

## Internal Control in Vietnam's Textile and Apparel Enterprises

### Author's Details:

<sup>(1)</sup>**Thi Hong Hanh Le, MA**-University of Economics - Technology for Industries

<sup>(2)</sup>**Thi Thu Hien Phan, PhD**-University of Economics - Technology for Industries

**Correspondence: Thi Hong Hanh Le**, 456 Minh Khai Street, Hai Ba Trung district, Ha Noi, Viet Nam

### Abstracts:

*Textile and garment industry plays an important role, contributing effectively to the development of Vietnam's economy, accounting for about 20% of GDP, about 15% of total export turnover and creating jobs for more than 3 million workers. 20% of the country's labor force. However, businesses in the industry are facing many difficulties; the most challenging is to ensure financial health and increase competitiveness. Therefore, improving the internal control system in textile enterprises is one of the effective management methods that need to be implemented*

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### 1. Introduction

One of the reasons for the failure of a factory or the collapse of a business is due to the loose control of internal control. Therefore, the strict and appropriate internal control system helps businesses proactively cope with and minimize risks and is also a tool for businesses to accomplish the strategic goals set out.

Under the pressure of economic integration, the requirements on enhancing corporate governance efficiency when Vietnam joins trade agreements, the more businesses have to pay attention to strengthening their corporate governance capacity. In order to increase the internal strength to ensure the competitiveness of enterprises ... In Vietnam, internal control is a new concept and is also one of the top concerns of managers. corporate governance to approach good internal control practices around the world.

Some legal provisions on internal control in Vietnam: In the field of finance and banking, the State Bank issued hard regulations on internal control in Circular 13/2018 / TT-NHNN dated 18 / 5/2018 stipulates the internal control system in commercial banks and foreign bank branches; and Circular No. 40/2018 / TT-NHNN dated December 28, 2018, amending and supplementing Circular 13. In addition, the Ministry of Finance also issued Decision No. 143/2001 / QDBTC dated December 21, 2001 on Auditing Standard 400 - "Risk assessment and internal control"; - Decision No. 214/2012 / TT-BTC dated 06/12/2012 of Standard No. 265 - "Discussing the deficiencies in internal control with the Management Board and Board of Directors of the audited units"

Thus, there is no mandatory regulation on internal control for businesses, but due to the management needs, enterprises build internal control systems in the organizational structure. A number of large enterprises that have learned good business management practices early should build a reasonable organizational structure and relatively good internal control system like Vietnam Dairy Products Joint Stock Company - Vinamilk; Bao Viet Group; Vingroup company...

### 2. Literature review

#### 2.1. Internal control system

There are many different definitions of internal control systems.

The Institute of Internal Auditors defines internal control as a process within an organization designed to provide reasonable assurance of the main goals of the business: (i) reliability and truthfulness of the information, (ii) compliance with policies, plans, procedures, laws and regulations, (iii) protection of assets, (iv) use of economic resources and efficiency. and (v) accomplishing established goals and objectives for business activities or programs.

According to the International Federation of Accountants (IFAC), internal control is defined as an integral part of the organization's management system and risk management capabilities, which are understood, be influenced and actively monitored by management, managers and other employees to take advantage of opportunities and respond to threats to achieve organizational goals.

The Canadian Institute of Chartered Accountants (CICA) defines internal control as the organization's plan and all coordination systems established by an organization's manager to achieve the goal. management criteria to ensure that as much as possible, the conduct of business activities is orderly and effective.

The most common and accepted definition issued by the Council of Sponsoring Organizations of the Treadway Commission (COSO), internal control is a process, influenced by the committee. The organization's directors, managers, and other employees are designed to provide "reasonable assurance" on achieving performance, reporting, and compliance goals. In accordance with the Vietnam Standards on Auditing (VSA), the internal control system is the control regulations and procedures developed and applied by the entity to ensure that the unit complies with laws and regulations. regulations to inspect, control, prevent, and detect frauds and errors to make honest and reasonable financial statements, in order to protect, manage and effectively use the units' assets.

