

## FINANCIAL STATEMENT OF COMMERCIAL BANKS IN VIETNAM

**Dr. LÊ TẤN PHƯỚC\***

*At present, especially after Vietnam's accession to the WTO, banking services become diverse and complicated and involve high degrees of risk, which requires independent audit of financial statements of commercial banks because this sector plays an important role in the economy and is sensitive to changes in economic and political conditions*

### **1. Factors affecting the audit of financial statements of commercial banks**

#### **a. Internal factors:**

In the internal controlling system of commercial banks, especially the internal audit, there exist many shortcomings.

- Direct cause: One of the main causes is the lack of distinction between internal audit and checking task in each operation.

- Indirect causes: Existing horizontal and vertical relations, to a certain extent, limit independence of the internal audit. In the vertical relation, operations of the internal audit at a branch are somehow directed by the central department of internal audit but its audit report must be sent to manager of the bank branch. In its horizontal relation, the internal audit department is responsible to the branch manager who directs all of its operations.

#### **b. Effects of independent auditing firms:**

At present, some 160 auditing firms are doing business in Vietnam. According to the Article 33 of Decree 105/2004/NĐ-CP dated March 30, 2004

on the independent auditing service and Decision 47/QĐ-BTC made on July 14, 2005 by Ministry of Finance on delegation of some tasks of controlling the accounting and auditing services to their trade associations, auditing firms as from Oct. 1, 2006 should register for working license for their auditors with Vietnam Association of Certified Public Accountants (VACPA). At present, only firms with at least three certified, full-time, and VACPA-approved auditors are allowed to supply auditing services. And such auditors can sign auditing reports.

- Local companies have no habit of using the audited financial information as a basis for their business decisions, which fails to enhance auditors' sense of responsibility for quality of service their supply.

- Unfair competition between auditing firms by offering lower fees for their services affects indirectly and unfavorably the quality of auditing reports. To ensure their profit from lower fees, auditing firms have to reduce time needed for auditing, and cut procedures and required number of documents audited, which leads to higher degrees of auditing risk.

- Most local auditing firms are in their first stage of development. Their army of auditors is small and lacks experience. They have no, or very small if any, department specializing in bank auditing and auditing operations are limited. In addition, these firms have no measures to supervise operations carried out by auditors in order to enhance the service quality.

#### **c. Effects of the business climate:**

- From legal infrastructure:

Control over the quality of independent auditing service is not carried out properly as shown in the following facts:

(1) Role of authority in the independent auditing business is not clear;

(2) There is no regulation requiring liability insurance for auditors;

(3) Control over auditors is not strict enough to prevent malpractices (leasing auditor's diploma, working for several firms at the same time, etc.); and

(4) Selection of auditing firm by tender encourages firms to offer the lowest fees to win the contract, which affects badly the quality of auditing service. This problem becomes more serious because auditing independently the commercial banks in Vietnam is difficult and costly. Moreover, selecting the auditor by tender leads to frequent change in auditors for a commercial banks, which may entail poor efficiency and service quality.

- From economic environment:

+ Poor disclosure of information: this situation leads to shortage of available information and its poor quality, which affects unfavorably assessment of credit officials in commercial banks and creates obstacles to auditing service.

Poor disclosure of information also lowers efficiency and significance of the auditing service, which shows itself in the fact that businesspersons have no habit of using financial statements and auditing reports for their decision making process.

+ Market institutions in Vietnam are poor and not well managed, especially the finance market.

## **2. Directions for development of independent audit of financial statements of commercial banks**

### ***a. Common trend of banking sector in the near future:***

At present, the banking system with its leading role played by state-owned banks is still strongly protected. When the market is open to foreign competition, the financial- banking sector can not be an exception. In other words, the competition in this sector will certainly get much keener, especially from foreign banks.

In the trend of international integration, banks can not be bystanders. The international integra-

tion provides banks with both opportunities and challenges, which forces banks to renovate their ways of doing business and improve their competitiveness. We can see that, in the near future, banking services in Vietnam will be more complicated and the competition much fiercer. In such a situation, auditing is an important instrument for supervising operations of banks.

### ***b. Directions for development of independent audit in the banking sector:***

Development targets of the auditing business in Vietnam up to 2020 are as follows:

- Increasing the number of auditing firms, expanding the size of each firm, diversifying the services supplied and gaining a high growth rate in terms of sales and profit.

- Improving the service quality in order to reduce liability risks, standardizing auditing procedures, controlling the quality of services supplied, and enhancing knowledge of state control on the auditing business in order to integrate the accounting business into regional and international markets.

## **3. Measures to enhance efficiency of independent audit of financial statements of commercial banks**

### ***a. For commercial banks:***

- An appropriate information service:

Information plays an important role in banking operations. To enhance quality of the information system, banks should increase their investment in technological application. At present, most banks recognize investment in technology is an important measure to maintain their competitiveness and improve their business performance when the competition on the market becomes keener and keener.

- Risk management:

Banks should establish departments responsible for managing risks, liabilities and assets, and a risk management commission under the board of directors specializing in (1) enhancing competence of the board of directors, especially in risk and strategic management; (2) establishing criteria for predicting changes in the business climate; and (3) estimating degrees of risks in business plans and estimating the business performance regularly.

A liabilities and assets management board di-

rectly under the directorate is also necessary. Other measures to control risks are:

- + Building an information system to record and supervise all business risks and supply information timely to the directorate.

