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Internal Control Factors Influencing the Operational Efficiency of Non-Financial Companies Listed on Vietnam's Stock Exchange

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Abstract

Purpose to assess the influence of the factors on the operational efficiency of non-financial companies listed on Vietnam's stock exchange. The study in factors influencing on the internal control system in non-financial companies listed on Vietnam's stock exchange has drawn a brief description of related issues and assessed the influence of the factors on the operational efficiency of non-financial companies listed on Vietnam's stock exchange. Findings: the Information and Communication has the most influence on the operational efficiency, then Risk Assessment, Control Environment and Monitoring. The Control Activities has the least influence on the operational efficiency.

Keywords: Internal control; Control system; Operational efficiency.

1. Introduction

The internal control (IC) is all of the rules, policies, and procedures designed and implemented by a company to efficiently manage its performance. In the global economic integration with increasing competition and risks, the development and implementation of internal control in companies are important tasks for managers. However, theoretically and practically, managers are inappropriately aware of the importance and necessity of development and implementation of internal control and there is a lack of measuring tools for managers to assess the influence of the internal control on the operational efficiency of the companies.

In fact, the internal control and operational efficiency are separately considered and carried out in non-financial companies listed on Vietnam's stock exchange, hence this paper has deeply focused on the internal control factors influencing the operational efficiency of non-financial companies listed on Vietnam's stock exchange.

2. Theory and Research Methodologies

2.1. Theory of Internal Control

The internal control has been researched by scholars and researchers all over the world since the early twentieth century. The theory has been systematically completed and widely applied in many fields, especially in accounting.

The concept of the internal control was first introduced by Robert H. Montgomery in "Auditing – Theory and Practice" and perspectives on it were simply approached and primarily aimed at identifying its influence on audits of auditors. The internal control was officially used by the US Federal Reserve System (Fed) in 1929. The U.S. Securities and Exchange Commission (SEC) mentioned the internal control in the Securities Exchange Act of 1934 that the internal control system ensures to provide complete, accurate and clear information and accurately and fairly reflect operations, risks and profits. The internal controls were distinguished and formally described as administrative controls or accounting controls in the Statement on Auditing Procedure (SAP) No. 29, Scope of the Independent Auditor's Review of Internal Control issued by Committee on Auditing Procedure (CAP) of the American Institute of Certified Public Accountants (AICPA) in 1958. The internal control has been highly considered by many enterprises since 1970; particularly, auditors in their audits are responsible for assessing and recommending improvements of the internal control system. In the 1980s, the internal control was concerned by the lawmakers with enacted regulations such as codes of ethics, fraud control policy, regulations on evaluating internal control systems, principles of reporting and functioning internal controls.

The comprehensive frameworks and guidance on the internal control have been developed in 1992 by the National Commission on Fraudulent Financial Reporting sponsored jointly by the major and reputable professional associations under the Committee Of Sponsoring Organizations of the Treadway Commission (COSO, USA). The report of COSO is considered as one of the initiative comprehensive and systematic studies on the internal control in the management of highly increasing enterprise risks. The report has studied five components of the COSO Framework including Control Environment, Risk Assessment, Control Activities, Information and Communication; and Monitoring. The report has also established the foundation to assess and manage the internal control. This report is considered as the foundation for further researches on the internal control.

In Vietnam, the internal control is mainly associated with audit activities to provide complete and accurate materials for the internal governance of enterprises. The first legal documents on the internal control is the Decision No. 67/2004/QD-BTC dated 13 August 2004 promulgating the Regulation on financial and accounting self-inspection in agencies and units using State budget funding. However, the Decision has not detailed regulations and

guidelines on the internal control. Recently, more specific legal documents have been promulgated. For instance, the Circular No. 16/2011/TT-NHNN dated 17 August 2011 provides Regulations on Internal Control, Internal Audit The State Bank of Vietnam; the 2005 Law on State Audit stipulates the powers and responsibilities of agencies, organizations and individuals involved in the management and use of the State budget, public finance and assets through audited activities to ensure the accuracy and truthfulness of financial statements, including the development and maintenance of the internal control; the 2011 Law on Independent Audit stipulates responsibilities of units operating for public interests for drawing up and operating the appropriate and effective internal control system; the Circular No. 214 dated 06 December 2012 promulgating "Vietnam Audit Standards No. 315 – Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment" defining the internal control and its five components, which are the same as those in the COSO's report. In general, circulars, decisions and regulations on the internal control in Vietnam are sketchy, inadequate and associated with internal control activities and the internal control is not really considered as an effective method of enterprise management.

