

CRITICAL THINKING WORKSHOP

(One and one-half hours Workshop for IAs, Online)

Institute of Internal Auditors - Philippines

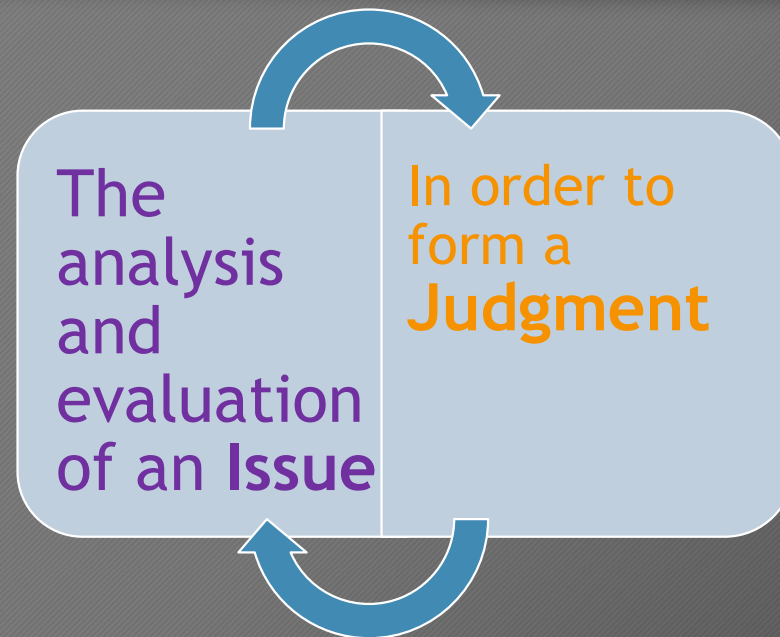
YOUNG INTERNAL AUDITORS SUMMIT: FUTURE LEADERS ADAPTING TO NEW LANDSCAPE

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Former Member-Board of Directors, BAIPHIL

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CRITICAL THINKING (simplified concept)

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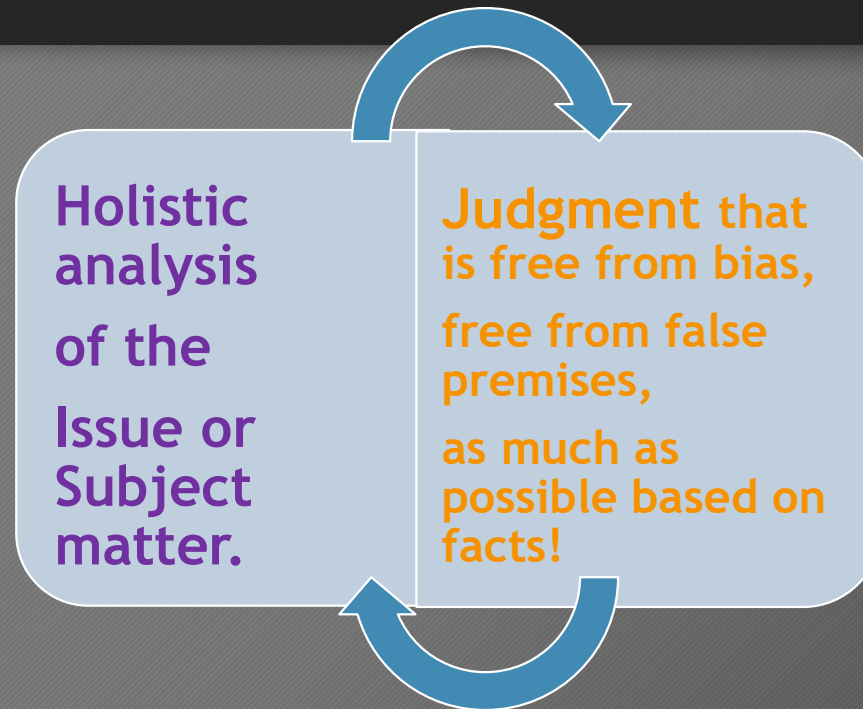


You may please refer to www.global.theiia.org for the professional standards and guidance as regards the professional competency framework, and detailed discussion on Critical Thinking in the 2018 Global Knowledge Brief.

