

## Constructing a Model for Assessment of Factors Affecting the Efficiency of Internal Control System in Businesses in Vietnam



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**SUMMARY:** The article has provided a theoretical basis for internal control, internal control system in general and internal control system in enterprises in Vietnam. This study also presents the background theories as a basis to explain the impact of factors on the effectiveness of the internal control system, which are: Theory of regulation; delegation theory; institutional theory, uncertainty theory of organizations, and psychosocial theory of organizations. Based on the theoretical basis system that has been built and the underlying theories, the research team has built a proposed research model on the factors affecting the effectiveness of the internal control system in the company. Vietnamese life insurers, including: control environment, risk assessment, control activities, information and communication, and supervision.

**KEYWORDS:** Model; Effective; Internal control; Enterprise; Vietnam

### 1. THE PROBLEM

Internal control is the establishment of regulations, procedures and business operations in order to improve the efficiency of business operations. Internal control helps enterprises comply with the laws and regulations of the organization, identify and eliminate risks, create trust and transparency in the financial statements of the enterprise. The internal control system is a combination of plans, control measures, viewpoints and operational directions to help an enterprise achieve its development goals. This system does not measure results based on growth numbers, but only performs the function of monitoring the operation of the business through evaluation of employees and departments. However, this activity is not really effective in enterprises, financial statements still contain many errors and frauds. Many businesses still lack legal compliance, causing damage to both businesses and regulators. Therefore, the research team builds a model to evaluate the factors affecting the effectiveness of the internal control system in enterprises, the research results will provide the theoretical basis and research model a group of factors affecting the effectiveness of internal control in enterprises.

### 2. THEORETICAL BACKGROUND

#### 2.1. Some concepts

##### Control

According to Henri Fayol (1949), Control is checking to confirm that things are done according to plan or established instructions and principles, thereby pointing out weaknesses and mistakes. offenders need to be corrected, find out the causes to prevent them from happening again.

##### Internal control

Article 39, Law on Accounting of Vietnam (2015), Internal control is the establishment and organization of internal implementation of internal mechanisms, policies, processes and regulations in accordance with regulations. provisions of the law to ensure timely prevention, detection and handling of risks and to meet the set requirements.

According to COSO (1992), Internal control is a process, governed by an entity's management, board of directors and employees, that is designed to provide reasonable assurance to achieve the following objectives: to ensure the reliability of financial statements; ensure compliance with regulations and laws; ensure operations are carried out efficiently.

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## Internal control system

According to Vietnam Auditing Standard No. 315 (2012), replacing the previous Vietnamese Auditing Standard No. 400, the term internal control was defined instead of the system of internal control as before as follows: Internal control is the process implemented and maintained by those charged with governance, management, and other individuals within an entity to provide reasonable assurance about the entity's ability to achieve the entity's objectives. ensure the reliability of financial statements, ensure the efficiency and performance of operations, and comply with relevant laws and regulations".

The effectiveness of the internal control system

According to Unegbu & Obi (2007), the effectiveness of internal control is analyzed and evaluated as an effective control tool established by management to ensure a smooth management process, control the Minimize costs, ensure maximum capacity and benefits.

## 2.2. Background theory

### Regulatory theory

There are many basic representations of the theory of regularity, but it is most common in the following three main theories:

Social utility theory: The main content of this theory states that in order to meet society's requirements in correcting the injustice or inefficiencies of market prices, thereby protecting the common interests of society. associations, regulations need to be established.

Holding theory also known as interest group theory: The main content of this theory shows that interest groups in society often require the establishment of rules to maximize the benefits of group members.

Self-interest theory: The main body of this theory assumes that those in charge in regulatory organizations often behave based on their own self-interest.

Regulation theory explains the legal supervision mechanisms of the insurance business system and the operating mechanism of the internal control system in each enterprise in particular. This theory explains the foundation of self-interest through profiteering and insurance fraud. Applying this theory in the research is expected that cross-checking and monitoring will help reduce self-seeking and group interests in insurance enterprises.

