PREFACE

The Country Financial Accountability Assessment (CFAA) is a diagnosis of a country’s financial management environment. Its purpose is to help the Borrower and the Bank assess and manage the risk that public funds may be used for non-intended purposes; identify the key risks, capacity gaps and constraints to progress; help the government develop a strategy for reform; and assist in designing a program to improve financial management capacity in the public and private sectors.

This CFAA has been prepared in close consultation with the Ministry of Finance, the State Audit of Vietnam, State Inspection Office, and other Government officials. The Vietnam Accounting Association, major auditing firms, selected SOEs, and members of the donor community were also consulted and provided input. The CFAA was carried out by a Bank mission in September 2000, with follow-up missions in October and November 2000 in which key recommendations in the summary report were discussed with the Government. A complete draft was presented during a workshop on June 14, and was discussed in detail during the week of June 25, 2001. The missions’ members included Mr. Behdad Nowroozi, Team Leader, Mr. Bernard Donge and Ms. Mong Thuy Mellor, Consultants, Mr. Nguyen Van Minh, Economist, Ms. Duong Do Quyen, Disbursement Analyst, and Mr. Hung Viet Le, Financial Management Officer. Mr. Kazi Matin, Lead Economist, provided overall guidance and advice. Mr. Douglas Arnold, Mr. John Fitzsimon, and Mr. Vinod Sahgal provided comments as peer reviewers. Mr. Peter Dean, Mr. David Shand, Mr. Loup Breford, Mr. Ronald Points, and Mr. Richard Calkins also provided comments. Mr. Bertin López provided assistance in document preparation. The mission is grateful for the cooperation and advice provided by Mr. Andrew Steer, Country Director, and concerned officials, particularly Mr. Bui Van Mai, Director, Mr. Dang Thai Hung, Deputy Director, and officials of the Accounting Policy Department, Ministry of Finance.

The CFAA aimed to build on existing knowledge and complement earlier studies such as the Joint IMF-World Bank Report on Fiscal Transparency (June 1999), the Public Expenditure Review carried out jointly by the Government of Vietnam and the Donor Working Group (December 2000), and the ADB Diagnostic Study of Accounting and Auditing (November 2000).

The CFAA reviewed the following critical aspects of financial accountability in the public and private sectors: public sector accounting, internal control system and internal audit function, systems of fund flows, related processes at national, sub-national and local government levels as well as in State-Owned Enterprises (SOEs); financial reporting in the public sector; the oversight functions related to the use of public resources, including the external audit function; the accounting profession; the accounting and auditing practices in the private sector and SOEs; and certain aspects of corporate governance related to private enterprises and SOEs. The CFAA did not cover issues related to transparency of the budget process as this issue has been adequately covered in studies mentioned above.
Currency equivalents
VND 15,025.18 = USD$1.00
As of October 17, 2001

Abbreviations/Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Definition</th>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<td>AFA</td>
<td>ASEAN Federation of Accountants</td>
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<td>BC</td>
<td>Budget Ceiling</td>
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<td>BOM</td>
<td>Board of Management</td>
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<td>CFAA</td>
<td>Country Financial Accountability Assessment</td>
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<td>COSO</td>
<td>Committee of Sponsoring Organizations</td>
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<td>CPA</td>
<td>Certified Public Accountant</td>
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<td>EU</td>
<td>European Union</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FEMD</td>
<td>Finance Enterprise Department of Ministry of Finance</td>
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<td>FMS</td>
<td>Financial Management System</td>
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<td>GAO</td>
<td>General Accounting Office</td>
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<td>IDF</td>
<td>Institutional Development Fund</td>
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<td>IFAC</td>
<td>International Federation of Accountants</td>
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<td>IFMS</td>
<td>Integrated Financial Management System</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IT</td>
<td>Information Technology</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>MPI</td>
<td>Ministry of Planning and Investment</td>
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<td>NAC</td>
<td>National Accounting Council</td>
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<td>ODA</td>
<td>Official Development Assistance</td>
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<td>PEMD</td>
<td>Public Expenditure Management Department</td>
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<td>Public Expenditure Review</td>
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<td>SAV</td>
<td>State Audit of Vietnam</td>
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<td>SBD</td>
<td>State Budget Department</td>
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<td>SDCC</td>
<td>Song Da Construction Corp</td>
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<td>SIO</td>
<td>State Inspection Office</td>
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<td>SOE</td>
<td>State Owned Enterprise</td>
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<td>ST</td>
<td>State Treasury</td>
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<td>SU</td>
<td>Spending Units</td>
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<td>VAA</td>
<td>Vietnam Accounting Association</td>
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<td>Vietnam Auditing Company</td>
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<td>Vietnam Accounting System</td>
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<td>VCCI</td>
<td>Vietnam Chamber of Commerce and Industry</td>
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<td>WB</td>
<td>World Bank</td>
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# Vietnam: Country Financial Accountability Assessment

## Table of Contents

**Preface**

**Executive Summary** ........................................................................................................................................... i

## 1. Accounting, Reporting, and Control Processes in the Public Sector ........................................... 1

*Overview of Accounting and Reporting Processes* ...................................................................................... 1

*Accounting Requirements* ............................................................................................................................... 2

*Monitoring and Verification* ........................................................................................................................... 4

*Flow of Information Between Different Levels of Government* ............................................................... 5

*Accountability at Sub-National Levels* .......................................................................................................... 6

## 2. Financial Accountability in the Public Sector ............................................................................ 9

*The Overall Framework* ................................................................................................................................. 9

*The State Audit of Vietnam* ............................................................................................................................ 10

*The Financial Inspection Function at the Ministry of Finance* ................................................................. 11

*The State Inspection Office* ......................................................................................................................... 12

*Budget Monitoring in the Ministry of Finance* ............................................................................................. 14

*Internal Control in the Public Sector* ............................................................................................................ 16

## 3. Institutional Framework for Setting Accounting and Auditing Standards .............................. 18

*The Vietnam Accounting Association (VAA)* ............................................................................................... 18

*Implementation of Standards* ....................................................................................................................... 18


*Financial Reporting of Private Enterprises* ................................................................................................. 21

*Private Sector Audit* ....................................................................................................................................... 21

*Financial Reporting of SOEs* ......................................................................................................................... 23

*External Audit of SOEs* ................................................................................................................................... 25

*Financial Accountability Issues Relating to SOEs* ...................................................................................... 26

## 5. Accountability of Boards of Directors and Management of SOEs and Private Enterprises 29

*The Control Committee in SOEs* ................................................................................................................... 30

*The Control Committee in Private Enterprises* .......................................................................................... 30
6. Remaining Agenda ...................................................................................................................... 33

Annex 1 – Budgeting, Accounting, and Reporting Processes in the Public Sector
Annex 2 – Public Sector Accounting: Review of Instruction 999
Annex 3 – Benchmarks for the Audit and Inspection Functions
Annex 4 – The Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the Modern Internal Control Concept
Annex 5 – Schedule of Promulgating Vietnamese Accounting and Auditing Standards

Box 1: The Case of Ha Tay Province .......................................................................................... 8
Box 2: Guidelines on Implementation of the Vietnam Corporate Accounting Regulations on Foreign Direct Investment Enterprises ................................................................. 21
Box 3: Song Da Construction Corp. (SDCC) ............................................................................ 28
Vietnam
Country Financial Accountability Assessment

Executive Summary

1. Vietnam is in the process of reforming its economy, adopting market economy mechanisms, and integrating into the world economy. Like a number of countries in the process of transition to a market economy, Vietnam faces challenges in improving its laws and regulations, strengthening its institutions, and building capacity to improve financial accountability. While it is difficult to attain quickly all the requirements of a market economy, it is possible to focus initially on a critical subset of these requirements and take a series of steps that are compatible with the Vietnamese environment. Such a gradual approach, currently being taken by the Government, should lead to tangible achievements in financial accountability over time.