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CRITICAL THINKING

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Critical Thinking and the Internal Auditor's Mindset

Illustrative Situation:

- A. Analyzing the IA's database of the company-wide Audit Universe vis-à-vis the Board-approved Table of Organization and recent organizational changes, *to know if IA's inventory of Audit Universe is complete and valid.*

The IA Head or IA Management is eventually expected to make a Decision or Conclusion, on the possible expected key results of critical thinking process:

- that the IA's inventory of Audit Universe has been incomplete and not valid,*
- That the IA Head / IA Management possibly agreeing to see the results of the analysis pointing to certain auditable areas, which have been missed in prior years' Annual Audit Plans. A rectification would then ensue.*

Critical Thinking and the Internal Auditor's Mindset

Illustrative Situation:

B. Risk-assessment of IA's inventory of the Audit Universe (as validated),

- ✓ to know which of the hundreds of auditable units, systems, or end-to-end business processes do need priority examination by IA, and
- ✓ to know which priority units are for inclusion in the Annual Audit Plan, as well as
- ✓ to know if the IA's Risk Factors will need some revision,
- ✓ to know if suitable risk-based alternative audit approaches would be feasible for areas of the organization that have upgraded their risk rating.

The IA Head or IA Management is eventually expected to make a Decision or Conclusion, on the possible expected key results of critical thinking process:

- ❑ *That the IA's Risk Rating Factors for the company-wide Audit Universe may need important changes; or*
- ❑ *That many BUs may receive their Upgraded Risk Ratings from Risk Management Group, from Regulatory Compliance Group, and from Internal Audit (from previously high-risk ratings) thus no longer requiring the full-scope audit approach that was applicable to high-risk units.*
- ❑ *That there may be lesser need for full scope audits in Annual Audit Plan, of the given year. Also, that the frequency of including the said BUs in the Annual Audit Plan could then be lessened, in line with the Company's Insurance covenants.*
- ❑ *and possibly the alternative risk-based approaches may become feasible; there may be a need to convince the Audit Committee and the Insurance Provider that the limited audit approach or spot audit approach could replace the full scope audit approach, for qualified BUs. (is this good news to IA?)*

CRITICAL THINKING and the INTERNAL AUDITING CORE PROCESSES (IA-CP)

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IA-CP-1. Annual Risk Assessment of the Audit Universe and Development of the Annual Audit Plan for the whole Company / Organization.

IA-CP-2. Conduct of Audit Engagements on prioritized Auditable Units to achieve the Audit Objectives.

IA-CP-3. Audit Issues Monitoring and the IA Team's Closure of the Satisfactorily Resolved Issues.

CRITICAL THINKING and the INTERNAL AUDITING CORE PROCESSES

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IA-CP-4. IA Budgetary Monitoring. IA Authorization of Advances. IA's Liquidation of Cash Advance. Reporting of significant variances;

IA-CP-5. Special Audit Engagement. Fraud Audit Investigation Process of IA.

IA-CP-6. KRI Reporting of IA. RCSA Self-Assessment of IA . Unit Compliance Officer of IA for Regulatory Self Assessment of IA

CRITICAL THINKING and the INTERNAL AUDITING CORE PROCESSES

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IA-CP-7. Reporting to AuditCom, monthly or quarterly.

IA-CP-8. Managing/Directing the IA Personnel. KRAs/Goal-setting for all IA Personnel. Annual performance review of all IA Personnel. Training & Development to meet Competency Standards.

IA-CP-9. IA Readiness Processes for Regulatory Examinations

CRITICAL THINKING and the INTERNAL AUDITING CORE PROCESSES

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C.P.-1. Annual Risk Assessment of the Audit Universe to produce the Annual Audit Plan

CRITICAL THINKING ISSUE. (ILLUSTRATIVE EXAMPLE):

1.1. There are several Auditable Units in an entire Company, and it is imperative that Internal Audit (IA) prioritize only the High-Risk Rated (and certain lower-than-high-risk) Business Units (BUs) or end-to-end Business Processes for audit examination within the pertinent Audit Cycle or earlier, in line with IA Policy.