To sum up, five components of the internal control, including Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring are studied in the paper as factors.

2.2. Theory of Operational Efficiency

The efficiency is an economic concept firstly used from the slave society to socialism when human beings are aware that resources are limited and they always optimize resources to achieve the highest results. This is the first perception of "efficiency". Over time, the efficiency along with the socio-economic development becomes the first concern of each specific activity, especially in economics and business. The efficiency are increasingly widely mentioned in all fields.

From various perspectives and approaches, the efficiency are divided into many categories. Based on the objectives of the entity, the efficiency is divided into general efficiency and specific one (including economic efficiency and social one). Based on the period of implementation, the efficiency is divided into short-term and long-term efficiency; Based on the nature of impact, the efficiency is divided into direct efficiency and indirect one.

The assessment of the operational efficiency of different enterprises is different on the basis of their operations and scale. However, an entity is assessed to operate efficiently if its activities are potentially profitable and the ultimate goal of the entity is to make profits and provide benefits for the society. The paper uses the variables of ROA and ROE to assess the operational efficiency of studied companies.

## 2.3. Research Methodology

Scope of the research: Non-financial companies, especially ones producing and running business in goods and services as their main business lines.

Data for Research: The paper's data for research are the secondary data collected from the financial statements of 300 non-financial companies listed on Vietnam's stock exchange (namely HOSE) with the reported data of 3 years (of 2014, 2015, and 2016) to evaluate the operational efficiency. At the same time, the paper also uses the primary data collected from surveying these enterprises via questionnaires to assess the internal control system.

Analysis Methods: The influence of internal control factors on the operational efficiency of non-financial companies listed on Vietnam's stock exchange is analyzed on the basis of the secondary data from their financial statements. The data in three years has reflected many economic and political changes and fluctuations which affect the companies' activities. Therefore, the data are averaged over three years to minimize the disproportionate factors over the years.

Since the data were taken over 3 years, there were many economic and political changes that affected more or less the activities of businesses in the years, so the data in the topic was adjusted to limit the factors. disproportionate over the years by averaging over 3 years.

Research Model: The research model is composed of five components of the internal control (according to COSO Framework) and two indicators of ROA and ROE to assess the operational efficiency.
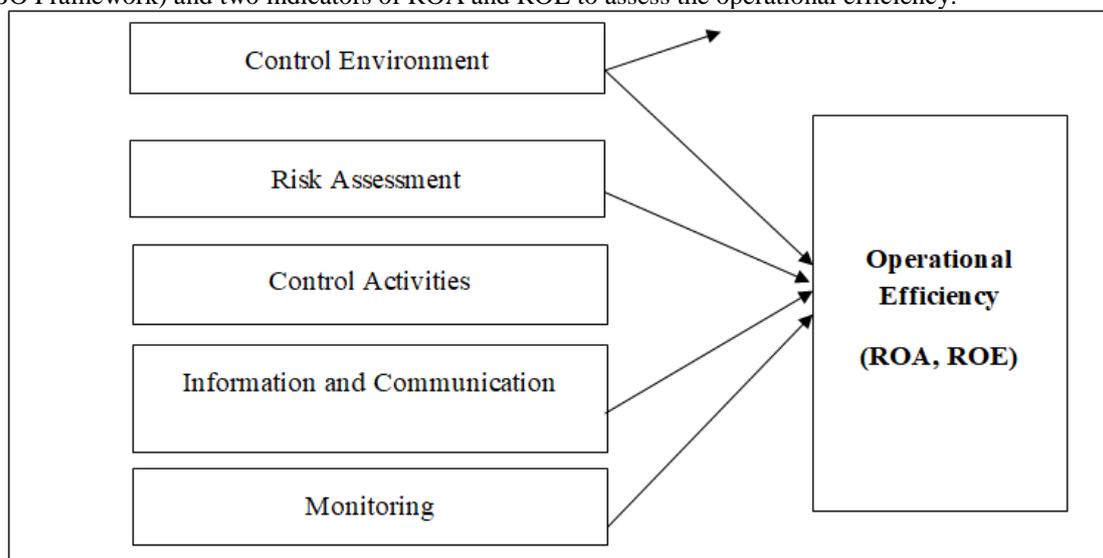
Research hypothesis: The internal control is directly proportional to the operational efficiency of non-financial companies listed on Vietnam's stock exchange.

