THE IMPACTS OF INTERNAL AUDIT PRACTICES ON THE QUALITY OF INTERNAL CONTROL IN VIETNAMESE SMES

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ARTICLE INFO	ABSTRACT
	Purpose: This study examines the impacts of internal audit practices on internal control in Vietnamese SMEs. **Theoretical framework:** This paper employs the three lines of defense model framework to study the impact of internal audit practices on internal control in Vietnamese SMEs. Internal auditing practices were measured by the items listed in the attribute standards and performance standards of the International Professional Practices Framework (IPPF). Internal control quality includes control environment, risk assessment, control activities, information and communication, and monitoring which are provided by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework. **Design/methodology/approach:** We collect primary data using questionnaire. Data collected from the questionnaire is divided into two groups (1) the measurement of the internal auditing practices and (2) the measurement of the quality of internal control system. We then use the Structural Equation Modelling (SEM) to test for the hypotheses related to the relationship between internal audit practices and internal control. **Findings:** Our results suggest that both attribute standards and performance standards have positive impacts on the control environment, risk assessment, control activities, and monitoring aspects of internal control. Meanwhile, internal audit seems to not influence the information and communication. **Research, Practical & Social implications:** The study contributes to the literature by shedding light on the impacts of internal audit practices on the quality of internal control in Vietnamese SMEs. **Originality/value:** This study examines the unique context of Vietnamese SMEs. Ultimately, the framework aims to provide a comprehensive understanding of how internal audit practices impact internal control quality in this specific context. Doi: https://doi.org/10.26668/businessreview/2023.v8i5.2027

OS IMPACTOS DAS PRÁTICAS DE AUDITORIA INTERNA NA QUALIDADE DO CONTROLE INTERNO NAS PMES VIETNAMITAS

RESUMO

Objetivo: Este estudo examina os impactos das práticas de auditoria interna sobre o controle interno em PMEs vietnamitas.

Estrutura teórica: Este artigo emprega a estrutura do modelo de três linhas de defesa para estudar o impacto das práticas de auditoria interna no controle interno em PMEs vietnamitas. As práticas de auditoria interna foram medidas pelos itens listados nos padrões de atributos e padrões de desempenho do International Professional

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Practices Framework (IPPF). A qualidade do controle interno inclui ambiente de controle, avaliação de riscos, atividades de controle, informação e comunicação e monitoramento fornecidos pelo Comitê de Organizações Patrocinadoras da Estrutura da Comissão Treadway (COSO).

Desenho/metodologia/abordagem: Coletamos dados primários por meio de questionário. Os dados coletados do questionário são divididos em dois grupos (1) a medição das práticas de auditoria interna e (2) a medição da qualidade do sistema de controle interno. Em seguida, usamos a Modelagem de Equações Estruturais (SEM) para testar as hipóteses relacionadas à relação entre práticas de auditoria interna e controle interno.

Descobertas: Nossos resultados sugerem que tanto os padrões de atributos quanto os padrões de desempenho têm impactos positivos no ambiente de controle, avaliação de riscos, atividades de controle e aspectos de monitoramento do controle interno. Enquanto isso, a auditoria interna parece não influenciar a informação e a comunicação.

Pesquisa, implicações práticas e sociais: o estudo contribui para a literatura ao lançar luz sobre os impactos das práticas de auditoria interna na qualidade do controle interno nas PMEs vietnamitas.

Originalidade/valor: Este estudo examina o contexto único das PME vietnamitas. Em última análise, a estrutura visa fornecer uma compreensão abrangente de como as práticas de auditoria interna impactam a qualidade do controle interno neste contexto específico.

Palavras-chave: COSO, Auditoria Interna, Controle Interno, IPPF, PME Vietnamita.

LOS IMPACTOS DE LAS PRÁCTICAS DE AUDITORÍA INTERNA EN LA CALIDAD DEL CONTROL INTERNO EN LAS PYMES VIETNAMITAS

RESUMEN

Propósito: Este estudio examina los impactos de las prácticas de auditoría interna en el control interno en las PYMES vietnamitas.