1.2. On top of priority BUs that IA has identified, there are still incoming new Requests for an Audit, such as those requests by the Board or Senior Mgt., by Regulators or arising from material Fraud Incidents. However, only those with criticality as to financial loss exposure, reputational risk exposure and legal risk exposure of the Company will have to be included (added) to the Annual Audit Plan, subject to the final approval of AuditCom, per IA Policy.

CRITICAL THINKING and the INTERNAL AUDITING CORE PROCESSES

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C.P.-2. Conduct of Audit Engagements and complete the Goals of IA in the Annual Audit Plan

CRITICAL THINKING ISSUE (ILLUSTRATIVE EXAMPLE):

- 2.1. The IA Management will need to determine what nature of Audit Strategy will IA develop on the so-called focus areas of the prioritized business unit? There are several auditable processes -- and the related products, systems / databases, transactions, reports, personnel accountabilities-- but not all shall be audit tested, since risk-based audit. Moreover, the CAE may need to evaluate the level of training for the Audit Examiners who will be expected to proactively formulate, develop, customize Audit Strategy or APGs as unforeseen factors happen on the field that are not yet captured in the standard APGs or Audit Strategies.
- 2.2. Out of the several observations, interview results, CAATs results, pieces of audit evidence gathered during the audit engagement, the IA must employ critical thinking as to which of these facts and evidential matter will be used by IA as the logical basis for IA's Overall Assessment that the Audit Objectives of the Engagement have been addressed.
- 2.3. The IA's Overall Conclusion / Opinion must also employ a risk-based audit rating criteria that must have been discussed upfront with Auditee Management. (It is no longer a demerit system!) Risk-based Audit Rating Frameworks may be developed in-house.

CRITICAL THINKING IN FRAUD AUDIT EXAMINATIONS REQUIRED/REQUESTED OF IA

• ILLUSTRATIVE EXAMPLE. CRITICAL THINKING FOR “QUANTUM” IN FRAUD AUDIT EXAMINATION.

TITLE OF CASE OR INCIDENT: _____		REF. REPORT DATE: _____		
NATURE	CRITERIA	INVOLVEMENT OF THE BANK PERSONNEL	AMOUNTS EXCLUDED	AMOUNTS INCLUDED
Discrepancies in Booked Cash Accountabilities in the FS, of Teller/Vault/ Other Custody VS. Cash Reports signed off by Culpable Person/s	Confirmed through actual cash count	a. Principal: _____ b. Secondary: _____	PHP	PHP
Discrepancies in Booked Asset or Liability Value in the FS, VS. the Tampered Certificates or Instruments being claimed by client/investor	A. Cash exchanged in bank premises? or B. Cash exchanged hands outside of bank premises? C. Express Authority by client / With evidence? D. Unauthorized by client/ No evidence?	a. Principal: _____ b. Secondary: _____	PHP	PHP
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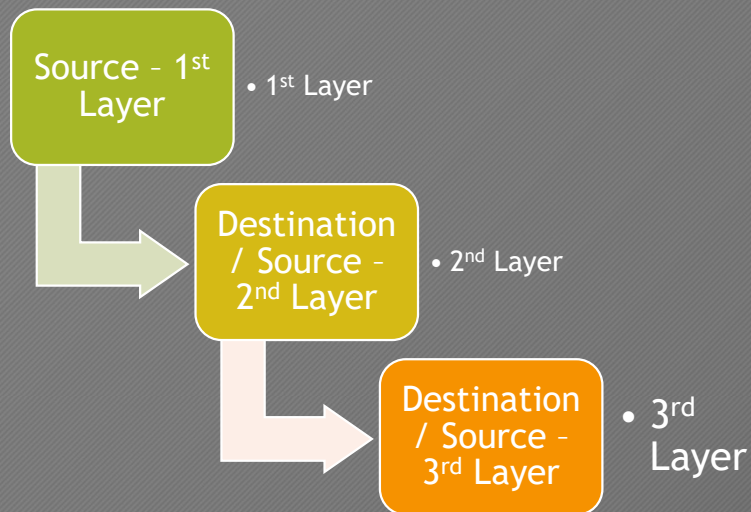
CRITICAL THINKING IN FRAUD AUDIT EXAMINATIONS REQUIRED/REQUESTED OF IA