Scales of the internal control: The observed variables of the internal control factors are based on COSO framework, and the five-point Likert-type scale from "Poor" to "Very good", specifically according to Table below.

Table

Scales	Item	Description of variables
Control Environment	MTKS1	Integrity and Ethical Values
	MTKS2	Commitment to Competence
	MTKS3	Management's Philosophy and Operating Style
	MTKS4	Organizational Structure
	MTKS5	Assignment of Authority and Responsibility
	MTKS6	Human Resource Policies and Procedures
	MTKS7	Board of Directors and Audit Committee
Risk Assessment	DGRR1	Risk Identification
	DGRR2	Risk Estimation
	DGRR3	Risk Analysis and Assessment
	DGRR4	Appropriate decision on dealing with risks
Control Activities	HDKS1	Policies and Procedures on Performance reviews
	HDKS2	Policies and Procedures on Information processing
	HDKS3	Policies and Procedures on Physical controls
	HDKS4	Policies and Procedures on Segregation of duties
Information and Communication	TTTT1	Developing and maintaining effective channels of information and communication
	TTTT2	Appropriate, complete, accurate, accessible, and timely information
	TTTT3	Communication among internal departments
	TTTT4	Communication among employees and between employees and managers
	TTTT5	Collecting information of external events, conditions and circumstances
Monitoring	GS1	Regular inspection and evaluation
	GS2	Periodic inspection and evaluation
	GS3	Report on shortcomings in the internal control system
	GS4	Internal audit activities
	GS5	Regular reviewing the accounting documents, statements and reports

3. Research Results
3.1. Evaluation of the Reliability of the Internal Control Scales

The first assessment of the scale reliability of the internal control factors has explored the internal control scales have the Cronbach's Alpha value > 0.6; and some variables, including MTKS4, DGRR1 and HDKS4, of the scales with the item-total correlation coefficient <0.3 are deleted from the scales. By deleting such variables, the remaining scales ensure the reliability with the Cronbach's Alpha value > 0.8, and the item-total correlation coefficient > 0.3. The remaining scales shall be applied in the Exploratory Factor Analysis (EFA).

Table-1

Scales	Cronbach's Alpha	N of Items	Item	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
Control Environment	0.773	7	MTKS1	25.8300	11.038	.514	.743
			MTKS2	25.8033	10.366	.628	.721
			MTKS3	25.8767	10.450	.644	.720
			MTKS4	26.3567	12.625	.056	.835
			MTKS5	25.9500	9.686	.628	.715
			MTKS6	26.0333	9.705	.580	.725
			MTKS7	25.8100	9.894	.560	.730
Risk Assessment	0.635	4	DGRR1	12.1900	4.917	.003	.830
			DGRR2	11.9867	3.518	.523	.494
			DGRR3	12.0300	2.899	.615	.400
			DGRR4	11.9033	3.138	.658	.389
Control Activities	0.689	4	HDKS1	10.7233	4.716	.533	.582
			HDKS2	10.5500	4.569	.703	.465
			HDKS3	10.5067	4.786	.612	.528
			HDKS4	10.4500	7.385	.098	.811
Information and Communication	0.837	5	TTTT1	13.9633	11.260	.600	.816
			TTTT2	14.0767	11.141	.705	.785
			TTTT3	13.9200	11.184	.708	.784
			TTTT4	13.8667	11.788	.655	.800
			TTTT5	13.8667	12.163	.537	.831
Monitoring	0.818	5	GS1	15.9367	8.628	.455	.829
			GS2	15.6833	7.903	.640	.772
			GS3	15.6767	8.133	.656	.768
			GS4	15.6333	7.758	.697	.755
			GS5	15.8567	8.418	.613	.781