In general, the concepts of internal control systems emphasize the following important characteristics. Firstly, the internal control system is a process. It is a means for an organization to carry on continuously until its completion; it is not an attainable eternal state. Second, the internal control system is influenced by personnel at all levels of an organization; it is not merely policy guidelines and forms. Third, the responsibility of establishing a complete and effective internal control system rests with the management. Moreover, the internal control system, no matter how well designed and implemented, can only provide reasonable assurance for an organization's board of directors and board of directors. Finally, the internal control system is directly related to the goals of the organization.

## **2.2. Parts of internal control system**

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) presents the five components of the system's most updated internal control system. Internal control is as follows.

### **2.2.1. Environment controlled**

The control environment component of the internal control system sets the overall tone of the entity, indicating the responsibilities of management and management at all levels of the entity in establishing the control environment. effective throughout the unit. This internal control influences and encourages ethical behavior and contributes to an honest and accountable culture. For those units with effective internal control systems, managers set an example of compliance with standards and developed policies and procedures appropriate to their units. The control environment is the foundation for all other components of the internal control system to provide discipline and structure of the unit.

### **2.2.2. Risk assessment**

Managers assess risks as part of the design and operation of internal control systems to minimize errors and irregularities. Managers must perform procedures to identify, analyze and manage risks. Identifying a risk that is likely to affect an entity is an important first step to reducing or managing risk. Once risks are identified, managers need to assess their likelihood and the severity of any negative impact that can be considered a basis for determining how risk is managed.

### **2.2.3. Operation control**

Control activities are policies and procedures established by a manager to assist in achieving the entity's objective of operating, financial reporting, or compliance. Managers must determine how to address identified

risks. The manager must evaluate whether controlling risk is beneficial for the entity. If risk reduction is potentially cost-effective, control activities implemented to reduce risk are identified.

#### **2.2.4. Information and communication**

The presence of effective information and communication systems is an important component of an effective internal control structure. Internal control systems are rarely effective unless an entity has the appropriate information to manage potential risks in a timely manner. Information and communication components within an internal control system mean that critical, relevant, accurate and timely information is identified, collected and provided to appropriate personnel within the organization. A well-functioning information and communication system helps managers make better decisions, make employees more responsible and have fewer problems. An effective information and communication system also helps the unit comply with laws and regulations. Information must be circulated throughout the organization if an effective internal control system is in place. In an effective internal control system, appropriate, accurate and timely information relating to all other components of the internal control system is communicated to the upper, lower and lower levels. throughout the unit.

#### **2.2.5. Monitoring**

The fifth component of the internal control system is supervision. This is the process involved in assessing the effectiveness of the internal control system. Monitoring activities are designed to provide information to managers about whether the internal control system is functioning as intended and information on whether the internal control system is adjusted in accordance with changes in operating conditions are not. Monitoring activities can be carried out regularly or periodically

### **2.3. The design principles of internal control**

The internal control system should be based on five effective general guiding principles: (i) democratic concentration; (ii) Assignment and assignment; (iii) Part-time duty; (iv) Operational independence; (v) Ratify, authorize.

#### **Limitations of internal control**

No matter how perfectly designed the internal control system can only provide the unit with a reasonable guarantee to achieve the financial reporting goals of the entity, it cannot prevent all errors and risks.

### **3. TEXTILE AND APPAREL ENTERPRISES AND INTERNAL CONTROL**

Industry characteristics that affect the internal control system in textile enterprises. Therefore, the important control procedures needed in production and business activities are quality control of finished products, production moderation, production costs; developing and implementing policies with customers; personnel quality through recruitment regulations and personnel quality assessment, etc.

However, at present, the internal control system in most textile enterprises still has many limitations and shortcomings, leading to the fact that many enterprises achieve the growth target but are not sustainable. The main reason comes from the manager's point of view on the role and effect of control in ensuring the achievement of the business goals. Therefore, the control system has not been fully designed, so it is difficult to assess and monitor the quality of operations of the whole enterprise.

Some businesses have only the Supervisory Board elected by the General Meeting of Shareholders but operate ineffectively because the Head of the Supervisory Board is a part-time member, the members are far away, so the inspection and supervision are relaxed ... Not only that. , the personnel policy in that enterprise also revealed many inadequacies reflected in a series of issues such as the quality of unqualified labor, the number of serious shortage. This fact is affecting the implementation of short-term and long-term goals of businesses.