2. Recent Developments. Over the last two years the Government has implemented significant reform measures across a number of areas. These include measures to facilitate international trade, ease private entry and develop domestic and foreign enterprises, diversify ownership of SOEs, improve the framework for prudent banking, and increase transparency of the budget. Specific actions taken include:

- The outturns for the 1998 and 1999 state budgets were published for the first time in mid-1999.
- Fiscal information is provided to international organizations and donors in a GFS-consistent format as well as to all relevant government agencies.
- Communes were requested to post budgets outside commune offices.
- Prudential regulations on capital adequacy, related-party lending, foreign exchange operations, bank inspection, collaterals and deposit insurance were adopted.
- Several accounting standards have been prepared and ten audit standards have been issued and the Ministry of Finance is implementing a plan for issuing more standards in the next few years.

3. Vietnam has also taken significant steps in improving laws and regulations to ensure more effective public expenditure management and help create a more conducive environment for the private sector to operate. A revised Budget Law has been put into effect. The new Enterprise Law has provided direction for improved corporate governance. While significant improvements, such as the recent provision of more information on public finances, have been made, other significant challenges lie ahead. These challenges need to be met in the context of an overall framework for reform in the area of financial accountability. This summary provides our assessment, proposes elements of an overall strategy, and recommends key measures for implementation.
4. **Accounting requirements.** Accounting requirements are detailed in terms of records to be kept, reconciliation, and reports to be prepared. There are, however, inconsistencies among the accounting systems used by the Budget, Treasury, and Tax authorities, resulting in inconsistent information. Therefore, the authorities with responsibility for monitoring and compliance with budget do not receive consistent information to perform this function effectively. The public expenditure accounting system also attempts to capture too much detailed data which is then aggregated in reports that do not distinguish between the important and the trivial. Hence higher management cannot use the reports effectively as there is no analysis of spending trends and of exceptions that call for special attention from the decision makers.

5. The Government has developed a public expenditure reform program. The Ministry of Finance has expressed strong interest in implementing an integrated financial management system and will seek technical assistance from the World Bank to do so. The reform strategy should also focus on functional review of various departments in the Ministry of Finance and their reporting requirements, on the simplification of processes and procedures, and on implementation of an integrated budgeting and accounting system using a common database. The Government is planning, or should consider taking, the following steps:

- Review the reporting needs of various departments of MOF management and streamline the reporting system, including the format of the reports.
- Streamline the requirements of public expenditure accounting. For instance, establish simple accounting procedures for small agencies with straight-forward transactions, and more complex procedures for agencies with complicated operations wherein the details are recorded into subsidiary ledgers.
- Take necessary steps to implement an Integrated Financial Management System (IFMS) to make financial data more timely, relevant, and reliable for effective management of public resources.
- Consider establishment of a government-wide Information Technology (IT) board with members from various ministries and other stakeholders. Develop an IT strategy for the Government as a whole and a public financial management reform program to be implemented in the next 5-10 years.
- Train staff in the use of the revised reports as management tools rather than as tools used merely to seek approval from higher level authorities for finalization of accounts.

6. **Monitoring and verification.** The requirements of the public expenditure accounting system (Instruction 999) are very comprehensive and detailed. The very nature of the requirements makes compliance difficult for all units, particularly at the lower levels. Thus the focus is shifted to activities that can be easily complied with, namely the duplicated checking and verification of supporting invoices for payments and monitoring of budget drawdowns. As a result, the key purpose of an effective public expenditure accounting system—namely, the regular and efficient monitoring of the
State Budget implementation, with its implications on the effective use of public funds--has been neglected in favor of mechanical verification of payments and receipts.

7. The Government should consider taking the following step:

- Streamline the internal control arrangements between the State Treasury (ST) office and spending units and ensure that a clear delineation of responsibilities is made in order to avoid duplication or overlapping of functions. Spending units should be responsible for checking the eligibility of an expenditure from an operational point of view, and the State Treasury should be responsible from a financial point of view.

8. **Information and monitoring at different levels of government.** Currently, little information on public expenditures at the lowest level of government is available at the center, due to the lack of proper accounting of off-budget items and the fact that not all communes’ expenditures are included in the national budget. This lack of information is particularly critical on expenditure outputs and outcomes, and as a result, the line ministries are unable to assess whether actual spending by provinces and lower levels of government has been consistent with sectoral policies. Additionally, data recording and reporting are inconsistent across ministries. A comparison of budgeted and actual spending at the disaggregated level is not possible because budget allocations and treasury releases are made using 11 categories, while spending agencies and the MOF report expenditures using full budget classification. Expenditures are accounted for under financial categories and are not related to objectives. More and better information is needed on the impact of public expenditures. This is the prerequisite for enhancing accountability for performance. Provinces and districts should be made responsible and fully accountable for achievement of programs agreed upon by the national Government. These responsibilities should go hand-in-hand with the further devolution of authority and resources.

9. In order to improve monitoring and accountability for budget implementation, the Government is planning, or should consider taking, the following steps:

- Complete a review of the Budget Law to provide more flexibility to lower level governments by providing them more discretion and flexibility on setting local priorities in spending funds for the benefit of local communities.

- Simplify budget monitoring procedures by: i) clarifying the monitoring and reporting responsibilities at the national and sub-national level, and ii) redesigning the reporting system to reflect the revised monitoring responsibilities for each level of government.

10. Currently, there is no single office in MOF that is fully responsible for preparation of financial management reports for the government as a whole. Having such an office is particularly critical with the planned implementation of an IFMS. This can be a two-step process. As long as the government uses a cash basis of accounting, this combined responsibility can be carried out by the State Treasury. However, when the Government moves to an accrual basis of accounting, this responsibility can only be carried out by a department with wider responsibility, which should include accounting policy for the Government as a whole. This is the practice in other countries such as Australia and Canada, which have an Accountant General office.
11. To improve overall coordination for financial accounting and reporting in the public sector, the Government should consider taking the following step:

- Consider the designation (establishment) of a single office in the MOF responsible for all accounting and reporting matters.

FINANCIAL ACCOUNTABILITY IN THE PUBLIC SECTOR

12. There is duplication of scope of work and overlapping functions between the State Inspection Office, State Audit of Vietnam, and Financial Inspection Directorate of MOF, in the areas of inspection and audit in the public sector. The current arrangement is not efficient. The roles and responsibilities of these agencies need to be rationalized to ensure that each body has a clear, distinct, and complementary function. The State Auditor General currently reports periodically to the Prime Minister and to the Standing Committee of the National Assembly, when required. The audit reports are not publicly available. Due to inadequate capacity and resources, the scope of work is mainly focused on compliance and financial issues, without sufficient emphasis on the efficiency and effectiveness in use of public resources. While audit and inspection bodies have adopted a risk-based approach, practices are not up to international standards and practices.

13. The reform strategy should focus on: i) improving effectiveness of financial oversight bodies by streamlining roles and responsibilities of oversight agencies, thus eliminating wasteful duplication; ii) adopting more modern auditing and inspection techniques of evaluating the adequacy and effectiveness of services provided to the public; iii) improving the oversight process to obtain a reasonable rather than absolute assurance that financial compliance works as expected, while at the same time focusing equally on the economy, efficiency, and effectiveness of operations. Implementation of such a strategy can be sequenced as follows: revising relevant laws and regulations, reorganizing concerned agencies, adopting international public sector auditing standards, and then providing training.