- **ILLUSTRATIVE EXAMPLE. CRITICAL THINKING FOR “CULPABILITY” IN FRAUD AUDIT EXAMINATION.**

NAME OF PERSON INVOLVED: _____ FUNCTION/POSITION TITLE: _____				
CRITERIA OF CULPABILITY - Policy / Rules / Code of Conduct	SUBJECT OF THE CULPABILITY	COUNT	REMARKS BY SUBJECT INVESTIGATED	REMARKS OF THE AUDITOR & OTHER INVESTIGATORS
(Specific provision excerpt & Ref No. Section/ Paragraph)	(Type of the Instrument/ Transaction/Documentation; Activity; Required Control Action - wherein the culpability is found)	(Number of Times Committed or Violated or Control Not Performed)	(Person admitted; Not yet admitted; Why he/she was involved; Relevant remarks in the Interview Sheets or Affidavits)	(Specific evidence by the Auditor or other Investigator or Outsourced Expert)

CRITICAL THINKING IN FRAUD AUDIT EXAMINATIONS REQUIRED/REQUESTED OF IA

• ILLUSTRATIVE EXAMPLES. CRITICAL THINKING IN FOLLOW-THE-MONEY FLOWS, SCHEME 1.



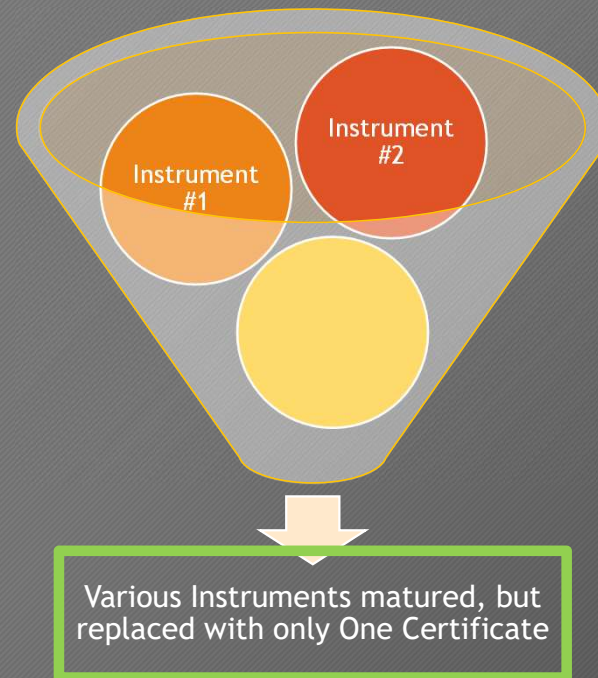
• ILLUSTRATIVE EXAMPLES. CRITICAL THINKING IN FOLLOW-THE-MONEY FLOWS, SCHEME 2.



CRITICAL THINKING IN FRAUD AUDIT EXAMINATIONS REQUIRED/REQUESTED OF IA

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- ILLUSTRATIVE EXAMPLE. CRITICAL THINKING IN MULTI-INSTRUMENTS FRAUD



CRITICAL THINKING and ROOT CAUSE ANALYSIS

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Why 1

Why is Customer M complaining that their Purchase Order for our No.1 Product has remained unserved?
ANSWER: Because the Production Line was not issued ON TIME with a very critical raw material that was not available in the Materials Inventory.

Why 2

- Why did the Material Store run out of this critical raw material, despite our company having a re-order point system that triggers ordering of materials from main supplier?
- ANSWER: The Purchasing Officer was not able to approve online the said re-order transaction.

Why 3

- Why was the Purchasing Department unable to approve the re-order transaction on time, per the SLA?
- ANSWER: The Purchasing Officer had an emergency confinement and did not have time to make a turnover to the Alternate Approver.

Why 4

- Why did it take too long for the Alternate Approver to approve online the Materials re-order transaction?
- ANSWER: The Purchasing System's re-order module could not proceed because the Alternate Approver had not been set up in the Approver Limits module to have a larger limit as that of the Purchasing Officer.