### Agency theory

In 1976, two authors Michael C. Jensen and William H. Meckling developed the theory of delegation. This theory focuses on the problem through which delegation creates the relationship between the principal and the delegate. Delegate problems often occur when the principal hires the delegate to do some work. The mandated party is entitled to represent the principal to decide on the authorized matters. In insurance activities, especially the relationship between the insurance company and the customer is the proxy relationship. Insurance enterprises use financial funds from insurance contracts to make investments or make decisions related to the interests of insurance customers. Therefore, managers themselves must control well the activities inside the insurance business they manage to ensure the interests of customers by creating a professional control environment, performing other tasks. assess risks, implement control activities, and ensure complete, reliable and timely information and communication.

### Institutional theory

Authors studying institutional theory point out that an organization will be affected by two factors: "technical factors related to how day-to-day operations are handled in order to make it effective. high performance and institutional factors related to expectations and values from the external environment rather than from the entity itself".

When applying the content of institutional theory in the research, we can see that this is the theory that explains the impact of regulatory organizations and supervisory organizations on each other in the operational organizational model. insurance businesses. In addition, the public and society always expect regulatory and supervisory organizations in countries to want to promulgate a legal system as a legal foundation for insurance business activities. harmonize in the integration conditions to enhance the position and prestige of that regulation-making and monitoring organization. In this study, this theory explains the supervisory mechanism factor that affects the effectiveness of the internal control system.

### Contingency theory of Organizations

This theory is based on the argument that: "There is no single effective management system that is suitable for all organizations and suitable for all circumstances because of its unique characteristics and Its effectiveness will depend on the specifics of the organization and on contextual factors" (Otley, 1980; Ferreira and Otley, 2005). Ferreira & Otley (2005) when applying this theory

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in management, said that: "factors related to the external environment, strategy, culture, organizational structure, technology, process size and ownership have an impact on organizational performance".

## Social psychology of organization theory

The theory, also known as behavioral theory, includes views in management that emphasize the role of psychological, emotional, and social factors in people's work. This theory states that: "the effectiveness of management is determined by labor productivity, but labor productivity is not only determined by material factors but also by the satisfaction of the psychosocial needs of people." People". (Don Hellriegel & Jonn W.Slocum, 1986).

This theory explains the construction of control activities in the organization and the monitoring mechanism in the internal control system. When applied to the study, according to the explanation of this theory, the research team expects that when control and monitoring activities are ensured, the effectiveness of the internal control system will be higher.

## 3. RESEARCH METHODS

Research using documentary research method: Through the study of documents, the research team has collected and researched relevant research works that have been carried out in the country and abroad to draw conclusions and Develop a theoretical basis for research. The theoretical contents are selectively inherited from the research results of published scientific works on the contents related to the effectiveness of internal control. From there, the research team draws out independent theoretical issues with scientific arguments on building a model to evaluate factors affecting the effectiveness of the internal control system in enterprises.

## 4. BUILDING RESEARCH MODEL

### 4.1. Overview of related research models

#### Studying the internal control system in the direction of governance

On the basis of the 1992 COSO report, the COSO organization conducted a study on the enterprise risk management (ERM) system. In this study, ERM is built with 8 components including: internal environment, goal setting, event identification, risk assessment, risk response, control activities, communication information communication and monitoring. In 2004, COSO officially issued ERM as the foundation for enterprise risk management.

In 2009, authors Angella Amudo & Eno L. Inanga conducted a study evaluating internal control systems from Uganda. This study was carried out on the regional member countries of the African Development Bank. The study developed a standard model for assessing internal control systems in Ugandan public sector projects funded by the African Development Bank. The empirical model developed by Amudo and Inanga based on the internal control framework of COSO and COBIT includes:

Independent variables are components of internal control (additional information technology variable according to COBIT): (1) control environment, (2) risk assessment, (3) information communication system communication, (4) control activities, (5) monitoring, (6) information technology.