14. To improve auditing and inspection in the public sector, the Government is planning, or should consider, taking the following steps:

- Conduct a comprehensive review of the oversight framework and functions to clarify roles and responsibilities; eliminate duplication in the scope of work; and revise objectives to be consistent with international best practices. Amend relevant laws, decrees, and regulations on SAV, SIO, and MOF to reflect the clarified roles and responsibilities. Establish internal audit functions, initially at the ministerial level, to gradually replace the present inspection function at each ministry. This internal audit department would, in addition to its traditional oversight responsibility, adopt the modern approach to internal auditing.

- Improve technical capacity of oversight institutions.

- Accelerate issuance of improved audit law (a draft on audit ordinance has already been prepared).
15. **Budget monitoring at the Ministry of Finance.** The specialized financial departments in the Ministry of Finance such as the Public Expenditure Policy Department (PEPD) and Finance Enterprise Department (FEMD). The Public Expenditure Management Department (PEMD) establishes budget norms and monitors expenditures of central ministries as well as those of national target programs in the provinces. However, there is duplication of accounting and reporting requirements as the roles and responsibilities of various departments within MOF are unclear. In addition, monitoring is lacking on “commercial” activities by ministries and their spending units. While there are instructions and regulations for activities undertaken by the latter, it is not easy to find out whether all financial regulations are consistent.

16. Some of these weaknesses will be partially addressed by implementation of an integrated financial management system. Additionally, the Government is planning, or should consider taking, the following steps:

- Consolidate all financial regulations, instructions, and circulars applicable to public sector agencies, and simplify these to the extent possible.

- Expedite the review of Circular 01/1994 to ensure that expenditure of “commercial” activities by budget dependent agencies is reported independently of the core function financial report (MOF recently prepared and submitted a draft Decree on commercial activities to the Government).

17. **Accountability at sub-national levels.** There is considerable autonomy given to provincial and sub-national levels of government in determining their expenditures and in implementing the budget once it is passed. This autonomy should be accompanied by adequate accountability, which is not yet fully in place. There is a critical need for capacity building with respect to budgeting, accounting and financial reporting at provincial, district and commune levels. In its effort to strengthen the financial management capacity of government employees, the government should take into consideration the critical skill needs at provincial, district and commune levels.

18. **Internal control in the public sector.** Vietnam needs to consider the adoption of a modern and holistic framework of internal control based on a control environment that promotes openness, competence, and ethical values; is reinforced by a structured risk management approach; and is balanced by effective ex-post audit and oversight functions. A shift from compliance control to accountability for results would assist Vietnam in developing a robust framework to support capacity building for improved management of its resources. For this purpose, there are several control models that are commonly used (i.e. Committee Of Sponsoring Organization, COSO).

19. The Vietnam Accounting Association (VAA) is weak and is not exercising its role as a professional body. MOF is responsible for developing and issuing accounting and auditing standards.
There is no professional code of conduct and ethics for accountants, aside from references in decrees and regulations. The Government (MOF) has a comprehensive strategy for development of accounting and auditing standards and significant improvements have been made. The World Bank recently approved an Institutional Development Fund (IDF) to support the government’s effort to improve accounting and auditing practices. This includes efforts on streamlining accounting and auditing regulations, issuing new accounting and auditing standards, harmonizing accounting and auditing standards applicable to SOEs with those in the private sector, and enhancing the role of VAA.

20. The Government’s reform should also focus on strengthening the role and management capacity of VAA so that it may play a more active role in standards setting, and on enhancing the professional skills of accountants and auditors.

FINANCIAL REPORTING AND AUDITING PRACTICES IN THE PRIVATE ENTERPRISES AND SOEs

21. The Vietnam Accounting System (VAS) is being developed and is not yet fully consistent with international standards. Its focus is on the code of accounts and is mainly a bookkeeping guide. It does not highlight basic principles such as going concern. Under the VAS, financial statements have to be presented in a standard format. This is not required by IAS. According to a recent study of accounting and auditing by the Asian Development Bank, disclosures and standards under VAS differ from those in the IAS. Financial reporting is driven by tax reporting. (e.g. Full provisioning is not allowed.) All enterprises are subject to compliance with the VAS. The Government is implementing a comprehensive plan to improve accounting standards, making them consistent with international standards with appropriate modifications to suit Vietnam’s environment.

22. In Vietnam, SOEs are not subject to the same level of disclosure, financial discipline and independent audit as the private sector. The Government should, therefore, aim for a single legal framework and a single set of accounting and auditing requirements for SOEs and private enterprises that includes clearly defined rules and regulations comparable with international standards.

23. SOEs are subject to not only auditing regulations issued by MOF and SAV, but also to audits and inspections by various government agencies. This results in delays in finalization and issuance of their final accounts. The objectives of SOE audits should be expanded to cover economy, efficiency and effectiveness of their operations in the use of public resources rather than only on compliance. SOEs should undergo an annual independent audit consistent with international auditing standards applicable to private enterprises (currently SOEs are audited by government-owned audit firms). However, the government auditor can carry out economy and efficiency audit.

24. The reform strategy should focus on: i) upgrading accounting and auditing practices to a level consistent with international best practices; ii) expending a major effort to build capacity and skills; iii) ensuring more independent audit of SOE; iv) streamlining audit and inspection processes and procedures for SOEs; v) streamlining auditing standards applicable to SOEs with those for the private sector, with a goal of merging the two sets of standards; and vi) revising the Decrees on the State Auditor General’s Office by expanding the oversight responsibility of this Office to include
evaluation of the entity’s internal control structure as well as the economy, efficiency and effectiveness of its operations.

25. The Government should consider taking the following steps:

- Accelerate issuance of improved accounting and auditing standards consistent with international standards.
- Apply the improved accounting and auditing standards to private enterprise as well as large SOEs as early as possible.
- Require large SOEs (General Corporations) to undergo annual independent financial audits in accordance with international standards.

ACCOUNTABILITY OF BOARDS OF DIRECTORS AND MANAGEMENT OF SOEs AND PRIVATE ENTERPRISES

26. The roles and responsibilities of the Board of Directors (known in Vietnam as the Board of Management) and line management (known in Vietnam as the General Director) are unclear. The role of the control committee (a committee appointed by the Board of Management of SOEs, and by shareholders of private enterprises) is not broad enough and not consistent with international best practices. Internal controls are weak. The control committee has a dual function of oversight (normally a Board of Directors’ function) and of supervision (normally a General Director’s function). These two functions are distinct. When combined, they lead to confusion in accountability.

27. The control committee has a limited role under the SOE Law and the Enterprise Law, which is confined to inspection and investigation of the financial and compliance aspect of operations. This is not consistent with international best practices that require the control committee to fulfill its oversight responsibilities and not get involved in line operations.

28. The reform strategy should focus on: i) subjecting SOEs and private enterprises to one set of laws and requirements on the roles and responsibilities of line management, the general director, the board of directors and the control committee, in conformance with international best practice; ii) revising the SOE Law and the Enterprise Law to redefine and upgrade the function of the control committee to the level of audit committee; and iii) strengthening the internal control systems in SOEs and enterprises by adopting a modern internal control system and enhancing the internal audit function.

29. The Government should consider taking the following steps:

- Consider drafting a combined law for SOEs and non-SOE enterprises so that the same requirements on internal monitoring and oversight are in effect for both types of enterprises. Subsequently, improve the accountability of Board of Directors and General Director under the combined Enterprise Law by bringing this law up to the minimum international best practices.
• Consider the establishment of an Institute of Directors as a professional body to enhance the skills and knowledge of members of Boards of Directors and management. Train accountants, auditors, members of control committees and company management in the enhanced role of the control committee.

• Consider the establishment of an Institute of Internal Auditors as a professional body to upgrade the skills and knowledge of internal auditors and provide them with careers as internal auditors.

