clear and accurate statement of condition evolves from the auditor's comparison or results with appropriate evaluation criteria.

2. Criteria

This attribute establishes the legitimacy of the finding by identifying the evaluation criteria, and answers the question: "By what standards was it judged?" In financial and compliance audits, criteria could be accuracy, materiality, consistency, or compliance with applicable accounting principles and legal or regulatory requirements. In audits of efficiency, economy, and program results (effectiveness), criteria might be defined in mission, operation, or function statements, performance, cost/budget standards, contractual agreements, program objectives, policies, procedures, or other external sources of authoritative criteria.

3. Effect

This attribute identifies the real or potential impact of the condition and answers the question: "What effect did it have? The significance of a condition is usually judged by its effect. In operational audits, reduction in efficiency and economy, or not attaining program objectives (effectiveness), are appropriate measures of effect. These are frequently expressed in quantitative terms; e.g., pesos, number of

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personnel, services offered, number of transactions, or elapsed time. If the real effect cannot be determined, potential or intangible effects can sometimes be useful in showing the significance of the condition.

4. Cause

The fourth attribute identifies the underlying reasons for unsatisfactory conditions or findings, and answers the question: "Why did it happen?"

If the condition has persisted for a long period of time or is intensifying, the contributing causes for these characteristics of the condition should also be described.

Identification of the cause of an unsatisfactory condition or finding is a prerequisite to making meaningful recommendations for corrective action. The cause may be quite obvious or may be identified by deductive reasoning if the audit recommendation points out a specific and practical way to correct the condition. However, failure to identify the cause in a finding may also mean the cause was not determined because of limitation or defects in audit work, or was omitted to avoid direct confrontation with responsible personnel.

5. Recommendations

This final attribute identifies suggested remedial action and answers the question: "What should be done?"

The relationship between the audit recommendation and the underlying cause of the condition should be clear and logical. If a relationship exists, the recommended action will most likely be feasible and appropriately directed.

Recommendations in the audit report should state precisely what needs to be changed or fixed. How the change will be made is management's responsibility. More generalized recommendations (e.g., greater attention be given, controls be re-emphasized, a study be made, or consideration be given) should not be used in the audit report, but they are sometimes appropriate in summary reports to direct top management's attention to compliance-type findings disclosed in several areas.

Unless benefits of taking the recommended action are obvious, they should be stated. Whenever possible, the benefits should be quantified in terms of additional revenue, lower costs, or enhanced efficiencies. The cost of implementing and maintaining recommendations should always be compared to risk.

Recommendations should be directed to the individual responsible for taking corrective action.

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6. Summary

Well-written audit findings should result in recommendations that add value to the organization and include: the nature of the findings, the criteria used to determine the existence of the condition; the cause of the condition; the significance of its impact; and what the auditors think should be done to correct the situation. Fully developed findings containing each of these five attributes are easily understood and convey impact and significance to management.

Each finding should be supported by an Audit Finding Data Sheet filed in the working paper.

4.5.7 Conduct of Exit Conference

The purpose of this procedure is to define certain events which should take place prior to and during the exit conference.

During the audit:

1. Discuss all aspects of a potential audit finding with the person performing the function.
2. Fully develop all audit findings using the Audit Finding Data Sheet or similar documentation.
3. Discuss fully developed audit findings and recommendations with the responsible head of office/unit. Also discuss any items requiring follow-up and document the auditee's response to the finding.

Prior to the exit conference, a presentation strategy should be developed. Related issues may be combined, and a presentation sequence should be developed. Avoid initial points which establish a tone of auditee's disagreement. Findings should be grouped into two categories and presented as such.

1. Reportable Items--receive top management visibility.
2. Memo Comments--less serious issues which will be communicated verbally or by informal memo to the head of office/unit concerned.

The IASO is responsible for scheduling the exit conference. The goal is to have the auditee present at the meeting. Exit conferences should be held prior to the last day of fieldwork or in the early morning of the last day of fieldwork to provide time for the auditee requested follow-up.

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The IASO will determine attendance at the exit conference. The purpose of the exit conference is to inform management about the audit results and the report process, reach agreement on findings, and learn of corrective action measures planned or taken to correct any deficiencies disclosed by the audit.

The IASO shall review the audit objectives, scope, and reporting process before discussing the audit findings. Where practical, audit findings and recommendations should then be discussed by the individual who developed the audit findings or audited that area. Consideration should also be given to noting any commendable practices or procedures observed. The IASO shall document all discussion during the meeting. An Exit Conference Summary Sheet should be prepared for each finding discussed during the exit conference.

4.5.8 Final Audit Report Preparation

The final audit report is prepared based on the results of the exit conference. The auditee's response to each recommendation is also incorporated in the final report if it is available within a reasonable time period following the discussion of the draft meeting. Confidential copies of the final report are distributed to the head of office of the area audited and the Office of the President. The Head of Internal Audit will present the final audit report to the Board Audit and Risk Oversight Committee, and then to the PPMC Board.

The final audit report contains the following parts:

- Table of Contents;
- Executive Summary;
- Detailed Audit Findings;
- Management Comments and Team's Rejoinder;
- Monitoring and Feedback on Prior Year's Recommendations;
- Recommendations; and
- Appendices.

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4.5.9 Audit Report Follow-Up

The *Standards for the Professional Practice of Internal Auditing* specifically addresses follow-up in Standard 2500. One of the primary responsibilities of professional auditors is to determine that the auditee takes corrective action or recommendations. This applies in all cases except where "senior management has accepted the risk of not taking action."