Marco teórico: este documento emplea el marco del modelo de tres líneas de defensa para estudiar el impacto de las prácticas de auditoría interna en el control interno en las PYMES vietnamitas. Las prácticas de auditoría interna se midieron por los elementos enumerados en los estándares de atributos y estándares de desempeño del Marco Internacional de Prácticas Profesionales (IPPF). La calidad del control interno incluye el entorno de control, la evaluación de riesgos, las actividades de control, la información y la comunicación, y el seguimiento que proporciona el Marco del Comité de Organizaciones Patrocinadoras de la Comisión Treadway (COSO).

Diseño/metodología/enfoque: recopilamos datos primarios mediante un cuestionario. Los datos recopilados del cuestionario se dividen en dos grupos (1) la medición de las prácticas de auditoría interna y (2) la medición de la calidad del sistema de control interno. Luego usamos el Modelado de Ecuaciones Estructurales (SEM) para probar las hipótesis relacionadas con la relación entre las prácticas de auditoría interna y el control interno.

Hallazgos: Nuestros resultados sugieren que tanto los estándares de atributos como los estándares de desempeño tienen impactos positivos en el entorno de control, la evaluación de riesgos, las actividades de control y los aspectos de monitoreo del control interno. Por su parte, la auditoría interna parece no influir en la información y comunicación.

Implicaciones de investigación, prácticas y sociales: el estudio contribuye a la literatura al arrojar luz sobre los impactos de las prácticas de auditoría interna en la calidad del control interno en las PYMES vietnamitas.

Originalidad/valor: este estudio examina el contexto único de las pymes vietnamitas. En última instancia, el marco tiene como objetivo proporcionar una comprensión integral de cómo las prácticas de auditoría interna afectan la calidad del control interno en este contexto específico.

Palabras clave: COSO, Auditoría Interna, Control Interno, IPPF, PYME Vietnamita.

INTRODUCTION

The objective of an internal audit (IA) is to give independent confirmation that a company's risk management, governance, and internal control mechanisms are running successfully (Fadzil et al., 2005). Meanwhile, internal control (IC) is a procedure meant to aid management in accomplishing three organizational goals: effectiveness and efficiency of

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operations, the accuracy of reporting, and compliance with applicable rules and regulations (Committee of Sponsoring Organizations of the Treadway Commission - COSO, 2013).

Internal control is the design and execution of essential control systems and procedures to mitigate the effect of potential risks. Management is responsible for establishing a successful internal control system, as well as operating and monitoring it as necessary. Internal auditing is a vital yet distinct aspect of internal control. The reports generated by the internal audit function as part of the internal control framework provide managers with insight into the nature of internal controls. Internal audit units assess the functionality of the administration's internal control mechanisms and submit their findings to high management. In other words, internal audit units give management with information on internal controls, as well as assessments and recommendations. The internal audit activity contributes to the organization's control effectiveness by analyzing the efficacy and efficiency of controls and promoting continual improvement.

According to the three lines of defense model from The Institute of Internal Auditors (The IIA), internal control is part of the first line of defense because it is the responsibility of operational management, which itself is accountable to senior management. Internal audit is part of the third line of defense. It even assesses the effectiveness of the first (operational management functions) and second (risk and compliance management functions) lines of defense. Moreover, unlike internal control, internal audit may report directly to the board of directors and specifically the audit committee, in order to maintain a certain independence and objectivity when assessing other functions in the company that operate at the first two lines of defense (Figure 1).