30. **Overall Assessment.** Financial accountability in the public and private sectors, a key aspect of the governance framework, calls for sound stewardship of all resources in both the public and private sectors. Fundamental aspects of financial accountability include transparent and reliable reporting on performance, a system of checks and balances to mitigate the risks of waste and abuse of public funds, a mechanism for third-party verification of information provided by government, and respect for the public’s right and access to information on government decision-making processes.

31. An effective system of public financial accountability focuses on “governance” of public finances rather than the traditional focus on “management.” This requires players other than the executive branch, such as the legislature, external auditors and regulators, civil society and the public. It also emphasizes that a focus on one aspect of public financial accountability at the expense of the others will not achieve the development objective.

32. At present, there is clearly a certain degree of fiduciary risk in the use of public resources, given that the budget process is not yet transparent, public access to government financial information is limited, and effective legislative oversight is not fully in place yet. Institutions responsible for ensuring financial accountability are also weak, audit findings are not publicly available as a matter of fact, and the reporting system does not support effective ongoing monitoring. At the present, accountability to citizens for the use of government revenues and for the quality of overall fiscal management does not fully meet the minimum standards of the IMF Fiscal Transparency Code. The Government has committed, however, to take steps to meet these standards.

33. Overall, fiduciary risk will be manageable on on-budget items provided that the Government takes the steps outlined in the attached table as well as those committed under the PER. The risk is currently high on off-budget items, which may not be subject to standard controls and oversight. Risk at the sub-national level is compounded due to the lack of adequate skills and experience in accounting and auditing. Although aggregate information from the budget has recently been made available, data on public financial statements, particularly those of SOEs, are still not available as a matter of course.

34. The Government has implemented significant reform measures to improve transparency of the budget in the last two years, but significant challenges remain. The Government has adopted recommendations of the PER 2000 report and has requested assistance from the World Bank in implementation of an integrated financial management system. It is in that context that consideration of the CFAA recommendations can be helpful.

35. **Going forward:** Efforts to improve financial accountability in the public sector need to focus on upgrading the government financial management system, streamlining processes and procedures,
and rationalizing and strengthening institutions responsible for ensuring accountability. There is also an urgent need to improve financial reporting and audit as well as corporate governance of private enterprises and SOEs. What is required are small but tangible achievements in all aspects of public and private financial accountability. The attached timetable of Next Steps sets out the possible time frame--short-term and medium-term of the main recommendations of this CFAA.
### Objectives

**To make financial data more timely, relevant, and reliable for effective management of public resources**

- a. Review the functions of various departments in MOF and streamline reporting requirements
- b. Streamline various laws, regulations, and decrees related to accounting and auditing practices in the public sector as well as the Budget Law and budget monitoring procedures
- c. Consider establishment of a government-wide IT Board with members from various ministries and other stakeholders
- d. Develop an IT strategy for the Government as a whole
- e. Take the necessary steps to implement an integrated financial management system, including development of a conceptual framework
- f. Consider designation of a single office in MOF to be responsible for all accounting and financial reporting matters in the public sector

**Time Frame**

- Short-term
- Short-term
- Medium-term
- Medium- to long-term
- Short-term

**To improve financial accountability in the public sector**

- a. Conduct a comprehensive review of the oversight functions to streamline roles and responsibilities of various agencies
- b. Establish an effective public accounts oversight function at the National Assembly with clear responsibility for overseeing the public finances. Ensure that SAV has a formal and direct reporting relationship to the National Assembly. Make audit reports publicly available
- c. Issue revised manuals and provide training
- d. Adopt a modern internal control framework appropriate for Vietnam
- e. Adopt international public sector accounting and auditing standards

**Time Frame**

- Short-term
- Medium-term
- Short- to medium-term
- Short- to medium-term
- Medium-term

**To improve institutional framework for setting accounting and auditing standards and regulating the profession**

- a. Streamline various laws, regulations, and decrees related to accounting and auditing practices in the private sector
- b. Strengthen the VAA to become a professional body
- c. Accelerate issuance of improved accounting and auditing standards
- d. Conduct a comprehensive training program on application of new standards

**Time Frame**

- Short-term
- Medium-term
- Short- to medium-term
- Short- to medium term
| To improve financial reporting in the private enterprise and SOEs | a. Require large SOEs to prepare financial statements in accordance with international standards and be annually audited by independent auditors  
| b. Apply improved accounting and auditing standards to private enterprise and large SOEs (General Corporations) | Short- to medium-term |
| To improve accountability of boards of directors and management of SOEs and private enterprises | a. Consider drafting a combined law for SOEs and non-SOE enterprises so that they are subject to the same requirements in terms of roles and responsibilities of line management, general directors, boards of directors, and control committees  
| b. Consider the establishment of an Institute of Training for Directors  
| c. Consider the establishment of an Institute of Internal Auditors | Short-term |

Short-term |
1. ACCOUNTING, REPORTING, AND CONTROL PROCESSES IN THE PUBLIC SECTOR

Overview of Accounting and Reporting Processes

1.1 Vietnam has implemented significant improvements in public expenditure management and in transparency of public spending by enacting the Budget Law in 1997 and removing the secrecy of budgetary information in 1999. The existing public expenditure system has certain strengths such as:

- Keeping aggregate spending in line with available public resources, even when there is a decline in the GDP share of revenue.
- Ensuring that actual spending is in line with the budget in each sector, with rare deviations.
- Implementing checks and verifications of quarterly expenditure limits.

1.2 The joint government-donor Public Expenditure Review (PER), Managing Public Resources Better (World Bank 2000), presented to the Consultative Group of donors in 2000, confirmed these features but identified the following weaknesses that need to be corrected:

- Data recording and reporting is neither consistent nor timely, in part because the classification and accounting systems used are not uniform across sectors. In addition, responsibility for reporting/recording the government’s accounts is not located in the treasury in MOF.
- Because such data is not available, there is limited within-year monitoring of actual line item expenditures by first and second levels of a ministry, the treasury and the state budget department.
- Budgetary spending data is not comprehensive in the sense that it excludes “off-budget” accounts and a share of the ODA funds.
- Detailed budgetary information is not accessible for the public at large nor for all government agencies (including local authorities and sector ministries)

1.3 Vietnam has very elaborate budgeting, accounting, and reporting processes and requirements (see Annex 1). Spending Units (SUs) at all levels in the public sector (Public Administrative Units) are required to keep accounting and financial reporting records in accordance with the Finance Ministry’s Instruction No 999-1996 titled Public Expenditure Accounting System. The chart of accounts used for this purpose requires SUs to record
assets, depreciation, payables, receivables, source of funds, budget revenue and expenditure, and off-balance sheet items.

1.4 The Instruction 999 specifies the format and content of each accounting record and ledger to be kept when using one of the three allowable bookkeeping systems. The Instruction also requires double-entry bookkeeping for each transaction, to be recorded on a daily basis (see Annex 2).

1.5 Monthly totals are reported to a higher level authority. The reports are then aggregated with those of the spending units at the same level and then reported to the next level in the Public Expenditure Management Department (PEMD) and the State Budget Department (SBD) of the MOF. Given the essentially manual nature of record-keeping activities of public sector agencies, the majority of spending units cannot comply with the monthly reporting requirements of Instruction 999. In practice, the majority of SUs only report quarterly on actual budget expenditure, total revenue where relevant, and the balance of remaining budget ceiling (BC). These reports are submitted together with the SU’s request for next quarter BC, with the under spending balance automatically rolled into the following month/quarter (except for end of year, when different procedures apply).

1.6 Under the requirements of Instruction 999, revenue and expenditure are reported in accordance with the state budget classification framework—i.e. by chapter, category, group, sub-group, items and sub-items—at end of year. The annual accounts are submitted to PEMD and SBD, which aggregate the data in accordance with the State Budget Accounting System. Final accounts of the State Budget are then prepared for reporting to the National Assembly.