Dependent variable: The effectiveness of the internal control system

Regulatory Variables: Authorization, Collaboration

The results of the study show that the lack of some components of internal control leads to ineffective performance of the internal control system. However, the study authors also state that these results are only investigated in Uganda. The application of research results depends on the circumstances and characteristics of each specific country. Research results will be changed if applied to countries with different circumstances and corresponding characteristics.

Empirical research by authors Sultana and Haque (2011) from 6 private banks listed in Bangladesh suggests that in order to determine the ability to ensure the operation of the unit in accordance with the set objectives, it is necessary to evaluate the structure of the unit. internal control structure within an entity. Research and develop a model from the framework of internal control according to the COSO report (Figure 1.6) as follows: Independent variables are components of internal control: (1) control environment, (2) risk assessment, (3) information and communication systems, (4) control activities, (5) monitoring.

Dependent variable: The effectiveness of the internal control system

Regulatory Variables: Authorization, Collaboration

The results of this study indicate that the above model is really meaningful when the independent variables have a relationship with each control objective of the banks, specifically each component in the internal control system (variable variable). independent) well functioning will reasonably ensure the control objectives and thus the effectiveness of the internal control system. (Sultana & Haque, 2011).

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## 4.2. Factors affecting the effectiveness of the internal control system

Based on the theory of COSO's internal control system. Agree with the author Sultana & Haque (2011) in using control environment factors, risk assessment, control activities, information and communication, monitoring to study the impact on efficiency internal control system. The research team has inherited a 5-component scale in the study of factors affecting the effectiveness of the internal control system in life insurance enterprises in Vietnam.

### Control environment

The control environment has an important impact on the performance and outcome of control procedures" (Ramos, 2004); (COSO, 2013). When a good control environment is established, the lack of control procedures can be minimized. The control environment includes the following elements: Honesty and ethical values; Competency Commitments; Philosophy and operating style of managers; Structure of the organization; HR policies.

### Risk assessment

Managers must regularly assess risks and analyze existing and potential risks. The activities of the enterprise and its surroundings are always changing, so the risk assessment methods must be changed by the manager accordingly to be able to meet the requirements. Managers cannot take actions to eliminate risk but only set the risk to an acceptable level and try to minimize it as low as possible. Defining the objective is the first and most important part of the risk assessment. There are many organizational goals but we can divide them into 3 goals: Operational goals; Financial reporting objectives; Compliance goals.

The above goals are interrelated and supportive of each other. The common goals for the whole unit when building need to be considered to be appropriate to the capacity and operation characteristics of the unit and to each department in the unit. Due to the impact of external factors that are difficult for the entity to control, the entity can only consider to achieve the appropriate objectives in the above objectives, depending on each period. Based on the established goals, managers need to identify and analyze risks, on that basis, propose solutions to manage risks. These two activities are conducted continuously and repeatedly.

### Control operation

"Control activities are a set of control policies and procedures to ensure that management directives are carried out in order to achieve objectives. These policies and procedures promote the activities necessary to reduce the risks of the business and enable the objectives to be rigorously and effectively implemented across the enterprise. Control activities take place throughout the organization at all levels and activities" (Ramos, 2004); (Kaplan, 2008).

Classification according to purpose, control activities are divided into 3 categories:

Preventive control: This is a control activity to prevent and minimize mistakes that affect the goals of the business to be achieved.

Detection control: This is a control activity to promptly detect violations that have been made.

Compensatory controls: These are controls that enhance or replace ineffective controls.

### Information and communication

Information: To ensure the performance of their functions, organizations need information. Information needs to ensure timeliness and accuracy when identifying, collecting and communicating to relevant individuals and departments in the organization. The task of the unit is to create reports containing information to ensure the management and control of the unit by the manager. Dinapoli (2007) states that: "A single piece of information can be used for a variety of purposes, such as preparing financial statements, reviewing compliance with laws and regulations, and operating operations. production and business of enterprises".

The information system of the unit needs to always change to be able to respond to changes in business activities with fierce competition with increasing requirements of customers.