In addition, many subjective managers do not attach importance to identifying, analyzing, and assessing risks during operation. Therefore, they have not designed appropriate control procedures to limit the risks that may affect the achievement of the business goals.

#### **4. SUCCESS IN INTERNAL CONTROL**

In some large enterprises such as Phong Phu Joint Stock Corporation, Hoa Tho Textile, and Garment Joint Stock Company, Hue Textile and Garment Joint Stock Company has shown many positive points, attaching importance to inspection and supervision. The managers of these enterprises have an internal control unit operating with the specific task of inspecting, supervising and managing risks of enterprises' activities.

Typically, Hue Textile and Garment Joint Stock Company have focused on inspection and supervision through the organization of 2 functional departments, Internal Control, and Quality Management. In particular, the Internal Control Department operates independently; the Quality Management Division has added the Risk Management function. In 2017, the Company researched and implemented risk management process in accordance with ISO 31000-2005 to apply to each production process.

After one year of implementing the Risk Management Process, the Company has built a risk profile in which the "Risk List" identifies in detail, assesses the impact of risks and measures to control risks. control risks according to the production stages of each unit. This list of risks is reviewed and updated periodically to ensure full identification of risks in different business contexts. Every month, the arising risks are sent to the General Quality Management Department and integrated into the monthly business situation report of the whole company to serve the management requirements of the Board of Directors. Integrating the function of risk management with quality management facilitates: (i) good control of production-related risks (product quality, delivery schedule ...); (ii) respond well to customer examinations and assessments.

Depending on the size and characteristics, each enterprise will organize its internal control functions and risk management in different ways. However, the way of working at Hue Textile and Garment Joint Stock Company is considered suitable for other textile enterprises to refer and apply for their own units.

Internal control is a coordinated process carried out by the Board of Directors, the Board of Directors and employees in the business to ensure that the financial statements are reliable and accurate and business activities are reasonable. effective and compliance with the provisions of the law as well as the rules, internal guidelines of the business. COSO's advanced internal control framework \* consists of 5 elements: control environment, risk assessment, control activities, information exchange, and monitoring.

#### **5. SOLUTIONS**

Firstly, enterprises need to strengthen the control environment through (i) raising the awareness and opinion of managers about the importance of the internal control system in accessing and applying standards. modern management such as the application of ISO standard processes to enhance the effectiveness of the control system in the enterprise; (ii) perfecting the organizational structure in the business with a focus on decentralization of management rights, clearly defining functions and duties and the relationship between functional departments, each individual involved in the process. The internal control process is responsible; (iii) improve the qualifications and independence of the members of the control committee or internal control unit (if any).

Second, businesses face many different types of risks from inside and outside. Therefore, the establishment of an internal control system associated with risk management to coordinate the identification, analysis, and evaluation of the impact of possible risks, thereby offering solutions to prevent effectively block and manage risk.

Third, control activities are policies and procedures that help ensure that management directives are implemented and the necessary actions are taken to minimize risks and achieve business goals. Development of

control mechanisms and procedures may be designed to be viewed but not overlapped and left blank. The development of business processes must also clearly identify the goals and possible risks of each process, thereby providing the most appropriate control mechanisms.

Fourth, enterprises need to improve the information system, in which: (i) paying attention to accounting information including documents, accounts, books, financial statements, and building an accounting information system. administration; (ii) promote the application of information technology in business and production such as the application of ERP (enterprise resource planning system) or cloud computing technology to store information ...

Fifth, the internal control system will be monitored over time to assess the quality of operation of the system. This is done through ongoing monitoring activities, or individual assessments and a combination of both. Any problems, incidents that adversely affect the business should be reported to the top; serious issues should be reported directly to the General Director and the Board of Directors.

Facing new challenges and opportunities in the process of international integration, textile enterprises have been making great contributions to ensuring social security and the development of Vietnam's economy. In fact, when the competitive advantage of cheap labor is gradually losing, some important production costs are increasing such as electricity price, if the enterprise does not change its operation method, good management method, then Enterprise is difficult to survive and grow. In this context, the fact that the company focuses on building a good internal control system is considered as one of the effective ways to improve the management and governance capacity of the business.

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