Why 5

- Why was the Larger Limit not the one assigned in the system to the Alternate Approver?
- ANSWER: The Company Policy has stated that the larger limit will be IMMEDIATELY assigned to the Alternate Approver when the need arises.

CRITICAL THINKING and ROOT CAUSE ANALYSIS

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ROOT CAUSE ANALYSIS AND VULNERABILITIES MAPPING STRATEGY

What VULNERABILITIES, on the part of the Company and its personnel,
may POINT TO THE ROOT CAUSE

Internal
Control Policy
not in place

Inherent
Limitations of
Internal
Control

Supervisors &
Checkers not
effective;

Management
Control and
Oversight not
effective

Weakness in
the design of
system
controls or of
the manual
control
process.

Assigned
personnel failed
to faithfully
comply with the
required internal
control
procedures,
rules, and laws.

Personnel
performed
acts “outside
of their
authority” or
“without
right”

Human
weakness:
Collusion;
Fear;
Greed;
Ignored
Values;

Other
Motives.

The LAST
POINT OF
CONTROL is
the PERSON
himself.

LEARNING ASSESSMENT. GROUP ACTIVITY GUIDELINES

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- Attendees are divided into 8 groups, at least 18 members per group (pre-assigned).
- Per group should appoint a Leader, Secretary who will prepare the required output in Powerpoint (or Word), and Presenter(s) who will present the output of the workshop.
- Each group will be transferred to the break-out rooms and given 20minutes to discuss and prepare their presentation.
 - While at the breakout room, please do a photo-op including all group members and include in your slides.
- After that, all attendees will be transferred back to the main room and each group have 5minutes to present their output.

CRITICAL THINKING IN DECISION MAKING (EXAMPLE: IA OUTSOURCING) LEARNING ASSESSMENT: GROUP ACTIVITY FOR GROUP 1, and GROUP 6.

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GROUP ACTIVITY WORKSHOP FOR GROUP 1, and GROUP 6.

STATEMENT OF THE ISSUE: IA has limited resources to handle all of the priority Auditing Projects in the approved Annual Audit Plan. The CAE shall have to determine: Which Audit Projects could be outsourced? Why the IA resources cannot handle those audit engagements?

The CAE needs to present to the Audit Committee a meaningful Proposal for Outsourcing IA Projects, so that provide IA with sufficient resources and ensure the achievement of the Annual Audit Objectives.

Your Group has been requested by the CAE to help her develop a good presentation deck for AuditCom.

REQUIRED OUTPUT OF THE GROUP ACTIVITY: Group 1, and Group 6.

- A. State what nature of factual information shall be included in Internal Audit's presentation to the AuditCom regarding the Proposal for IA Outsourcing.
- B. State what specific matters related to IA outsourcing should be in the AuditCom Agenda as "Matters for Approval" by AuditCom.
- C. State what possible means of "Knowledge Transfer" in IA Outsourcing could be feasible, considering that the auditors are spread thinly because of several audit projects. State what features of "Knowledge Transfer" could be considered as "win-win" for the IA organization.

CRITICAL THINKING IN DECISION MAKING (EXAMPLE: IA OUTSOURCING) LEARNING ASSESSMENT: GROUP ACTIVITY FOR GROUP 1, and GROUP 6.

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GROUP ACTIVITY WORKSHOP FOR GROUP 1, and GROUP 6.

REFERENCE: Please see below, excerpts of BSP Circular 871 / MORB Sec.XI86, which describe the regulatory conditions (or limitations) for Internal Audit Outsourcing for Banks.

This material is being provided for our Participants who work in the banking industry.

BSP Circular 871 / MORB Sec.XI86.