1.7 The hierarchical reporting system requires an elaborate reconciliation between reports of lower-level finance departments and the relevant records of the State Treasury office on BCs approved and received during the quarter, expenditure roll-over from the previous period, and remaining BC balance at the end of the period. The detailed requirements may not be excessive in a fully computerized environment, but are burdensome for the mainly manual book-keeping system that is currently in place in Vietnam. Furthermore, the present Public Expenditure Accounting system relies on checks and controls by higher level authorities—a situation which has the effect of removing the monitoring function further from the place where activities occur. This reduces the effectiveness of controls.

**Accounting Requirements**

1.8 Accounting requirements are unnecessarily complex in a mainly manual record keeping system. Because of this complexity, staff with limited accounting skills can not comply with all the requirements in such an environment. In addition, for information that is available during the year, the authorities with responsibility for monitoring and compliance with budget do not receive the information they need to perform this function effectively. The public expenditure accounting system also attempts to capture too much detailed data which is then aggregated in reports that do not distinguish between the important and the trivial. Hence higher management cannot use the reports effectively as there is no analysis of
spending trends and of exceptions that call for special attention from the decision makers (see Annex 1).

1.9 For example, the current system requires double-entry book-keeping for some transactions even though a simple single-entry cash system would suffice for many spending units. Processes could be simplified for agencies that have, in addition to recurring budget expenditures, revenues from core budget activities, commercial operations, or acquisition of fixed assets funded by capital budget allocation or foreign borrowing. For these agencies, separate ledgers could be maintained for expenditures other than core budget activities.

1.10 Government has developed a public expenditure reform program. The Ministry of Finance has expressed strong interest in implementing an Integrated Financial Management System (IFMS) and will seek technical assistance from the World Bank to do so. The reform strategy should also focus on functional review of various departments in the Ministry of Finance and their reporting requirements, on the simplification of processes and procedures, and on implementation of an integrated accounting and budgeting system using a common database. To streamline and improve the Government accounting system, the Government is planning, or should consider taking, the following steps:

- Review the needs of various departments of MOF management and re-design the reporting system, including the format of the reports, with the goal of streamlining and simplifying the information flow between agencies at the same level as well as between the lower and higher levels.

- Streamline the requirements of public expenditure accounting. For instance, establish simple accounting procedures for small agencies with straightforward transactions, and more complex procedures for agencies with complicated operations wherein the details are recorded into subsidiary ledgers.

- Take the necessary steps to implement an IFMS to make financial data more timely, relevant, and reliable for effective management of public resources (see Annex 6).

- Consider establishment of a government-wide Information Technology (IT) board with members from various ministries and other stakeholders to ensure uniform standards and protocols for IT development. Develop an IT strategy for the Government as a whole and a public financial management reform program to be implemented in the next 5-10 years.

- Train staff in use of the revised reports. Ensure their understanding that these reports provide information as a management tool and are not meant to be used merely for seeking approval from higher level authorities on the finalization of accounts.
The Public Expenditure Review has also identified the same shortcomings. The above recommendations complement those found in the PER.¹

**Monitoring and Verification**

1.11 There is excessive checking and verification at the national and sub-national levels, particularly on compliance with the quarterly budget draw-down limit. (Unspent limits are automatically rolled over to the next quarter). The State Treasury uses the Treasury accounting system, which focuses on revenues and expenditures with other details for the purpose of treasury control. The State Budget, however, uses the Budget accounting system and follows Budget classification consistently for budget expenditure reporting. (see Annex 1) There are differences between the Treasury accounting system and the Budget accounting system. MOF is currently working on unifying the two systems.

1.12 Monitoring of actual budget expenditure by line items is required to be undertaken by level 1 and 2 of a ministry, the State Treasury offices, the State Budget Department and Public Expenditure Management Department of MOF. However, as this information is not generally available during the year, there is no effective monitoring of line item expenditure. The focus is solely on compliance with budget limits. As a result, the key purpose of an effective public expenditure accounting system—namely, the regular and efficient monitoring of the State Budget implementation, with its implications on the effective use of public funds—has been neglected in favor of mechanical verification of payments and receipts.

1.13 To eliminate unnecessary checking and duplicative monitoring, the Government should consider taking the following steps:

- Review and clarify the responsibility for checking compliance with budget limits. For example, the role of the State Treasury office is to ensure that no disbursement is made unless the relevant spending unit is operating within its budget limit, while all spending units are required to check for budget availability before an expenditure commitment is made. No report is needed by a higher level authority unless it concerns over- or under-spending. In the absence of any exception report, approval for next quarter disbursement should be automatic in accordance with the annual expenditure plans.

- To avoid duplication or overlapping functions, clearly delineate responsibilities, with the spending units made responsible for checking the eligibility of an expenditure from an operational point of view, and the State Treasury made responsible from a financial point of view.

Information and Monitoring at Different Levels of Government

1.14 Currently, little information on public expenditures at the lowest level of government is available at the center, due to the lack of proper accounting of off-budget items and the fact that not all communes’ expenditures are included in the national budget. This lack of information is particularly critical on expenditure outputs and outcomes, and as a result, the line ministries are unable to assess whether actual spending by provinces and lower levels of government has been consistent with sectoral policies. Additionally, data recording and reporting are inconsistent across ministries. A comparison of budgeted and actual spending at the disaggregated level is not possible because budget allocations and treasury releases are made using 11 categories, while spending agencies and the MOF report expenditures use full budget classification. More and better information is needed on the impact of public expenditures. This is the prerequisite for enhancing accountability for performance. Provinces and districts should be made responsible and fully accountable for achievement of programs agreed upon by the national Government. These responsibilities should go hand-in-hand with the further devolution of authority and resources.

1.15 National policy stipulates that, in accordance with the economic parameters and national priorities set by the central government, responsibility for setting local priorities and service delivery is to be devolved down to the level closest to the intended beneficiaries. One example of best practice is Australia, where grants from Federal to lower levels of government are made in accordance with the formula determined by the Federal grant commission, in a process which is transparent and is open to public scrutiny. Once the grants and reporting arrangements have been agreed by the two parties, local governments are given the necessary authority and budgetary resources to carry out the program. They are held fully accountable for the results.

1.16 To improve the flow of financial information, the Government is planning, or should consider taking, the following steps:

- Complete a review of the Budget Law to provide more flexibility to lower level governments by giving them more discretion on setting local priorities in spending funds for the benefit of local communities;

- Simplify budget monitoring procedures by:
  i) Clarifying the monitoring responsibilities at the national and sub national levels. For example, it should be the responsibility of the local finance department (district or provincial) to monitor in detail disbursements made for compliance with financial, technical and any other requirements. Reports to a higher level authority, on the other hand, should disclose total expenditure for the period and include comment on significant events that may have influence on current and/or future expenditure or revenue plans.
  ii) Redesigning the reporting system to reflect the monitoring responsibilities of each level of government.
• Review the applicability of current budget accounting requirements to ensure they capture data for accounting and reporting purposes while remaining sufficiently simple to suit local skills and capability.

1.17 Currently, there is no single office fully responsible for preparation of financial management reports for the government as a whole. Having such an office is particularly critical with the planned implementation of an IFMS. It is also important to separate the budgeting and cash management functions from those of accounting and reporting in order to satisfy the needs of all users, and to ensure the reliability and integrity of data and information coming out of the system. The designated department should incorporate the accounting policy function to ensure that regulations and guidelines take into account the cost and benefit of information requirements and operational feasibility (i.e. consideration of system amendments arising from a change of an accounting or reporting requirement). This can, however, be a two-step process. As long as the government uses a cash basis of accounting, this combined responsibility can be carried out by the State Treasury. However, when the Government moves to an accrual basis of accounting, this responsibility can only be carried out by a department with wider responsibility, which should include accounting policy for the Government as whole. This is the practice in other countries such as Australia and Canada, which have an Accountant General office.

