

# Effects of Internal Control on Performance in Small and Medium Enterprises in Vietnam: Research Overview

**Author's Details:** <sup>(1)</sup>Thi Thuy Lien Dinh <sup>(2)</sup>Thi Thu Hien Phan

<sup>(1)</sup> <sup>(2)</sup> University of Economics – Technology for Industries **Correspondence: Thi Thu Hien Phan**, 456 Minh Khai, Hai Ba Trung, Ha Noi

## **Abstract:**

*The paper summarizes and analyzes a theoretical basis as well as an overview of previous studies on the impact of internal control on the business performance of enterprises in general and small and medium enterprises in particular. Based on the analysis of the internal control system in small and medium-sized enterprises and based on the characteristics of the internal control system, we propose a future research model.*

**Keywords:** *Internal control, small and medium business, Vietnam*

## **1. Introduction**

Currently, most of the SMEs in Vietnam are facing many obstacles for the development of business activities, such as: capital and financial difficulties; lack of governance differentiation in enterprises; limited access to information technology; few opportunities to integrate into foreign markets; ...

In order to support the development of SMEs, the State has provided many support contents such as: support to access credit; establishing SME Credit Guarantee Fund; tax and accounting support; support of production premises; technology support, nursery facilities, technical facilities, common working areas; support market expansion; information, advice and legal assistance; supporting human resource development; support SMEs to convert from business households; supporting - investing in innovative startups; supporting SMEs to participate in industry clusters and value chains; establishing SME development fund ...

Even so, the access to capital of SMEs remains difficult due to the lack of credibility for SMEs. Therefore, to improve access to credit, SMEs need to strengthen their management capacity, management skills, and financial transparency. One of the measures to improve the financial transparency of businesses is the development and operation of internal control effectively in SMEs. Because internal control is the policies, procedures, regulations, processes designed to prevent fraud, minimize errors, encourage operational efficiency and to achieve compliance with policies. and the procedure has been established. A strong internal control system, which will help the hospital ensure the accuracy of the entity's accounting records and financial statements; reduce risk, fraud or revenue loss for the unit.

In the world, there have been a series of scientific studies published in famous scientific journals such as: Research of Cohen (2002), Springer (2004), Alan G. Hevesi (2005), Amudo & Imaga (2009), Gamage & Kevin Low Lock & Fernando (2014), Babatunde SA & Dandago KI (2014), Aristanti Widyaningsih (2015), Zipporah (2015), Adebisi Ifeoluwa Mary (2017), Mahmoud Ibrahim (2017) ... all confirmed that internal control system is one of the very important measures to prevent prevent and detect errors and weaknesses to minimize losses. In Vietnam, the typical research projects such as Pham Quang Huy (2015), Nguyen Thi Thanh Huyen (2015) Vu Thu Phung (2016), Ho Tuan Vu (2016), Tran Trinh Nhu Quynh (2016) ... all gave that internal control system has a very important role in the management activities of the unit. Within the scope of this article, will introduce: (1) Relevant studies on internal control systems; (2) the effect of internal control to the performance of financial management activities; (3) Proposing a future research model.

## **2. Theoretical basis**

## **2.1. Internal control system**

In studies of internal control systems (KSNB), the report of COSO (The Committee of Sponsoring Organizations, 1992) on internal control is widely applied in the world. Accordingly, Internal Control is a system of policies and procedures set up to achieve 4 objectives (Protection of assets of the entity; ensuring the reliability of the information of financial statements (Financial Statements); ensure compliance with laws and regulations, ensure activities are carried out effectively).

According to the Vietnam Standard on Auditing No. 315 issued together with the Circular No. 214/2012 / TT-BTC dated 06/12/2012 of the Ministry of Finance: “Internal Control is a regulation set by the Board of Directors, Board of Directors and individuals. Other entities in the design and implementation department maintain to provide reasonable assurance on the unit's ability to achieve its goals in ensuring the reliability of financial statements, ensuring efficiency, performance, comply with relevant laws and regulations”. Thus, one of the goals that the internal control system aims to ensure the reliability of the information on the financial statements.