Communication: Author Dinapoli, (2007) said: "Communication is the exchange and communication of necessary information to stakeholders both inside and outside the business. Each information system itself has a communication function, because only then can the information that has been collected and processed can reach the objects in need to help them fulfill their responsibilities. me". Typically, a unit's communication system includes the following components:

The way of communication within the unit: For within the unit, the way of communication represents the transmission of information from the manager to each employee performing the task and how to respond to suggestions. output of employees to unit managers. The unit must ensure information channels from top to bottom or from the bottom up to ensure that

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communication activities in the unit are transparent in many different forms. In addition, the daily exchange of information between individuals or departments in the enterprise also ensures smooth internal communication.

### Monitor

Author Spiner, (2004) in his study that: "Supervising is the final part of the internal control system, the process of evaluating the quality of the control system. internal control over time. Monitoring has an important role, it helps internal control always work effectively. Monitoring is carried out by those responsible to assess the establishment and implementation of control procedures" (Spinger, 2004); (Kaplan, 2008). Monitoring is carried out in all activities in the enterprise, even those outside the unit can be monitored in two ways: Regular monitoring of activities and periodic monitoring of activities.

### 4.3. Constructing a research model

Based on the background theory and presented research models, the research team proposes a model to study the factors affecting the effectiveness of the internal control system in enterprises as follows:

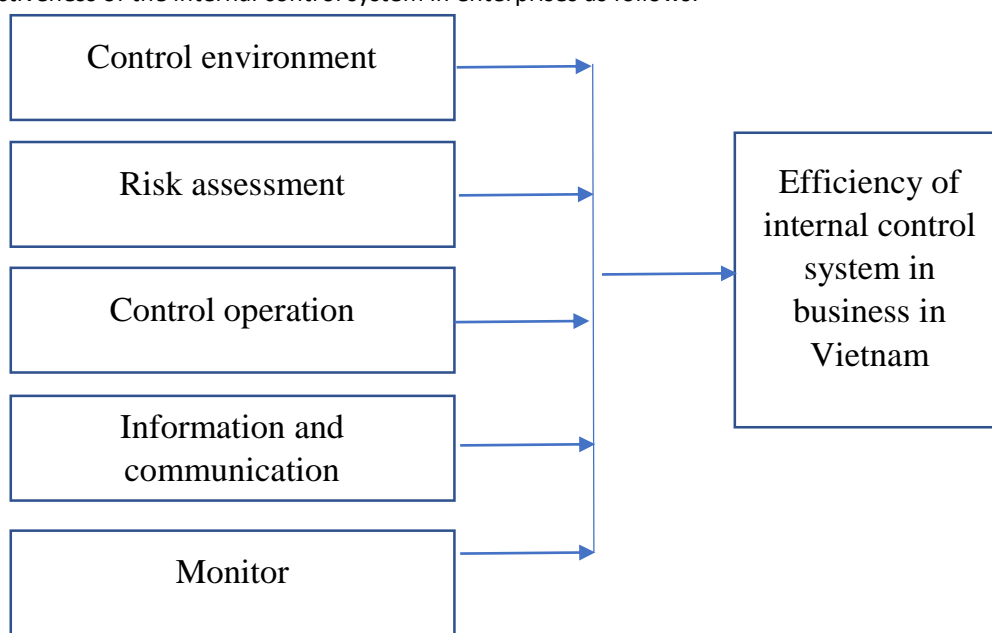


Figure 1. Conceptual framework

Source: The research team

## 5. CONCLUSION

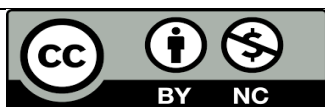
Based on the theoretical foundations of internal control: Theory of regulation; delegation theory; institutional theory, uncertainty theory of organizations, theory of social psychology of organizations, ... combined with the systematization of research-related works has clarified the issues more clearly. Theoretical issues on internal control, the effectiveness of the internal control system in enterprises in Vietnam

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