1.18 To consolidate the responsibility for all financial accounting and reporting in the public sector, the Government should consider taking the following step:

• Consider the designation of a single office in the MOF to be responsible for all accounting and reporting matters.

Accountability at Sub-National Levels

1.19 Overall, the budgeting and public expenditure management system provides for good aggregate control of expenditures within years. There have been no significant over-runs of expenditure, release of funds has been tightly controlled and there has been no problem of expenditure arrears. There is considerable autonomy given to provincial and sub-national levels of government in determining details of their expenditures and in implementing the budget once it is passed. This autonomy should be accompanied with adequate accountability.

1.20 The need for capacity building with respect to budgeting, accounting and financial reporting, is particularly acute at provincial, district and commune levels.

1.21 Decentralization can facilitate cost-efficient service delivery, if it is accompanied by accountability for performance. Besides better financial accounting and audit, this requires improved reporting and monitoring of results of expenditures, particularly at the lower levels of the Government. Good governance, tight accountability mechanisms, and transparency in

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local government finances are essential elements of local government effectiveness. These issues can be exemplified in the case of Ha Tay Province (see Box 1).
Box 1: The Case of Ha Tay Province

Ha Tay, one of the provinces nearest to the capital city of Hanoi, consists of 14 districts and is divided into 324 communes. From a budgetary point of view, the province has about 700 Spending Units and 146 State Owned Enterprises.

At the provincial level, the provincial Finance Department reports monthly to the central government’s State Budget Department the actual revenue and expenditure of broad categories such as Salary, Capital Expenditure, Recurrent Expenditure and Off-Budget Items. This information represents a consolidation of data reported from communes to districts, and from districts to the province. At year-end, the final budget accounts contain more details on chapter, group, sub-group, items and sub-items. However, information from some communes is not available, since the Budget Law was only recently promulgated, and since 201 communes out of a total of 324 have not been included in the final accounts. Efforts are being made to include them gradually. The provincial State Treasury Office is in charge of effecting disbursement of funds and advises the Finance Department monthly of the details of actual expenditures. These data are used to reconcile total expenditures before reports are finalized for the State Budget Department.

At the SOE level, the SOEs report their budgetary expenditures monthly to the SOE Monitoring Unit within the province’s Finance Department. The same information is also forwarded to the relevant Sector Department, the Tax Bureau and the Statistical Office of the province. The SOE Monitoring Unit’s role is threefold: providing guidance on financial accounting and reporting, checking on financial compliance through site visits on a quarterly basis, and gathering information for reporting to MOF.

At the district level, the district Finance Department prepares the budget for approval by the district People’s Committee and People’s Council, and is also in charge of budget allocation, monitoring and reporting to higher level authorities. In the Hoai Duc district of Ha Tay province, for example, there are 21 communes and 1 township. As the district Finance Department has 7 computers and appropriate software provided by MOF, it does the recording of daily transactions by the communes from transaction reports received from the district State Treasury. Its software uses the state budget classification system, so it is duplicating the recording already carried out by the district ST. By doing so, however, the district Finance Department is able to meet the monthly reporting deadline to the provincial Finance Department by the 5th of the following month. The district ST office’s view is that it is closer to its clients and is thus better able to provide guidance and monitoring of transactions effected by communes. In addition there are approximately 100 spending units in the district, with each unit having more than 1 “bank” account with the district ST (one account for budget and the others for project and/or trust monies). There are some cooperatives in the district but they do not use the district ST as they have their own bank account with the Agriculture Development Bank.

There are thus many parties involved in this elaborate system of checks and balances. But the perception is that these parties are doing similar—if not identical—tasks, and it appears there is no clearly defined accountability. It may be argued that under such a system, overspending is effectively controlled. The downside, however, is that in such an environment, controls are considered the responsibility of the higher levels of hierarchy, and not the responsibility of staff at all levels. In addition, controls tend to be complied with for the sake of compliance and are not viewed as actions taken by management and staff to help an organization achieve its objectives.

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3 This case confirms and illustrates findings by the Public Expenditure Review. “Vietnam – Managing Public Resources Better, December 13, 2000”. Box 2.1
2. FINANCIAL ACCOUNTABILITY IN THE PUBLIC SECTOR

The Overall Framework

2.1 Public financial accountability can be defined as the obligation of the government to report to the public on effective use of financial resources.\(^4\) The audit plays an important role in ensuring accountability. There are three agencies responsible for audit and inspections in the public sector: the State Inspection Office, State Audit of Vietnam, and Financial Inspection Directorate of MOF.

2.2 The roles and responsibilities of these agencies need to be rationalized to ensure that each body has clear, distinct, and complementary functions. Due to inadequate capacity and resources, each agency currently focuses mainly on compliance and financial issues with insufficient emphasis on efficiency and effectiveness in use of public resources. For instance, none of these agencies review the quality of services that the government provides to its citizens. The agencies also attempt to check every detail, putting equal importance on the minor and major issues irrespective of risk. While audit and inspection bodies have adopted a risk-based approach, practices are not up to international standards and practices. (see Annex 3)

2.3 \textit{Audit findings and criminal acts.} A structured follow-up procedure is undertaken systematically. Auditees generally implement the audit recommendations. Criminal acts, if found, are the subject of investigations and a prosecution process based on the criminal code. This process is not done by SAV, but by the police or the People’s Prosecutor Office. Criminal acts include bribes above Dong 500,000,000 (US$ 36,000). Thefts of public funds above Dong 500,000,000 (US$ 36,000) carry the death penalty. (About a dozen employees of SOEs and enterprises have received this sentence in the last few years.)

2.4 \textit{Internal controls.} While internal control is built into the control procedures that exist in all government operations, good controls covering the control environment, effective information and communication, and risk assessment, are missing. It is apparent that SAV staff understand “internal control” in the traditional sense and not according to the modern definition of control, ie. COSO Framework (see Annex 4). The focus of control is still on compliance with rules and regulations, and on integrity of the financial statements. Insufficient attention is paid to the aspects of economy, efficiency and effectiveness of operation. Risk assessment is not conducted in a structured manner.

2.5 \textit{Internal audit.} External audit is still heavily relied upon, since most government entities and SOEs have no internal audit function. Three factors have been cited as reasons for the non-existence of internal audit: (i) weak capacity of staff; (ii) a very low salary

\(^4\) The Operational Evaluation Department of the World Bank has identified seven elements critical to sound public financial accountability. These are as follow: i) quality and openness of the budget process; ii) adequacy of internal control within the government; iii) quality of public accountants of the nation; iv) effectiveness of the public audit function; v) adequacy of legislative scrutiny over the performance of the executive; vi) right and access of the public to information and vii) adequacy of corporate accounting, auditing, and oversight functions.
structure resulting in a lack of motivation of staff; and iii) difficulty in recruiting staff of a high caliber. The current perception is that, given the state of the control environment in Vietnam, the country is not yet ready for the establishment of an internal audit function in the public sector. Two main reasons are cited: (i) that staff of each entity owe allegiance to the head of the organization and will not have the necessary objectivity; and (ii) that this is a sensitive political issue.

The State Audit of Vietnam

2.6 The State Audit of Vietnam (SAV) has been established fairly recently. It was founded by Decree No. 70 of July 11 1994 and governed by Decision No 61 of January 24 1995. The State Auditor General and Deputy Auditor General are appointed and dismissed by the Prime Minister. The State Auditor General reports to the Prime Minister. Audit programs are approved by the Prime Minister and audit reports are submitted to the Prime Minister.