Table-2

Scales	Cronbach's Alpha	N of Items	Item	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
Control Environment	0.835	6	MTKS1	21.9100	9.841	.544	.822
			MTKS2	21.8833	9.374	.615	.808
			MTKS3	21.9567	9.333	.663	.801
			MTKS5	22.0300	8.497	.670	.796
			MTKS6	22.1133	8.569	.607	.811
			MTKS7	21.8900	8.720	.592	.814
Risk Assessment	0.830	3	DGRR2	8.1400	2.676	.609	.839
			DGRR3	8.1833	2.077	.728	.728
			DGRR4	8.0567	2.361	.742	.713
Control Activities	0.811	3	HDKS1	7.0967	3.559	.591	.819
			HDKS2	6.9233	3.536	.741	.661
			HDKS3	6.8800	3.685	.660	.741
Information and Communication	0.837	5	TTTT1	13.9633	11.260	.600	.816
			TTTT2	14.0767	11.141	.705	.785
			TTTT3	13.9200	11.184	.708	.784
			TTTT4	13.8667	11.788	.655	.800
			TTTT5	13.8667	12.163	.537	.831
	0.818	5	GS1	15.9367	8.628	.455	.829
			GS2	15.6833	7.903	.640	.772
			GS3	15.6767	8.133	.656	.768
			GS4	15.6333	7.758	.697	.755
			GS5	15.8567	8.418	.613	.781

3.2. Exploratory Factor Analysis (EFA) of the Internal Control Scales

The Exploratory Factor Analysis (EFA) in this paper applies the extraction method to Principal components and Varimax rotation. The EFA result with KMO = 0.781 and sig = 0,000 demonstrates that the data are appropriate for EFA; 22 observed variables are extracted into 5 factors at Eigenvalues = 1.786, and the total variance is 63.83%. The observed variables are extracted from the factors.

Table-3

Rotated Component Matrix[a]					
	Component				
	1	2	3	4	5
MTKS5	.790				
MTKS3	.772				
MTKS7	.739				
MTKS6	.727				
MTKS2	.723				
MTKS1	.676				
TTTT3		.832			
TTTT2		.826			
TTTT4		.796			
TTTT1		.751			
TTTT5		.678			
GS4			.819		
GS3			.790		
GS2			.779		
GS5			.748		
GS1			.644		
DGRR4				.892	
DGRR3				.874	
DGRR2				.775	
HDKS2					.892
HDKS3					.848
HDKS1					.799
Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. a. Rotation converged in 5 iterations.					

Source: Authors' calculations

3.3. Regression Analysis and Hypothesis Testing

Firstly, the paper analyzed the Pearson correlation coefficient to analyze the correlation between quantitative variables. With the 5% significance, the correlation coefficients shows that the relationship between the dependent variables and independent ones is statistically significant (Sig. < 0.05). The correlation coefficients ensure the multicollinearity does not exist. Therefore, other statistics can be used to verify the relationship between variables.

Then, the multiple linear regression analysis is used to describe and explain the relationship between influential factors and the operational efficiency. The R^2 = 0.805 in the Table 4 shows that the appropriateness of the multiple linear regression model with the data is 80.5%. The regression analysis indicates that five independent variables of MTKS, DGRR, HDKS, HTTT and GS (in Table 4) have non-standardized B-coefficients of 0.193; 0.262; -0,004; 0.267; and 0.192 respectively with the significance < 0.05. Thus, the hypotheses of H1, H2, H3, H4, and H5 are accepted.

Based on the B-coefficients, it can be concluded the Information and Communication has the most influence on the operational efficiency, then Risk Assessment, Control Environment and Monitoring. Control Activities has the least influence on the operational efficiency. The multiple linear regression model is as follows:

$$QTDP = 0,376 + 0,193 * MTKS + 0,262 * DGRR - 0,004 * HDKS + 0,267 * HTTT + 0,192 * GS + e \qquad (1)$$

Table-4. Regression analysis of influential factors on the operational efficiency