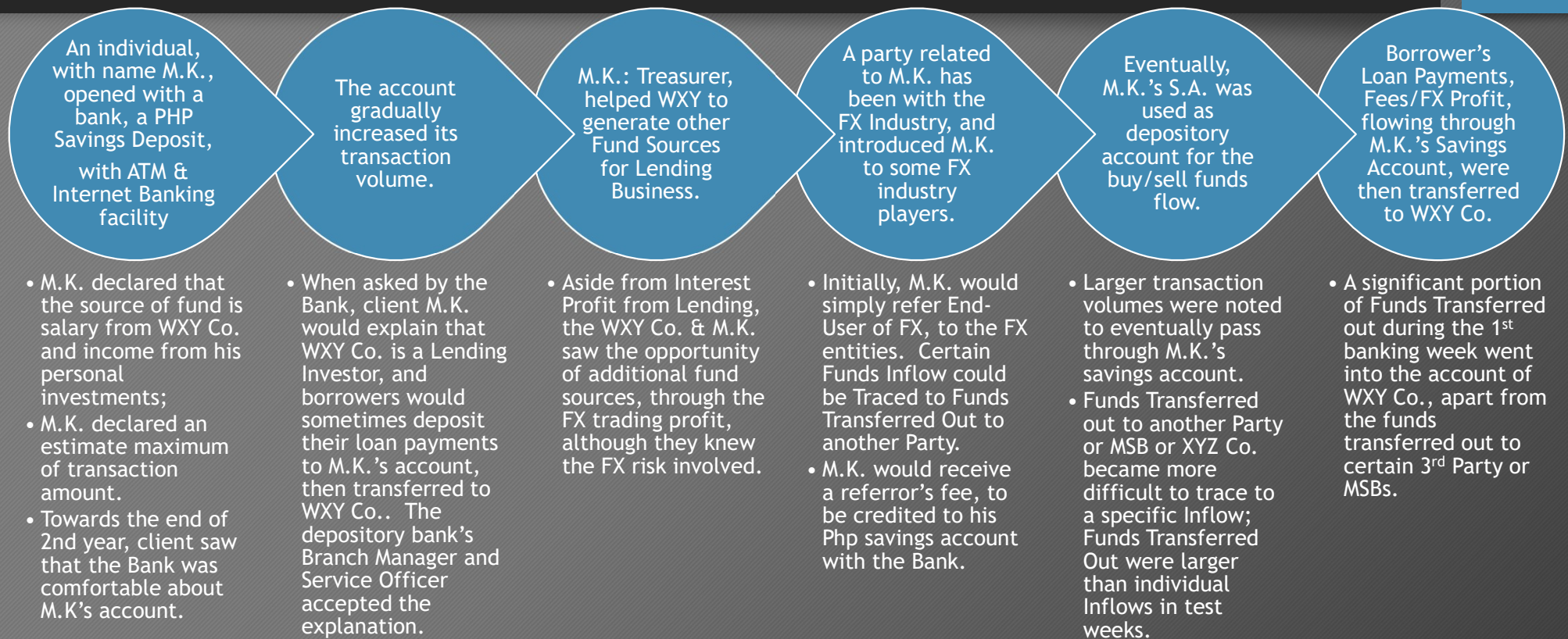
Allows, in general, the outsourcing of internal audit activities in banks:

- *xxx except for areas covered by existing statutes on deposit secrecy.*
- *xxx to have access to certain areas of expertise that are not available to the IA function or to address resource constraints.*
- *xxx shall not be outsourced to the bank's own external auditor*
- *xxx shall not be outsourced to the IA service provider that was previously engaged by the bank in the same area intended to be covered by the IA activity that will be outsourced, without a one-year "cooling-off" period;*
- *xxx knowledge or inputs from the outsourced experts shall be assimilated into the bank to the greatest extent possible.*

LEARNING ASSESSMENT.

GROUP ACTIVITY WORKSHOP: for Group2, Group5, and Group8

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LEARNING ASSESSMENT. GROUP ACTIVITY WORKSHOP: for Group2, Group5, and Group8

Read the illustrative highlights of the **case about Mr. M.K., and WXY Co.**, and a bank, as described in the preceding page. This case is now assigned to your Group (No.2, No.5, and No.8) for your critical analysis.

THE FOLLOWING ARE THE REQUIRED OUTPUTS OF YOUR GROUP ACTIVITY. TO BE PRESENTED IN PLENARY SESSION.

OUTPUT 1: Indicate your **Statement of the Issue** that requires the Auditor's critical thinking process.

OUTPUT 2: Agree in the Group as to what is your **One Important Question to be Answered** in the course of the critical thinking process or audit verification process by the Auditor assigned to this case.