2.7 The function of the State Auditor General is to evaluate and confirm the following: (i) the implementation of financial and accounting policies and systems, and (ii) the correctness, integrity and compliance of accounting data and of financial statements. Through the audit, the SAV advises the auditees to correct mistakes and irregularities in order to strengthen financial and accounting management. It also makes recommendations to concerned authorities on the resolution of infringements to and enhancement of financial and accounting systems. (This task excludes letters of complaint, which are handled by the State Inspection Office and not by SAV). The scope of audit includes financial statements of National budget accounts and financial statements of ministries, provinces or centrally managed cities, capital constructions funded by the Government, and State-owned enterprises. It does not, however, provide a professional opinion on the government’s financial statements, as a whole. The SAV covers about 12,000 administrative entities and 5,000 SOEs.

2.8 SAV is organized as follows: (i) audit units, including units specialized in national budget, security, defense, diplomacy, national programs, etc. (ii) five regional offices; and (iii) a training center and science and information center.

2.9 Legislative oversight, independence, and transparency. Legislative oversight over public finances hinges on the separation of executive and legislative functions. The legislature provides authority for the acquisition and use of financial resources and is responsible for overseeing their administration. It exercises this control by reviewing and approving the overall budget. It also reviews the annual budget reports of public sector entities, evaluates their standard of work and makes recommendations to the executive on the basis of audit reports by the supreme audit institution of the country.

2.10 From the standpoint of appointment, dismissal, budget and reporting, SAV is not independent. Audit findings are not made public routinely but can only be made public with Government authorization. The Government is attempting to address this issue through
policies aimed at improving transparency and participatory aspects of the budget process. The Government has established a mechanism for SAV to report to the standing committee of the National Assembly, when required. This reporting relationship, however, should be formal and ongoing. The oversight responsibility over public finances also needs to be clearly understood and exercised by the National Assembly. Adequate training should be provided to help ensure that this responsibility is effectively carried out consistent with international best practices. SAV is doing research on making audit reports on provincial budgets available to the public. The Bank commends these efforts and can provide assistance through the World Bank Institute.

2.11 It seems that the principle of transparency has been accepted. What is unclear, however, is exactly how much and what kind of information will be made available to the public. As part of its effort to improve transparency, the Government should consider using SAV’s Magazine and Newsletter or press conferences as mechanisms for informing the public of audit results.

2.12 SAV plans to increase the number of its staff from 600 to 2000, to cover all 61 provinces and 105 central government agencies. It also plans to audit large construction projects, such as the North-South Highway. To be able to successfully realize these plans, SAV will need training and recruitment of people with higher-level skills, as well as automation of its work. There is also an urgent need for the provision of technical training materials. GTZ has provided assistance to upgrade the present Decree No. 70 into a law (now in the second phase). ADB has also been providing assistance to produce three manuals on audit of the Public Sector, the Budget, and SOEs.

2.13 The Government, with the assistance of donors, should consider strengthening the capacity of staff, including those at the newly established Information Center, on the application of IT. The SAV has discussed the possibility of getting technical assistance from the Bank. They would like to hold a workshop to get stakeholders’ participation in the design of a technical assistance project (Grant).

The Financial Inspection Function at the Ministry of Finance

2.14 The Financial Inspection Directorate is a Department of MOF. Its main functions are to conduct inspections of financial matters of all government and non-government organizations that use public funds and to review and resolve all complaints and denunciations relating to matters involving public finance. The Financial Inspection Directorate has widespread powers similar to those of the State Inspection Office and the State Auditor General’s Office. It conducts inspections on the basis of an annual program that takes into consideration the country’s direction and priorities, its social and economic development strategy, and its financial policies. This program utilizes about 70 percent of the Financial Inspection Directorate’s resources; the rest is reserved for unforeseen complaints and denunciation.

2.15 Each line ministry has its own Inspection Unit: MOF has a Financial Inspection Directorate, and the Ministry of Transport has a Transport Inspection Directorate, for example. Since the State Inspection Office and the State Auditor General’s Office have even
more widespread powers, these two offices have often in the past infringed on the line ministries’ Financial Inspection, resulting in a great deal of duplication.

2.16 Recently, however, this problem has become less acute, as the practice now is that if an inspection or audit has been conducted by one oversight agency on any particular entity in any given year, the other two agencies refrain from conducting a similar operation at that entity. Moreover, the State Inspection Office and the State Audit of Vietnam are expected to exchange their annual programs to avoid duplication of work. Nevertheless, there is still room for improvement by focusing on compliance and efficiency and effectiveness of public administration. For instance, these agencies should review the quality of services that the government provides to its citizens.

2.17 There is in general a shortage of competent staff for the oversight agencies. Salaries are only 10 percent higher than in other government offices. In addition, the technical capacity of the staff is still low. Some of these agencies like the MOF Financial Inspection Directorate have regular training programs for their staff. However, the focus is mainly on compliance with rules and regulations.

The State Inspection Office

2.18 Based on the Inspection Ordinance (1990), Law of Complaint and Denunciation (1998), and Anti-Corruption Ordinance (1998), the State Inspection Office (SIO) is organized into 3 administrative levels (central, provincial and district) and according to subject areas (finance, banking, labor, army, etc.)

2.19 Appointment and independence. The General Inspector of State Inspection Office (SIO) holds the rank of minister. He is appointed by the President of Vietnam on the basis of a recommendation by the Prime Minister and approval by the National Assembly. The Chief Inspector of a ministry is appointed by the Prime Minister on the basis of a recommendation by the Minister and consent of the General Inspector of SIO. Thus, both the Executive authorities and the Inspection authorities have an influence on choice of the inspector. In the case of disagreement between the executive and inspection parties, the Inspector authorities of a higher level have the right to review and make a decision of their own or to consult with the government administrative head and then make the decision. In practice, the inspector is not independent, as his regular budget is approved by the administration. Only his special (occasional) budget comes from the Inspection Office.

2.20 Organization. The SIO is comprised of 200 staff at headquarters and 8000 throughout the country (5000 inspectors and 3000 administrative staff). Salaries follow the civil service scale, with an addition of 10 percent. With this minimal difference, the Office finds it difficult to recruit capable people. SIO carries out its work based on its own program, requests by the Government, and citizens’ complaints.

2.21 SIO functions: The SIO does the following: i) inspects compliance with the law by the executive branch in all its areas of operation, including financial, economic, army, police and national defense, etc.; ii) issues regulations in the inspection area, provides guidelines on implementation of these regulations, approves the inspection programs to avoid duplication,
sets the standards for appointment and performance of inspectors, oversees provincial inspectorates, resolves all legal complaints, and assists the government in resolving the people’s complaints in administrative areas. (In this respect, SIO performs the functions of an Ombudsman Office); and iii) strengthens the inspection framework by providing training and guidance in the implementation of related laws and regulations.

2.22 SIO has programs focusing on one or several particular themes every year. For instance, in a recent year the theme was “Inspection of Commercial Banking System,” an effort to prepare banks for a possible adverse effect of the East-Asian financial crisis. In 1999, SIO concentrated its effort on “Public Administration in the Communes.” The theme for the year 2000 is “Resettlement in the Cities.” The program for the year 2001 is “Investment for Development.” (It could cover implementation of the country’s development program and the use of resources, including funds from foreign assistance bodies like the World Bank and Asian Development Bank.)

2.23 Duplication of work. There seems to be duplication of work among the State Auditor General’s Office, the Inspection Directorate of MOF, and the inspectorates of the line ministries especially in the areas of finance and budgeting. However, the government is fully aware of this issue and has taken some measures to alleviate the situation, for instance by having all three parties consult one another during formulation of the annual work program. They also exchange their programs after finalization. (A report is being prepared for the Prime Minister’s Office on this issue).