Figure 1. The three lines of defense model
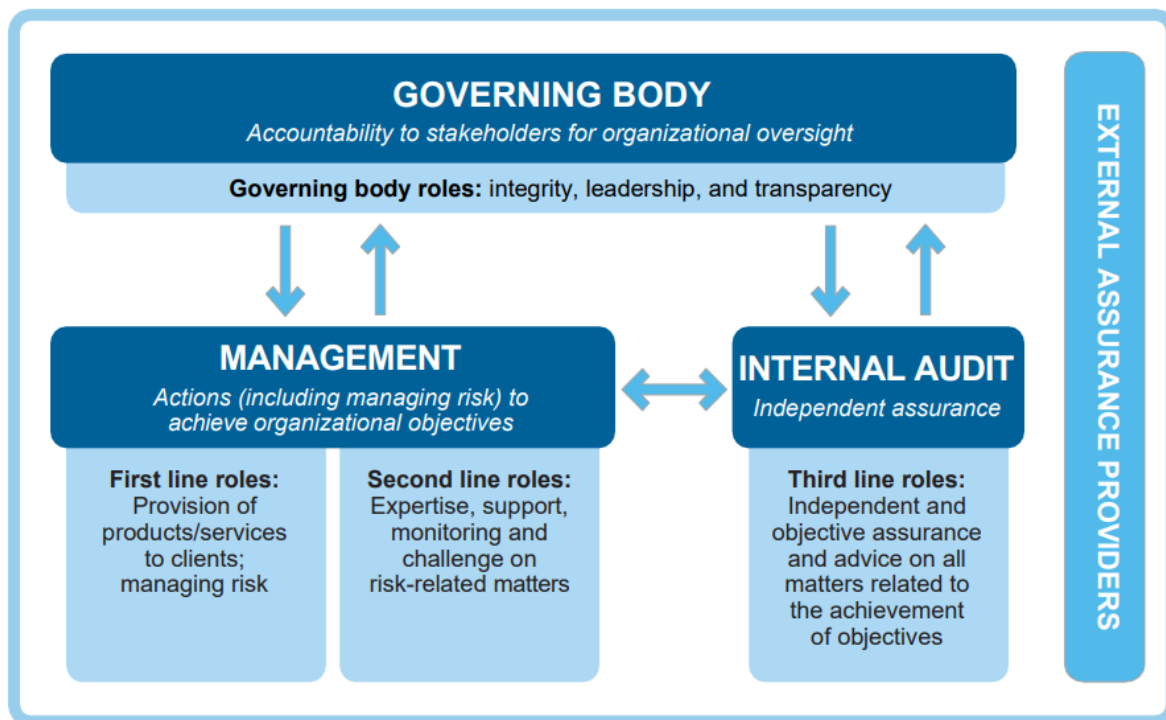
Source: The institute of internal auditors (The IIA)

Sawyer and Vinten (1996) give four benefits that corporate managers receive from the help of internal audit. The recommendations of the Internal Audit, including pointing out the weaknesses in the internal control system, advising on improving this system are the basis for managers to evaluate and act towards the goal. Internal audit provides periodic reports with timely, useful and reliable information that is the solution to all business problems that any leader in the company needs.

Davies (2001) gives the definition of internal audit as an independent evaluation activity established by managers in the company to review the internal control system. Internal audit will objectively examine, evaluate and report on the adequacy of the internal control system, thereby contributing to the optimal use of the enterprise's resources.

Hanim et al. (2005) have found that the management and performance of the internal audit department has a significant influence on the monitoring of all aspects of the internal control system. The workload of audit activities affects the information exchange process of the internal control system. The study also shows that the management of the internal audit department, the implementation of audit programs and audit reports greatly affects the risk assessment process of the internal control system. This study also provides recommendations for the scope of internal audit work of listed companies in Malaysia, which clearly states that compliance with best practices of internal audit will impact the quality of internal control.

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Chang et al. (2019) examine the association between internal audit quality and internal control deficiencies in operations and compliance of Taiwanese companies. The findings of this study indicate that a bigger internal audit team can improve internal audit performance for both operations and compliance, but internal auditor competency is positively linked with the efficacy of internal control over compliance, but not operations.

In this study, we examine the impact of internal audit practices on internal control quality of Vietnamese SMEs. According to the Ministry of Planning and Investment of Vietnam, SMEs account for 97% of enterprises that are operating in Vietnam, contributing 45% of GDP of Vietnam, 31% of total budget revenue and attracting more than 5 million employees in the country. Internal control is a tool by which are directed, monitored and measured resources of these SMEs. It plays an important role in the prevention and detection of fraud and physical protection; more over it leads to high operational efficiency of the business. Besides, internal controls ensure a company complies with state laws and regulations in the management of financial data; strong internal controls can improve operational efficiency and ensure accurate financial reporting during internal or external audits.