OUTPUT 3: Explain whether the activities of M.K., WXY Co., and the Bank, as described in the case, are **considered high risk or not, and Why so.** (Your Group may agree to use as reference a Company's Risk Rating Methodology per their Risk Management Policy.)

OUTPUT 4: State how you plan to conduct your verification of the case, so that you could potentially arrive at an **Answer to the One Important Question** in Output 2 above.

CRITICAL THINKING AND NEGOTIATION SKILLS (EXAMPLE: REVISIT AND PROPOSE FOR IMPROVEMENT OF THE OLD STANDARD FOR AUDIT MANDAYS OF AUDIT ENGAGEMENTS)
LEARNING ASSESSMENT: GROUP ACTIVITY FOR GROUP 3, and GROUP 7.

GROUP ACTIVITY WORKSHOP FOR GROUP 3, and GROUP 7.

STATEMENT OF THE ISSUE: The Head of Internal Audit, who has been with the Company for a year now has been able to review the audit engagements for one full calendar year cycle and has noticed that several audit engagements took too long to complete and noticed varying disparity in the number of audit mandays spent for the more than 500 engagements completed in a given year. With the business process reengineering of many organizational units of the company to target a 20% cost savings, the CEO has requested that the support units, including Internal Audit, be the next to reengineer their operations to target a 15% to 20% cost/budget savings. Thus, the Head of IA has called for an auditors' assembly and assigned a group of IAs to revisit the standard audit mandays and related fieldwork expenses. The assigned Group will then present their proposal of a feasible way to reduce audit mandays by 15% initially. The reduction in mandays has significant impact on the related costs especially for out-of-town audits. In the meantime, the Head of IA has directed an initial trial period to already plan engagements with a 15% reduction in mandays which shall take effect for audits to be opened in the beginning of the next audit year, with a window for Auditors to request for pre-approval of additional mandays, subject to proper justification, such as for work exigencies that may arise during the fieldwork assignments.

SEE NEXT PAGE FOR THE REQUIRED OUTPUT OF THE GROUP ACTIVITY: Group 3, and Group 7.

CRITICAL THINKING AND NEGOTIATION SKILLS (EXAMPLE: REVISIT AND PROPOSE FOR IMPROVEMENT OF THE OLD STANDARD FOR AUDIT MANDAYS OF AUDIT ENGAGEMENTS)
LEARNING ASSESSMENT: GROUP ACTIVITY FOR GROUP 3, and GROUP 7.

GROUP ACTIVITY WORKSHOP FOR GROUP 3, and GROUP 7.

REQUIRED OUTPUT OF THE GROUP ACTIVITY: Group 3, and Group 7.

1. State the important facts to be gathered, to serve as take-off point for specific items that will be considered for the change, i.e., reduction in audit mandays and IA's OPEX by 15% to 20%.
2. Describe the possible "immediate wins" that could contribute to the 15% - 20% reduction in audit mandays or OPEX.
3. Describe the possible alternatives, improvements, in the internal audit approach/techniques / procedures that could be implemented first on pilot test basis, to observe their doability, but without sacrificing the IA's primary mission of independent and objective internal audit services.
4. Describe how the risk-based audit approach can be used in identifying "saveable" Mandays, without sacrificing quality of the internal audit results.

Lessons Learned in this Critical Thinking Workshop. May we hear from you?

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- Learning 1...
- Learning 2...
- Learning 3...
- Learning 4...
- Learning 5...

Tips

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- ❑ You may have to Define the Issue or Challenge that will require your critical thinking.
- ❑ You are not alone, to confront this issue or challenge. There are other Humans who have gained knowledge and experience, whose studies/writings/sharings/teachings could be of use to you.
- ❑ You may also be inspired to use your “Mentors”, and sometimes your “inner teacher” whenever your critical thinking comes to a standstill.
- ❑ You may need make an important Decision, towards the end of your critical thinking process. Do not be afraid to make a “painful” decision or conclusion.
- ❑ Enjoy that feeling of professional satisfaction at the end of a Well performed and well Documented critical thinking process, which has helped your organization to solve important problems and challenging issues.

End of CT Workshop.

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Thank you, and God bless each
one of you more and more!

Q&A

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