According to COSO standards (1992, 2013), the internal control system consists of 5 components: control environment; risk assessment; control operations; Information Communication; monitoring. In addition to the 5 components of the internal control system, COBIT (Control Objectives for Information and Related Technology, 2007) adds an information technology component.

Internal control is an effective tool to help businesses achieve operational goals and profits, prevent the loss of resources, help ensure the published financial statements are reliable and ensure businesses comply with the law. regulations have been set up, avoiding damage to the reputation of the business and other consequences, helping an entity to identify the goals it wants to achieve, avoiding risks and adverse fluctuations.

Internal control is an effort of the Board of Directors to minimize risk factors or to achieve control objectives, a close relationship between the objectives of the entity and the internal control system is established for achieving those goals.

## **2.2. Internal control goal**

Internal control goals can be divided into 4 groups:

- (1) High-level strategies and objectives consistent with the enterprise vision: Internal control must ensure to help the company improve its reputation, expand market share, implement its business strategies ...;
- (2) Financial information system (Internal Audit system of financial information system): Internal control must ensure the honesty and reliability, management must be responsible for preparing and presenting financial statements. in accordance with current accounting standards and regimes;
- (3) Activities: Internal control needs to help the unit effectively use resources during its production and business activities;
- (4) Compliance with laws and regulations: Internal control needs to ensure reasonable compliance with laws and regulations.

## **2.3. Impact of internal control to performance**

Mawanda (2008) uses correlation and regression analysis to examine the impact of internal control efficiency on business performance. Internal control is measured by the control environment, internal audit and control activities. Business performance is measured through three groups of liquidity, accountability and reporting. Control variables in the model include policies of the Government, local governments and the Ministry of Education. The study shows the positive (+) impact of internal control on business performance in Uganda. The drawback of this study is that the focus of the study on internal control on the control environment, internal

audits, control activities, without fully investigating the components of internal control also impacts. up financial efficiency like.

Byanguye's (2007) study used regression and correlation analysis to study the relationship between internal control and value (money) of the financed projects in Kamuli province. Control environment, risk assessment, information and communication systems, control and monitoring activities are a measure of internal control. The value of projects is measured by three groups of indicators, including economic group, efficiency group and efficiency group.

The data used in the study were through a survey by a questionnaire with a Likert scale from 1 to 5. The study used correlation analysis and regression analysis to prove the relationship between internal control systems. and the value of the project. The value of the project is high when its internal control is effective. The limitation of this study is to focus only on the impact of internal control on project value, without mentioning other factors that also affect project value.

Muraleetharan (2010) uses the When squared test method and the regression analysis method to determine the relationship between internal control and business performance. In which internal control is measured the following criteria: control environment, risk assessment, control activities, information and communication systems, monitoring. Business efficiency is measured through: profit (profit), efficiency (efficiency) and solvency.

The study uses the questionnaire survey method with a sample of 181. The study has proved the hypothesis that internal control has an impact on the business performance of enterprises, especially the impact of internal control on business performance. is the positive effect (+). However, the study did not prove the impact of the two components of internal control, the control environment and the information system on business performance.

Nyakundi's study (2014) uses both qualitative and quantitative approaches to examine the impact of internal control on business performance in small and medium-sized enterprises in Kisumu City, Kenya. Data used in statistical analysis includes both primary data (collected through questionnaires) and secondary data (through financial reports of enterprises). Internal control is measured through: control environment, operational control, supervisory control. And business performance is measured by the rate of return on investment (ROI). Research has shown that internal control has a significant impact on the change in business performance in small and medium enterprises.

The study of Mary et al. (2014) has demonstrated the positive impact of internal control on the business performance of sugar companies in Kenya through regression and correlation analysis. Research has shown that internal control explains 42.8% of business performance changes in these companies. Internal control measures include control environment, risk assessment, information systems and control activities. The business performance of companies is measured through three indicators: unit cost, achieving goals and profitability.

Wambugu (2014) studied the impact of internal control on the performance of non-governmental organizations (NGOs) in Kenya. Research results show a positive relationship. Research by Zipporah (2015) measures the impact of internal control on the business performance of businesses in Nairobi (Kenya). The research using secondary data is the annual report of 35 enterprises in the period (2013-2014), through multivariate regression analysis, with the dependent variable being returned on assets (ROA) and other The independent variables are Control Environment, Risk Assessment, Control Activities, Information - Communication and Monitoring. The research results show that 04 components (Control environment, Risk assessment, Control activities, Information - communication) of internal control have a positive impact on ROA, during the close to the opposite effect with ROA.