Model	Non-standardized regression coefficients		Standardized regression coefficients	T value	Sig.	Multicollinearity	
	B	Standard errors	Beta			Tolerance	VIF
(Constants)	.376	.117		3.226	.001		
MTKS	.193	.018	.283	10.612	.000	.928	1.077
DGRR	.262	.015	.479	18.005	.000	.934	1.070
HDKS	-.004	.012	-.009	-.355	.723	.967	1.034
HTTT	.267	.013	.548	21.140	.000	.984	1.016
GS	.192	.015	.333	12.600	.000	.950	1.053
Dependent variable: Operational efficiency (HQHD)							
Adjusted R^2 = 0.805							

(Authors' calculations)

3.4. Research Model Testing

The Structural Equation Modeling (SEM) result (as Figure 1) shown on the Figure 2 with Chi-square/df=1.833; GFI=0.923; TLI=0.930; CFI=0.939; and RMSEA=0.043, means that the model is suitable for the data. However, the estimates (standardized) of the relationship between MTKS → HQHD are not statistically significant at the reliability of 90% (as Table 5). Therefore, it may delete the item of MTKS.

Figure-2. CFA of factors of operational efficiency (standardized)
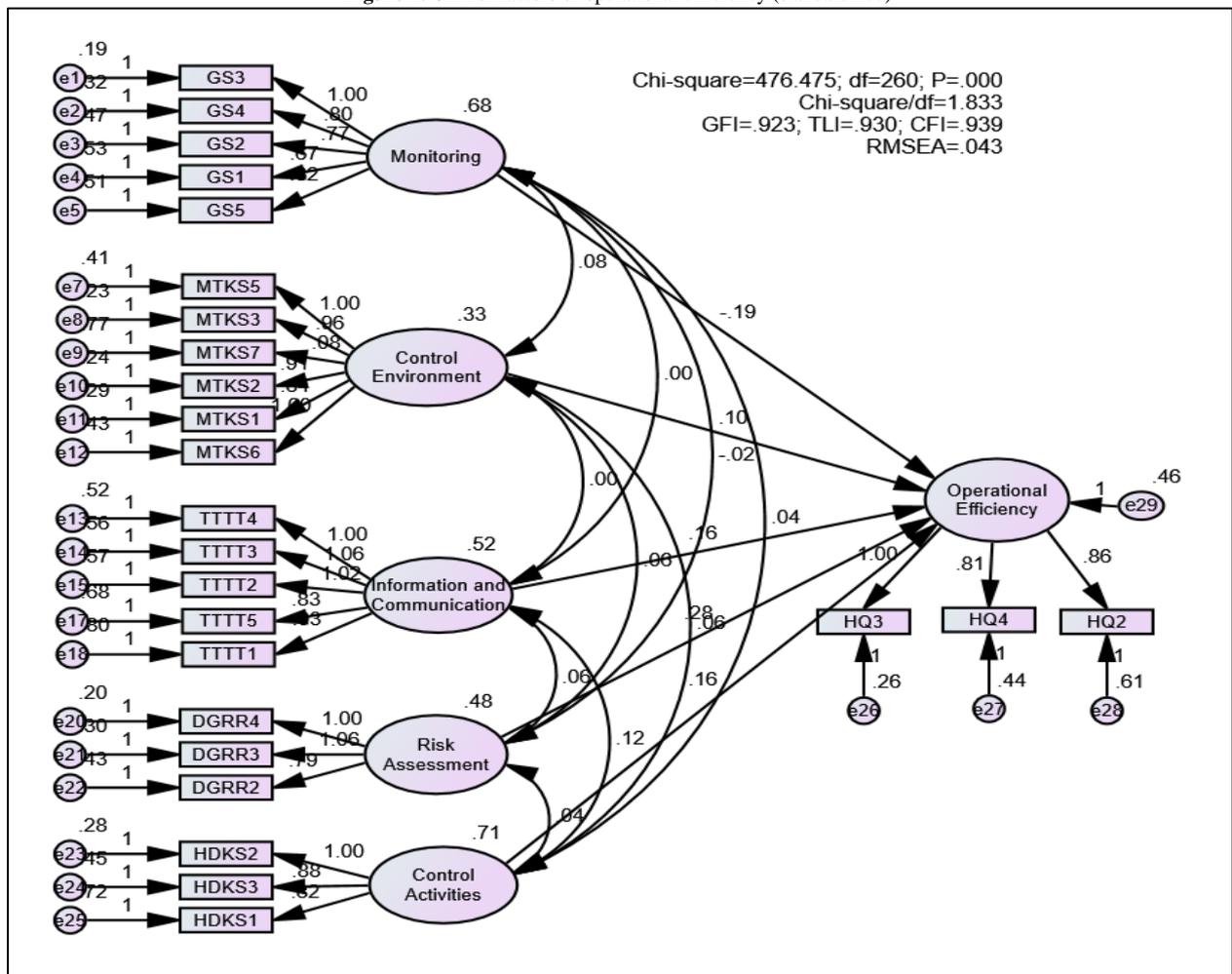
Source: Authors' calculations