- + Studying and applying modern measures to control the risks, especially the task of building a model for quantifying the risks.

- + Recruiting and training employees in skills and knowledge needed for risk management and supervision.

- Development of human resource for internal audit:

It is necessary to make plan to train and check the quality of the army of internal auditors on a regular basis. The training program for internal auditors must aim at (1) general knowledge of banking operations, law, economics, IT, foreign languages and auditing operations; (2) auditing skills; and (3) people skill.

- Independence of auditors and their position:

Internal auditing body should be allowed to fulfill their task autonomously and independently. Internal auditors should not do their jobs in departments where their relatives work.

The internal auditing body is only responsible to and under direct management of the directorate. If they detect serious violations, including ones committed by members of the directorate, they can report to the board of directors. Internal auditing body in branches of the bank has right to report directly to their superior auditors instead of waiting for approval of the branch manager.

## ***b. For independent auditing firms:***

- Independent auditing firms should enhance the services supplied, avoid such practices of unfair competition as unreasonable cuts in service fees, work out reasonable program to train new auditors, develop general auditing procedures and techniques and the ones used for commercial banks, and cooperate with Ministry of Finance, SBV and related organizations in building and promulgating a system of Vietnam auditing standards, and building accounting procedures for commercial banks according to international practices.

## ***c. For authorities:***

- Beefing up the control over independent auditing in commercial banks:

Conditions for establishment of auditing firms should be stricter and higher in order to prevent unfair competition and falls in the service quality. Operations of auditors must be well under control to prevent such malpractices as leasing of auditor's diplomas and certificates or working for many firms simultaneously.

Subordinate legislation must be promulgated to provide guidelines on implementation of regulations about the auditing business, especially sanctions against violations of these regulations. In fact, investigations of financial authorities have discovered many violations but such cases couldn't be handled properly because of lack of necessary sanctions. In an effort to improve the situation, the SBV has promulgated some stricter regulations on the auditing business to enhance the service quality, introduce standard auditing reports, and facilitate cooperation between SBV inspectors and independent auditors, and between independent and internal auditors.

- The role of governing bodies:

The professional association plays an important role in controlling operations and service quality of independent auditors, therefore, regulations and rules related to the Vietnam Association of Accountants and Auditors must be perfected as soon as possible. This association will be responsible for checking and supervising the quality of services supplied by its members, and play its role in training and controlling its members.

The role of Ministry of Finance in management of independent auditing business must be also enhanced.

In the banking sector, the SBV should beef up its control over independent audit of commercial banks. This task could be assigned clearly to a specialized body, such as banking inspectors under the SBV.

- Relations between banking inspectors, independent and internal auditors:

Foreign experience shows that such relations allow them to learn work experience from others and gain benefits from work of others. Banking inspectors can study auditing results and discuss with auditors in do their jobs better. Auditors can form initial assessment based on information supplied by banking inspectors (through inspection reports or direct conversation).

Banking inspectors can use reports from independent auditors to estimate roughly performance of banking institutions and work out appropriate procedures for inspection. They have right to allow, or refuse, services supplied by independent auditors. They can also inspect the internal controlling mechanism and force banking institutions to observe SBV regulations on the internal control and audit.

Banking institutions should cooperate closely with independent auditors and banking inspectors when they carry out their tasks in the institutions. Banking institutions should provide all reports of internal auditors for external auditors as required and report to banking inspectors on results of internal auditing.

As for large-scale institutions with numerous branches or subsidiaries, they can have part of internal auditing jobs done by independent auditors to save labor and ensure objectivity of the internal audit.

- A more perfect system of accounting and auditing standards:

Systems of accounting and auditing standards serve as bases for auditors to work out their plans, carry out their auditing tasks and offer their assessment. In the banking sector, this is much more important because operations of banks are different from those in other concerns and involve higher degrees of risk.

To enhance the quality and efficiency of auditing service, therefore, financial authorities must develop and apply accounting practices appropriate to international standards to commercial banks. In addition, perfecting the system of national accounting standard with a view to improving quality of information supplied and transparency of all kinds of companies is also very important. This is appropriate to the need to integrate into the world economy of the banking sector and the whole economy as well.

On Nov. 6, 2009, Ministry of Finance issued Circular 210/2009/TT-BTC providing guidelines on application of international accounting standards to presentation of financial statement and disclosure of information for financial instruments. The Circular has a special importance to efforts to integrate the Vietnamese economy into the world and enhance transparency of financial statements, which demonstrates Vietnam's determination to

apply all international accounting standards (IAS). Up to the day when the Circular was issued, IASs about financial instruments include IAS 32 Financial Instruments: Presentation; IAS 39 Financial Instruments: Recognition and Measurement; and IFRS 7 Financial Instruments: Disclosures. The three sets of IASs (referred to collectively as IASs of financial instruments) are among a group of complicated, demanding and influential standards for the making and presentation of financial statements. The Circular 210 only includes IAS 32 and IFRS 7, not IAS 39 (it is reportedly promulgated in the near future).

The Circular 210 applies to all kinds of concerns in all sectors whose operations have something to do with financial instruments. Because financial instruments have a broad definition and comprise various kinds of assets and liabilities, application of accounting standards will have a strong influence on all organizations, including the ones in financial- banking sector■

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