We focus on the impacts of internal audit practices on the internal control in Vietnamese SMEs. Internal auditing practices was measured by the items listed in the attribute standards and performance standards of the International Professional Practices Framework (IPPF). Internal control quality includes control environment, risk assessment, control activities, information and communication, and monitoring which are provided by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework. Our results suggest that both attribute standards and performance standards have positive impacts on the control environment, risk assessment, control activities, and monitoring aspects of internal control. Meanwhile, internal audit seems to have no influence on the information and communication.

The rest of our paper is as follows. Section 2 shows the research framework. Section 3 illustrates the data information. Section 4 provides results and discussions, and Section 5 gives concluding remarks.

LITERATURE REVIEW
Internal Audit Standards

The mission for internal auditing is to enhance and protect organizational value by providing risk-based and objective assurance, advice and insight. The International Professional

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Practices Framework (IPPF) is the conceptual framework that organizes authoritative guidance promulgated by the Institute of Internal Auditors (IIA). The standards of IPPF consist of three sets of standards: attribute, performance, and implementation standards. The Attribute Standards address the characteristics of organizations and parties performing internal audit activities. The Performance Standards describe the nature of internal audit activities and provide quality criteria against which the performance of these services can be evaluated. While the Attribute and Performance Standards apply to all internal audit services, the Implementation Standards apply to specific types of engagements.

The attribute standards incudes:

– Purpose, Authority, and Responsibility

– Independence and Objectivity

– Proficiency and Due Professional Care

– Quality Assurance and Improvement Program

The quality standards incudes:

– Managing the Internal Audit Activity

– Nature of Work

– Engagement Planning

– Performing the Engagement

– Communicating Results

– Monitoring Progress

– Communicating the Acceptance of Risks

Quality of Internal Control

The COSO Framework is a system used to establish internal controls to be integrated into business processes. Collectively, these controls provide reasonable assurance that the organization is operating ethically, transparently and in accordance with established industry standards. There are five interrelated components of an internal control framework: control environment, risk assessment, control activities, information and communication, and monitoring.

Research Framework

This study focuses on examining the impacts of internal auditing practices on quality of the internal control system in Vietnamese SMEs. Figure 2 illustrates the research framework in our study.

Figure 2. Research framework
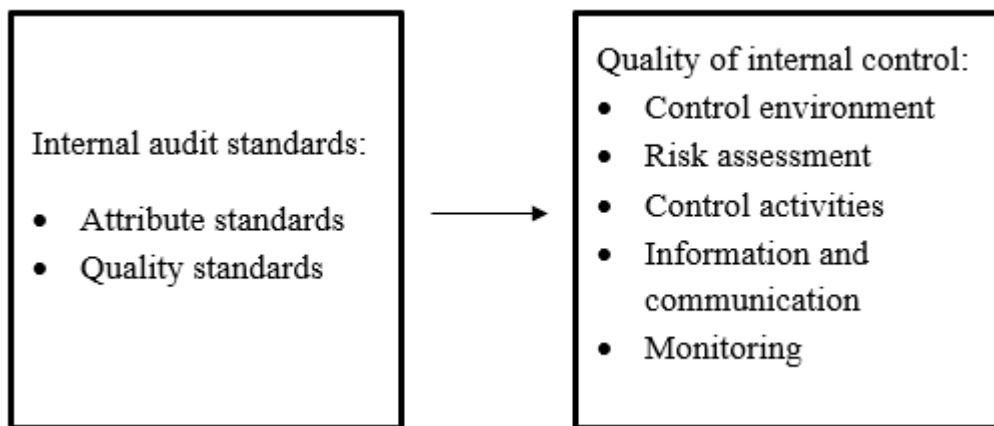
Source: Prepared by the authors (2023).

The research hypotheses will examine the compliance of the internal auditing practices to the quality of the internal control system. There are 10 sub-hypotheses relating the internal auditing practices to internal control system.

H1: The better attribute standards of internal auditing practices, the higher the quality of the internal control system.

H1a: The better attribute standards of internal auditing practices, the better the control environment.

H1b: The better attribute standards of internal auditing practices, the better the risk assessment.

H1c: The better attribute standards of internal auditing practices, the better the control activities.