Table-5. Testing the causal relationship between items in the official model (standardized)

Relationship	Estimate	SE	CR	P
HQHD <--- GS	**-.192**	**.051**	**-3.777**	*******
HQHD <--- MTKS	.105	.077	1.368	.171
HDHD <--- TTTT	.164	.062	2.659	.008
HQHD <--- DGRR	.282	.063	4.459	***
HQHD <--- HDKS	.157	.053	2.973	.003

4. Testing Research Hypotheses

The other method used in the research with Amos 23 software has resulted in the testing result of the official model with five hypotheses of H1, H2, H3, H4, and H5. The estimates (in Table 5) show that the scales of Risk Assessment, Control Activities, Information and Communication and Monitoring are directly proportional to the operational efficiency due to the statistical significance (at $P \leq 0.05$); while Control Environment is inversely proportional to the operational efficiency due to the statistical significance (at P>0,05). It indicates that:

- Risk Assessment has a positive relationship with factors of the operational efficiency.
- Control Activities has a positive relationship with factors of the operational efficiency.
- Information and Communication has a positive relationship with factors of the operational efficiency.
- Monitoring has a positive relationship with factors of the operational efficiency.
- Control Environment has a negative relationship with factors of the operational efficiency.

It means that the hypotheses of H2, H3, H4, and H5 are accepted. Only hypothesis H1 is different from the results analyzed in SPSS software and the difference is appropriate because the Control Environment has little influence on factors of the operational efficiency of companies.

5. Recommendations and Conclusion

The Information and Communication has the most influence on the operational efficiency, then Risk Assessment, Control Environment and Monitoring. Control Activities has the least influence on the operational efficiency.

The operational efficiency depends on the internal control system used in non-financial companies listed on Vietnam's stock exchange (with the impact levels are as follows: Information and Communication, Risk Assessment, Control Environment; Monitoring and Control Activities with the standardized regression coefficients of 0.282, 0.164, 0.157, 0.105; and -1.92 respectively).

The different operational efficiencies are related to various control systems which have different influence on the components of the internal control systems. Hence, it is necessary for non-financial companies listed on Vietnam's stock exchange to pay attention to the influence of each component of the internal control systems to promote the operational efficiency. For example, Risk Assessment has the strongest influence on factors of Control Environment (with the standardized regression coefficient of 0.282).

For example, a company with the internal control system encouraging the creativity, flexibility and adaptability with changes to obtain achievements shall require a strong control environment so that all members of the company are aware of the importance of control activities. That company should pay attention to the control environment in the internal control system. The strong control environment makes them more stable to face internal and external challenges and promote new products and opportunities. In addition, it is essential for the company to enhance the risk assessment and control activities of the control system to maintain competitive advantages and flexibility with changes so that the company can differentiate products/services from competitors.

The companies using the control systems often face business problems such as maintaining market share in existing markets, looking for and exploiting opportunities at new markets. For this reason, Information and Communication should be paid attention to. Information of competitors and demands of customers are extremely important for companies to sustain current business activities and make creations in business operations in order to survive and compete when the business environment changes.

5.1 Internal Control System Requires Suitable Changes to the Organizational Structure

In the centralized organizations, senior executives shall make all decisions and junior managers follow and implement such decisions and directions. The more levels of decentralization companies have, the more complex the control activities are. The companies with many levels of decentralization authorizes their employees to make decisions in order to more quickly seize opportunities. Nonetheless, they may face with potential risks because of their decision makers with insufficient experience, so they need more control activities. Thus, the entities shall adjust components of the internal control systems depending on their organizational structure. The more centralized companies are, the more the companies promote the factors of information and communication in order to ensure to timely, completely and accurately identify, gather and transmit the information and ensure the full and smooth communication between the leadership and employees and among departments, and vise versa. (The organizational structure has the greatest influence on the information and communication with the standardized regression coefficient of 0.267). The more centralized companies require the stronger control environment in which all members must comply with decisions by the senior executives towards the common goals of the company. Besides, the concentration also influences monitoring (with the standardized regression coefficient of 0.192). The junior decision-making levels require more monitoring in companies.