Being an integral part of the internal audit process, follow-up should be scheduled along with the other steps necessary to perform the audit. However, specific follow-up activity depends on the results of the audit and can be carried out at the time the report draft is reviewed with concerned management personnel or after the issuance of the report.

Follow-up activities may generally be broken down into three areas:

1. Casual-This is the most basic form of follow-up and may be satisfied by review of the auditee's procedures or an informal telephone conversation. Memo correspondence may also be used. This is usually applicable to the less critical findings.
2. Limited follow-up typically involves more auditee interaction. This may include actually verifying procedures or transactions and, in most cases, is not accomplished through memos or telephone conversations with the auditee.
3. Detailed follow-up is usually more time-consuming and can include substantial auditee involvement. Verifying procedures and audit trails, as well as substantiating account balances and computerized records, are examples. The more critical audit findings usually require detailed follow-up.

Follow-up scheduling can begin when corrective action is confirmed by acceptance of an audit recommendation or when management elects to accept the risk of not implementing the recommendation.

Based on the risk and exposure involved, as well as the degree of difficulty in achieving the recommended action, follow-up activity should be scheduled to monitor the situation or confirm completion of the changes that were planned. These same factors establish whether a simple telephone call would suffice or whether further audit procedures would be required. At the end of each quarter, a summary follow-up report is prepared. This report reflects all current period findings with appropriate comments to reflect end-of-quarter status.

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Additionally, this report highlights all outstanding findings from prior periods and their status. The intent of this summary report is to track all findings so that they are appropriately resolved.

4.6 REQUESTS FOR SPECIAL AUDIT

FRAUD/IRREGULARITIES/INVESTIGATIONS

Auditors will be familiar with the organization’s fraud policy (as appropriate) and be alert to situations involving possible fraud or irregularities. In cooperation with the Legal Office, the following guidelines will be followed if such a situation is encountered.

If shortages or irregularities are found, carefully avoid openly accusing anyone.

Contact the IASO, and provide the following details:

1. The name(s) of the employee(s) who has/have knowledge of the situation.
2. The approximate peso amount of the suspected or potential fraud or irregularity.
3. A brief description of the evidence which substantiates the suspected or potential irregularity.

Maintain confidentiality about possible shortages/ irregularities/ fraud until the IASO has approved an investigation plan.

The IASO will consult with the Legal Office regarding the investigation plan and the appointment of an investigation team.

The IASO will provide additional instruction if a full investigation is indicated

5. PERFORMANCE APPRAISAL

The Board Audit and Risk Oversight Committee is responsible for reviewing the performance of the IASO. Periodically assessing performance and addressing opportunities for improvement can help maximize the efficiency and effectiveness of the internal audit function.

Steps in Performance Evaluation:

1. Determine Key Performance Indicators (KPIs) that are aligned with the strategic and annual work plan of the IASO. KPIs include measurements of the IASO accomplishment per audit engagement, such as:
 - a. Timely completion of each audit engagement

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- b. Benefits exceed the cost of audit;
- c. Number of audit findings approved by the Board Audit and Risk Oversight Committee;
- d. Number of recommendations implemented by the auditee;
- e. Number of audit support activities undertaken; and
- f. Over-all contribution made by IASO.

2. Design Performance Monitoring Reports

The IASO designs the performance monitoring report forms to collect data in between and during each audit engagement aligned with the KPIs.

3. Prepare Evaluation Report

The IASO prepares an evaluation report on its performance after an audit engagement for the information and advice of the Board Audit and Risk Oversight Committee.

6. RECORDS MANAGEMENT

6.1 SECURITY AND CONTROL OF WORK PAPERS

6.1.1 Physical Control

Work papers are the auditors' property and should be kept under their control. The auditors should know exactly where manual work papers and supporting documents are during the conduct of the audit. When not in use, they should be kept in a locked file or otherwise secured so they are not readily available to persons unauthorized to use them. Access to electronic workpapers should be controlled via electronic data processing security controls (passwords, shared file controls, etc.).

6.1.2 Storage

The most recent set of work papers for each project should be kept in the Department's central files. Work papers are usually filed by cycle and by audit title (or other specific designation) within the cycle. Maintaining an index of all files in the central file is advised. Files removed should be recorded on the appropriate sign-out sheet. The current electronic work paper files should be maintained in a directory of active audits. Each audit should be segregated in sub-directories. Adequate back-up routines should be established for all electronic files.

Prior work papers may be filed in a centralized record retention. A designated individual should be assigned to maintain a list of work papers sent to record storage. A destruction date should be placed on each carton sent to storage. Electronic work paper files from prior audits should be moved to a directory for inactive audits.

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6.1.3 Retention

Work papers should be retained seven years (depending on industry, regulatory constraints, etc.) after the date of the report.

7. MISCELLANEOUS PROVISION

Any amendments affecting the provisions of this Manual shall be subject to the approval of the PPMC Board through the Board Audit and Risk Oversight Committee.

8. REFERENCES

- Philippine Government Internal Audit Manual
- Institute of Internal Auditors (IIA) Standards
- National Guidelines on Internal Control System
- Department of Budget and Management Circular Letter No. 2008-8, October 23, 2008
- Republic Act 3456, otherwise known as Internal Auditing Act of 1962
- Republic Act 4177
- Administrative Order No. 278 dated April 28, 1992
- Administrative Order No. 119 dated March 29, 1989
- Memorandum Order No. 277 dated January 19, 1990
- Standards for the Professional Practice of Internal Auditing References

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