H1d: The better attribute standards of internal auditing practices, the better the information and communication.

H1e: The better attribute standards of internal auditing practices, the better the monitoring.

H2: The higher quality standards of internal auditing practices, the better the quality of the internal control system.

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H2a: The higher quality standards of internal auditing practices, the better the control environment.

H2b: The higher quality standards of internal auditing practices, the better the risk assessment.

H2c: The higher quality standards of internal auditing practices, the better the control activities.

H2d: The higher quality standards of internal auditing practices, the better the information and communication.

H2e: The higher quality standards of internal auditing practices, the better the monitoring.

For the hypothesis testing, we employ the PLS-SEM approach.

MATERIALS AND METHODS

The basic data collection utilized for this study was a survey design. The collection of primary data was accomplished through the use of questionnaire. Data collected from the questionnaire is divided into two groups (1) the measurement of the internal auditing practices and (2) the measurement of the quality of internal control system. All observed variables are defined using the Likert scale, which ranges from 1 (strongly disagree) to 5 (strongly agree). Face-to-face, drop-off, and email methods were employed to distribute the questionnaire, culminating in 389 returned copies. Table 1 shows information on sampling and return rates of the questionnaires sent to the internal auditors and the audit committees Of the 800 questionnaires sent, 250 responses from both internal auditors and audit committees were received resulting in a response rate of 31.25 percent. Table 1 shows the demographic profile of the study participants.

Table 1. Summary of demographic data on respondents

Demographic	Characteristics	Frequency	Percent
Current position	Manager	88	35.2
	Director	59	23.6
	Audit committee	57	22.8
	Senior	6	2.4
	Others	40	16.0
Qualification	First degree	82	32.8
	Post graduate	34	13.6
	Diploma	6	2.4
	Certificate	4	1.6
	Others	124	49.6

Source: Prepared by the authors (2023).

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RESULTS AND DISCUSSIONS

The bias generated by Common Method Variance (CMV), known as common method bias, appears when the estimated relationship between one construct and another might be inflated. In another word, CMV produces a systematic covariation above the true relationship between the scale items (Malhotra et al., 2017). To avoid this threat of biased outcomes in our data analysis, we employ Harman's single-factor test to check for CMV in our data.

The results of the principal component factor analysis showed that the highest value of a single factor explained 30.12% of the total variance, which is less than the threshold of 50% (Kumar, 2012; Doty and Astakhova, 2020). Hence, bias from CMV does not exist in our data and it is not a concern in our data analysis.

Reliability and Convergent Validity

Before studying the causal effects of variables, we first ensure the validity and reliability of the study model using the factor loadings, Cronbach's alpha (CA), factor loadings from Exploratory factor analysis (EFA), Average Variance Extracted (AVE), and Composite Reliability (CR).

Table 2 illustrates the measurement model. The CA met the recommended value higher than 0.70, the value ranges from 0.894 to 0.939. The CR ranging from 0.814 to 0.907 also fulfilled the criteria as it was above the minimum recommended value of 0.70 (Hair et al., 2019). The AVE value of the four variables was within the range 0.594 and 0.765, which fulfilled the recommended value above 0.50. The factor loadings satisfy the recommended value above 0.4 (Hair et al., 2019).

Table 1. Reliability and Convergent Validity results

Constructs	Items	Factor loading	Cronbach's alpha	Average Variance Extracted	Composite Reliability
Attribute standards (AS)	AS1	0.815	0.901	0.594	0.814
	AS 2	0.804			
	AS3	0.798			
	AS4	0.864			
Quality standards (QS)	QS1	0.797	0.927	0.640	0.842
	QS2	0.783			
	QS3	0.782			
	QS4	0.854			
	QS5	0.743			
	QS6	0.703			
	QS7	0.811			
Control environment (CE)	CE1	0.846	0.864	0.765	0.907
	CE2	0.818			
	CE3	0.802			

Risk assessment (RA)	RA1	0.788	0.932	0.630	0.836
	RA2	0.765			
	RA3	0.760			
Control activities (CA)	CA1	0.750	0.939	0.639	0.842
	CA2	0.726			
	CA3	0.716			
Information and communication (IC)	IC1	0.895	0.906	0.676	0.862
	IC2	0.865			
	IC3	0.861			
Monitoring (MON)	MON1	0.837	0.914	0.634	0.874
	MON2	0.807			
	MON3	0.793			

Source: Prepared by the authors (2023).