Some previous typical studies of Fadzil (2005), Brown (2008), Kakucha (2009) ... said that there is a positive relationship between the Internal Audit System and Corporate Income (after-tax profit).

In most recent years, some typical case studies include:

In summary, the above scientific researchers are published in prestigious scientific journals in the world and all show that there is a close connection between internal control systems and the performance of enterprises or enterprises. public sector unit. In particular, the performance of an enterprise is measured by profit, revenue, liquidity, ROI, ROA [Beeler et al. (1999), Jensen (2003), Ittner (2003), Fadzil and others. partner. (2005), Kenyon and Tilton (2006), Brown et al. (2008), Mawanda (2008), Ndungu (2013), Nyakundi et al. (2014) Zipporah (2015)]. Weaknesses or omissions of internal control systems all affect the performance of businesses or units.

### **3. Internal control in small and medium enterprises**

According to Vietnam Standards on Auditing - VSA 315, KSNB includes 5 components: (1) Control environment; (2) The entity's risk assessment process; Information systems related to the preparation and presentation of financial statements, including relevant business processes, and information exchange. (4) Control activities; and (5) Monitor the controls.

The design, implementation and maintenance of internal control systems can vary with the size and complexity of the entity. In SMEs, it is possible to use fewer functions, fewer procedures and simpler processes and procedures to realize their goals. Therefore, in SMEs, it may not be able to distinguish the components of internal control equipment clearly; however, all elements of internal control will still be implemented. This can happen when the owner and the manager can simultaneously perform many functions related to different components of internal control.

#### **3.1. Environment controlled**

The control environment includes the management and management functions, the views, perceptions and actions of the Management Board and the Board of Directors related to internal control and the importance of internal control to the operations of the entity.

Key elements of the control environment: Communicate information and demand the enforcement of integrity and ethical values; Commitment to capacity; Participation of the Board of Directors; Management philosophy and style of the Board of Directors; Organizational structure; Assigning powers and responsibilities; Human resource policies and practices.

In SMEs, often the management responsibilities focus on managers. Owners' participation in the management process in SMEs does not mean the lack or disadvantage of internal control enterprises. Typically, the involvement of a qualified owner in managing day-to-day operations can increase the effectiveness of a controlled environment. And in this case, to reduce the risk of fraud from the managers to a certain extent can be done through the application of some basic controls.

#### **3.2. Risk assessment process**

Each business does not depend on the structure, size of the organization or sector, always facing the types of risks in the process of business operations.

The risk assessment process is an iterative process and an important part of internal control. All entities need a risk assessment process (formal or informal) to identify conditions that significantly affect their ability to achieve their goals.

Objectives of the risk assessment process: (a) Identify business risks related to the objectives of preparing and presenting the financial statements; (b) Estimate the level of risk; (c) Assess the likelihood of risks; and (d) Decide appropriate actions for such risks.

In SMEs, distinguishing each content of the risk assessment process is sometimes relatively difficult,

sometimes SMEs do not develop specific documents on the risk assessment process.

### ***3.3. Information system related to the preparation and presentation of financial statements and information exchange, including relevant business processes.***

The information system provides reports, operational, financial and compliance information of the enterprise, which ensures the operation and monitoring of enterprises.

For SMEs, the information and information exchange system can be simpler to build because of the number of personnel, as well as the decentralization of management in SMEs is often small, and managers can directly monitor most activities in the enterprise.

However, this also leads to some higher risks for SMEs than others:

- The risk of duplication or wrong recognition of transactions (transactions may be recorded not following the process, not in order, may reflect dishonestly on the financial situation of enterprises, this increases the risk of fraudulent financial reporting);

- A small number of employees can lead to duplication of assignments (usually will violate the principle of non-part time);

- Ability to perform frauds from employees. In SMEs, accountants sometimes have the ability to access assets in enterprises, perform embezzlement due to violations of the principle of non-part time;

- Possibility of violating tax laws. SMEs typically make a relatively large number of cash payment transactions, resulting in a lack of revenue recognition or an increase in expenses;

- The small number of employees in the SMEs also reduces the conditions for conducting cross-sectional reconciliation (the "four-eye" principle or cross-checking), which increases the risk of fraud from the staff side.