5.2. The Internal Control Requires to be Strong Enough to Improve the Operational Efficiency in Case of the External Environment Instability

Companies have face external environment issues related to the increasing social responsibilities and accountability on ecological environment, socio-economic conditions and welfares to employees. The more unstable

external environment is, the higher reliability the internal control system needs to be strengthened. In the unstable external environment, companies take use of the structure to mitigate the instability and the internal control system becomes a reasonable solution. Companies operating in the highly unstable external environment requires the flexible structure to adapt with changes of the environment. The information and communication should be paid high attention in order to timely be aware of the instability of the environment. (The companies' awareness of the instability of the external environment has the greatest influence on the information and communication with the standardized regression coefficient of 0.267). The instability of the external shall limit the necessary information to make plans and strategies on products and services, reduce reliability for evaluating demands of customers and make backup plans, so the information and communication and control activities should be strengthened to achieve goals.

(3) Enhancing the effectiveness of control activities in non-financial companies listed on Vietnam's stock exchange

The analysis of items of control activities discovers the difference in assessing the importance of control activities between companies with less than 300 employees and ones with 300 employees or more (Sig. = 0,045 < 0.05). Hence, control activities should be improved in companies.

The rational segregation of duties and responsibilities shall minimize frauds or mistakes as well as identify frauds or mistakes in the operations. However, the segregation of duties and responsibilities is not sufficiently implemented in listed non-financial companies in which one personnel shall be concurrently in charge of many tasks. Frauds or mistakes usually occur and is difficult to detect in concurrent many tasks. Therefore, in order to minimize possible risks, companies should not assign an individual to carry out all the stages of the whole business process.

In listed non-financial companies, control policies and procedures are often not officially regulated in writing, which make employees underestimate the importance of control activities, so it is essential to enhance the employees' awareness of the importance of control activities. Control regulations, policies and procedures should be made in writing and regularly updated in order to support companies to effectively cope with risks.

(4) Promoting the information and communication in non-financial companies listed on Vietnam's stock exchange

The analysis of items of the information and communication discovers the difference in assessing the importance of the information and communication between companies with less than 300 employees and ones with 300 employees or more (Sig. = 0.024 < 0.05). Hence, the information and communication should be improved in large-scale companies.

The information and communication become increasingly important for companies achieve their goals of survival and development. The information and communication must ensure to access to all departments, divisions and individuals in every company as well as related external partners. However, the internal information and communication in large-scale companies from senior managers to employees who perform tasks is often difficult because of multiple management levels. Therefore, it is necessary for department heads to disseminate policies and directives made by senior managers and ask employees to sign the written confirmation of having understood to perform works and duties.

Open and public information channels should be provided so that employees could reflect occurring problems ready-to-listen and senior managers should make employees believe that they are ready to listen and solve effectively arising problems.

(5) Completing the control environment in non-financial companies listed on Vietnam's stock exchange

The analysis of items of the control environment discovers the difference in assessing the importance of the control environment between new companies (operating less than five years) and ones operating ten years or more (Sig. = 0.032 < 0.05). Hence, the information and communication should be improved in new companies operating less than five years.

The control environment reflects the general nuance of a company, affecting the awareness of its all managers and employees. The control environment influences a company's business manner and its set goals. Factors of the control environment include honesty and moral values, organizational structure, authorization and responsibilities, human resource policies. Unlike companies operating for a long time, new ones usually do not promulgate regulations and policies in writing. Therefore, human resource policies in new companies need to be drawn up in order to face increasingly complicated changes due to technological advancements and increasing competition.

In addition, new companies should effectively segregate duties and powers. The segregation of duties and powers encourage the initiative of individuals for their works and duties should be effectively segregated to ensure the achievement of business goals.

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