Structural Equation Modeling results

The impacts of attribute standards of internal audit on internal control quality

Table 3 shows the results for the impacts of attribute standards of internal audit on internal control quality. Among five related hypotheses, four hypotheses (H1a, H1b, H1c, H1e) are supported by our empirical results while hypothesis H1d rejected.

Table 3. The impacts of attribute standards of internal audit on internal control quality

Hypotheses	Causal relationships	Coefficients	S.E.	p-value
H1a	AS → CE	0.166^{**}	0.071	0.019
H1b	AS → RA	0.191^{***}	0.070	0.006
H1c	AS → CA	0.151^{*}	0.079	0.056
H1d	AS → IC	0.050	0.069	0.725
H1e	AS → MON	0.120^{*}	0.068	0.077

Note: *, **, *** indicates coefficients significant at 10%, 5%, 1% significance level.
Source: Prepared by the authors (2023).

The attribute standards address the characteristics of organizations and parties performing internal audit activities. Conformance with the attribute standards can be assessed by breaking them down into simple concepts: 1) reviewing the internal audit charter; 2) determining the independence of the internal audit activity and objectivity of the internal auditors; 3) evaluating the proficiency and due professional care with which engagements are performed; and 4) confirming the completion, maintenance, and communication of the quality assurance and improvement program. For existing internal audit activities, these concepts should already be established. Newly formed internal audit activities should determine how they are going to apply the attribute standards, and then implement and document them, as they help set the stage tor why the internal audit activity exists and how it will function.

According to the hypotheses testing results, the attribute standards of internal audits have positive influences on the control environment, risk assessment, control activities, and

monitoring of internal control quality of Vietnamese SMEs. However, attribute standards do not affect risk assessments and information and communication of internal control.

The impacts of quality standards of internal audit on internal control quality

Table 4 shows the results for the impacts of performance standards of internal audit on internal control quality. Among five related hypotheses, four hypotheses (H2a, H2b, H2c, H2e) are supported by our empirical results while the hypothesis H2d is rejected. This result is similar to the impact of attribute standards on internal control.

Table 2. The impacts of quality standards of internal audit on internal control quality

Hypotheses	Causal relationships	Coefficients	S.E.	p-value
H2a	QS → CE	0.143**	0.071	0.044
H2b	QS → RA	0.114*	0.065	0.079
H2c	QS → CA	0.250***	0.071	0.000
H2d	QS → IC	-0.024	0.065	0.756
H2e	QS → MON	0.368***	0.081	0.000

Note: *, **, *** indicates coefficients significant at 10%, 5%, 1% significance level.
Source: Prepared by the authors (2023).

The performance standards describe the nature of internal audit activities and provide quality criteria against which the performance of these services can be measured. Performance of audit work plays a great impact on the control environment of the quality of the internal control system (Fadzil et al., 2005). Therefore, the better the performance of the audit work, the greater is the control environment on the quality of the internal control system. In performing the audit work, the internal auditors have been trained and are competent to do the audit work. Consequently, they are able to identify and analyze the necessary records to achieve the audit objective. This will have a positive impact on the control environment of the quality of the internal control systems since the senior management will demonstrate a higher climate of trust with better performance of the audit work.

CONCLUSION

The effects of internal audit procedures on internal control in Vietnamese SMEs are investigated in this study. The International Professional Methods Framework's attribute criteria and performance standards were used to gauge internal auditing practices (IPPF). Internal control quality is defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework and encompasses the control environment, risk assessment, control actions, information and communication, and monitoring. Our findings

imply that the control environment, risk assessment, control activities, and monitoring aspects of internal control are all positively impacted by both attribute standards and performance standards. Internal audit, meanwhile, doesn't appear to have any impact on information or communication. Our findings add to the body of knowledge by illuminating how internal audit procedures affect the effectiveness of internal control in Vietnamese SMEs.

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