In addition, SMEs also face risks in applying information technology in their operations. Because of the small number of employees, especially in the accounting department, sometimes accountants have access to all information and every part of the information technology system. This increases the likelihood of frauds from the accountants such as entering false data into the accounting system, changing accounting data, performing retroactive, performing operations that have not been approved by authorization...

### ***3.4. Operation control***

Control activities are policies and procedures that ensure that management directives are followed. They help ensure that the necessary actions will be taken to address the risks occurring, helping businesses achieve their goals. Control activities occur in the entire enterprise, in all levels and in all functional departments. They include a variety of activities such as approvals, authorizations, verification, reconciliation, performance evaluation, asset protection and task assignment. The implementation of these measures, processes and procedures will ensure to minimize risks and create conditions for businesses to achieve the set goals, decisions and directives from the Board of Directors are strictly implemented throughout DN.

In SMEs, the usual control activities are rarely formally written. The reason for this is that managers often directly control activities in enterprises. For example, managers can develop corporate culture, enhance the importance of control activities; Recruiting highly qualified personnel; Monitoring revenue and expenditure compared to the estimates; Approving all major transactions in the enterprise; Implement division of responsibilities among departments and employees.

### ***3.5. Monitor the controls***



Internal control and application of controls will change over time. This is due to reasons such as: New personnel, effective monitoring procedures are not the same, inconsistencies in time and resources, changes in circumstances. Therefore, managers need to carry out the identification and continuous observation of internal control and efficiency of internal control.

Monitoring of control is the process of evaluating the performance of internal control in each period.

The monitoring of controls can be divided into routine and segregated monitoring. (1) Regular monitoring: takes place right in the process of operation, through management and supervision activities carried out by managers and employees in their responsibilities. (2) Isolated monitoring: usually through managers and internal audit departments. The supervisor provides information to the Board of Directors on whether internal control is effective in determining control objectives; Understand and enforce by staff in the unit; Used and complied with daily; and May be modified or improved to suit the changing circumstances.

In SMEs, ordinary managers will directly supervise all activities of enterprises, and the errors in operations will also be likely to be detected in a timely manner. However, the monitoring of control activities at the SMEs is usually not formal, and is carried out within the framework of business activities. And if managers directly participate in the activities of businesses, in many cases, it will promptly detect financial information discrepancies and provide appropriate countermeasures.

From the results of the review, we propose the following research model:

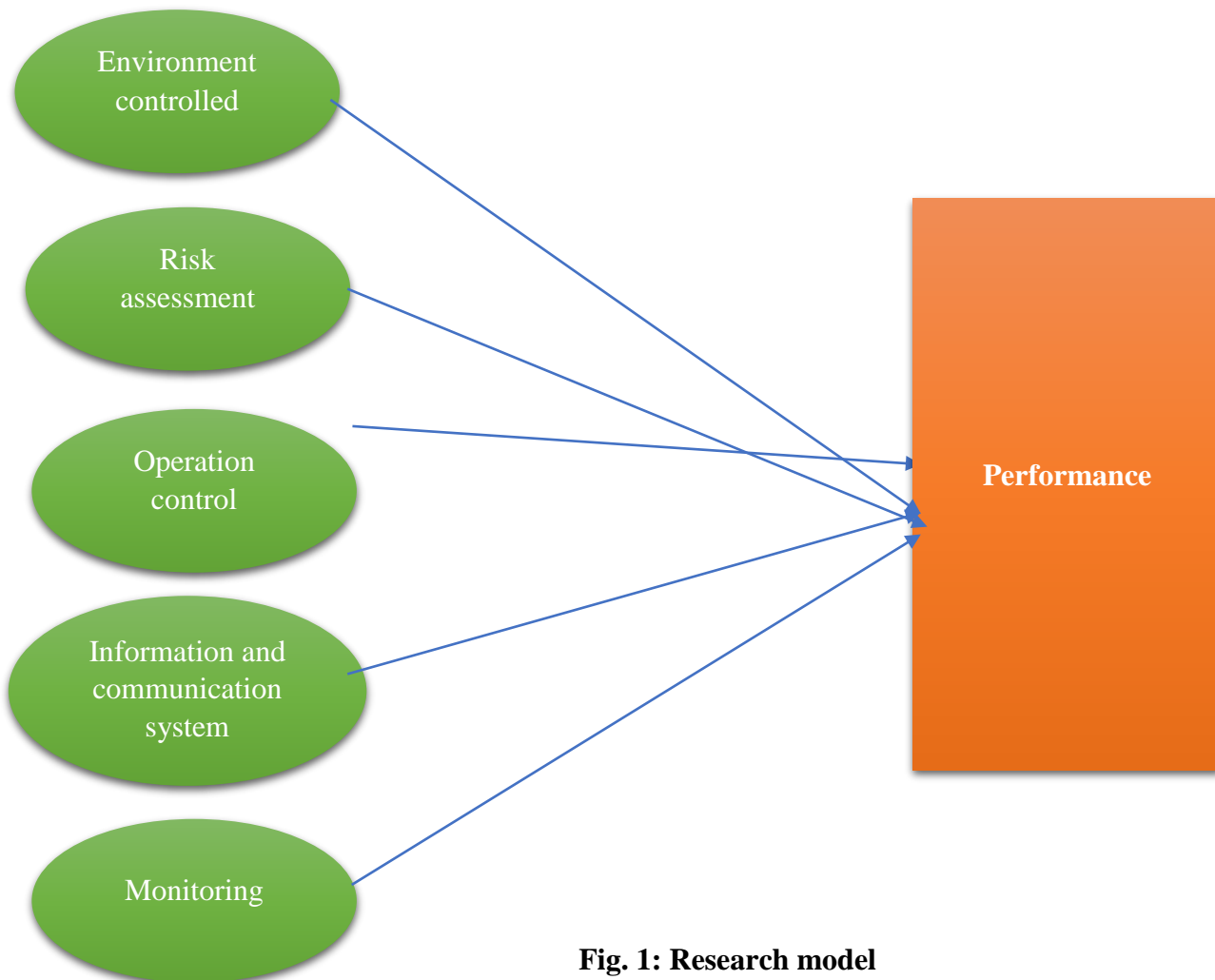


Fig. 1: Research model

*From the above research model, the authors make the following hypothesis:*

*Hypothesis H1: control environment that affects business performance in small and medium enterprises in Vietnam.*

*Hypothesis H2: risk assessment affecting business performance in small and medium-sized enterprises in Vietnam.*

*Hypothesis H3: information and communication impact on business performance in small and medium enterprises in Vietnam.*

*Hypothesis H4: Control activity has an impact on business performance in small and medium enterprises in Vietnam.*

*Hypothesis H5: monitoring has an impact on business performance in small and medium enterprises in Vietnam.*

*Inside:*

The control environment is measured by scales: Integrity and Ethical Values (MTKS1), Commitment to the competency and qualifications of employees (MTKS2), Executive style and philosophy of management. (MTKS3), organizational structure (MTKS4), Assignment of power and responsibility (MTKS5), Human Resource Policy and Practice (MTKS6).

Risk assessment is measured by the scales: Risk Identification (SDR1), risk assessment (SDR2), Risk Reduction (SDRR3).

Information and communication systems are measured by scales: The information system of the enterprise is fully collected (HTTT1), the quality of information of the enterprise is guaranteed (HTTT2), the information transmission system connected to all related objects (HTTT3).

Control activities are measured by scales: Reasonable division of responsibilities in production and business activities of the company (HDKS1), Control of scientific information processing (HDKS2), material control (HDKS3), Assessing the operational status of the business (HDKS4).

Monitoring is measured by scales: Weaknesses in internal control are detected through monitoring activities (GS1), Monitoring plays an important role to achieve goals (GS2), Monitoring is daily activities. and built on business operations (GS3).

Business performance is measured by the following scales: Assets of the enterprise in the past year increased steadily (HQKD1), Profitability of enterprises in recent years grew steadily (HQKD2), Profitability The company's assets over the past years have steadily increased (HQKD3).

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