2.24 Powers. The SIO is empowered to perform nine functions, of which the most frequently used are the following:

- Request the inspected party to provide information and documents, no matter how confidential. The inspected party cannot refuse this request.
- Conduct an inventory of assets and put them in an out-of-bound enclosure.
- Request the inspected party to stop the operation in question, or stop the latter’s function if there is evidence of obstruction to the inspection operation.
- Request any government agency to provide a technical expert, at this agency’s cost.

2.25 Upon discovery of an irregularity, the inspector sets up a file together with evidence and drafts a report which is then transmitted to the concerned investigative authorities (for instance the police, or the army). The investigation, if positive, results in the file being transmitted to the People’s Public Prosecutor’s Office, which brings the suspect to justice.

2.26 Guiding principles. In conducting an inspection, the state inspector has to follow the five guiding principles of objectivity, accuracy, transparency, democracy and timeliness. The mission of the SIO is to prevent and resolve infringement of the law, in accordance with the following motto: “The Inspector is the eye and ear of the supervisor, and a friend of the subordinate. Inspection is assistance in correcting mistakes.”
2.27 Follow up. There is no separate department in charge of monitoring the implementation of the inspector’s recommendations. Follow-up is left to the local office of SIO, which is often not effective.

2.28 To increase effectiveness of audit and inspection in the public sector, the Government should consider taking the following steps:

- Conduct a comprehensive review of oversight framework and functions to clarify roles and responsibilities; eliminate duplication in the scope of work; and revise objectives to be consistent with international best practices. Amend relevant laws, decrees, and regulations on SAV, SIO, and MOF to reflect the clarified roles and responsibilities. This review could take into account the experience of other countries such as the USA, China, and Australia, where an organization similar to the State Inspection Office exists side by side with an Auditor General’s Office.

- Review all existing manuals and guidelines on audit and inspections in order to make them consistent with the revised scopes and objectives. Issue new audit and inspection manuals and guidelines.

- Provide training to inspectors in the performance auditing technique so that they also look at the economy, effectiveness and efficiency of the programs and operation.

- Accelerate issuance of the improved audit law (A draft on the audit ordinance has already been prepared).

- Make audit reports publicly available.

Budget Monitoring in the Ministry of Finance

2.29 The major issues in improving the public expenditure management system relate to improving expenditure prioritization and monitoring expenditures on a timely basis throughout the year. The first issue has been dealt with extensively in the PER 2000, which made a number of recommendations pertaining to government policy on investment and recurrent expenditures, medium-term sectoral strategies and expenditure norms. These are the areas of responsibility of the State Budget Department (SBD). The CFAA, on the other hand, discusses the improvement of budget monitoring and reporting, which is the responsibility of the Public Expenditure Management Department. The Public Expenditure Management Department (PEMD) in the Ministry of Finance has the following main functions and objectives: i) developing and preparing financial guidelines on public administration policies and spending limits for Public Administrative Units for submission to the MOF or the Prime Minister; ii) examining the annual budget allocation from central Public Administrative Units to lower levels; iii) providing budget to central Public Administration Units following the regulations, policies, and approval plan; iv) inspecting
and approving the final annual budget of Public Administrative Units receiving budget from the central budget (See flow charts in Annex 1 for more detail).

2.30 PEMD monitors level 1 ministries by checking actual expenditure against budget allocations and norms, and by monitoring compliance with financial policies and regulations. Currently PEMD receives quarterly reports from ministries on actual expenditure against budget ceiling for the quarter and makes recommendations to SBD on the following quarter’s budget ceiling and any request for line item transfer from ministries. PEMD is aware that SBD receives monthly reports from CST on ministries’ expenditure but only requests access occasionally as it relies on the quarterly reports from ministries.

2.31 At the end of the year, PEMD receives detailed data from the ministries in accordance with Instruction 999 requirements. Some of the information such as fixed asset balances and movements is shared with the State Assets Management Department, which may also obtain the same data from ministries but in a different format. This exemplifies again the need for an integrated financial management system to ensure more efficient reporting. The State Assets Management Department is responsible for physical management of assets while PEMD monitors funding of annual asset acquisition and disposals.

2.32 PEMD monitors all activities undertaken by ministries and their SUs, including operating revenue from core Budget functions as well as revenue from activities that use budget funded resources and facilities. These “commercial” activities are subject to Circular 01/1994, which specifies what to do with revenues, what can be spent, and use of any excess of revenue over expenses. As this information is not reported by ministries/spending units during the year, reliance is placed by PEMD on inspection by the taxation authority. The taxation authority carries out detailed checking in assessing tax liability concerning these activities. It is understood that the Circular 01/1994 is being reviewed for an update of its requirements.

2.33 To improve PEMD’s performance, the Government should consider implementing the following proposal:

- Creation of an asset database with financial as well as physical data in order to eliminate duplicated reporting by spending units and facilitate the sharing of information by all interested parties.

2.34 There is a lack of effective monitoring of ministries’ budget implementation during the year as PEMD relies on quarterly reports from ministries that are very brief in content and focused on compliance with budget limits. Online interface with the ST system will not improve monitoring unless there is some change in the data available from the ST system. Online access would provide the same data as is currently available but is not being used by PEMD. Secondly, there seems to be unclear accountability on “revenue earning” activities carried out by ministries and their spending units. There seems to be an overreliance on the taxation authority for compliance with Circular 01/1994 for reporting. It is important that there is a clarification of the roles and responsibilities of various departments within MoF to ensure that there is no duplication of accounting and reporting requirements and to reduce the workload of spending units. Finally, while there are instructions and regulations for almost
every activity undertaken by a spending unit, it is not easy to ensure that instructions and requirements are consistent and do not duplicate each other. The reporting requirements of various departments within MOF need to be streamlined.

2.35 To improve budget monitoring in the Ministry of Finance, the Government is planning, or should consider, taking the following steps:

- Consolidate all financial regulations, instructions, and circulars applicable to public sector agencies, and simplify these to the extent practicable.

- Expedite the review of Circular 01/1994 to ensure that expenditure of “commercial” activities by budget dependent agencies is reported independently of the core function financial report (MOF has recently prepared and submitted a draft Decree on commercial activities to the Government).

Internal Control in the Public Sector

2.36 Control activities such as verification, approval and authorization of payments are highly structured and tight. The focus of control of budget utilization is on the amount as a figure, not on the results and outcome of the expenditure. In budget reporting, there is no linkage between amount spent and physical progress of projects. Evaluation of the economy, efficiency and effectiveness is not systematically done. On the other hand, evaluation of the achievement of project objectives is done occasionally. Risk management is not done in a systematic way. While goals with specific targets and deadlines are identified and the adequacy of resources relative to objectives is examined, procedures are not in place to review the critical success factors and the internal and external risks for achievement of objectives. In sum, the accounting function is viewed as a measure to enforce compliance with rules and regulations, not as a governance tool that assists the ministries’ management in achieving its objectives. (see Annex 4)

2.37 Vietnam needs to consider changing its present traditional accountability structure, which emphasizes compliance with rules and regulations and an ex-ante audit to one that emphasizes a modern and holistic framework for internal control at all levels of the Government. Such a framework would rely on establishment of a control environment that promotes openness, competence and on an integrated and automated system of verification with emphasis on high-risk areas and sample checking. This would be reinforced by effective ex-post audit and oversight functions. A shift from compliance control to accountability for results would assist Vietnam in developing a robust framework to support capacity building for better management of its resources.
2.38 To improve the effectiveness of internal controls, the Government should consider taking the following steps:

- Conduct a functional review of MOF (particularly SBD, PEMD, Financial Inspection Department) and the concerned players such as State Treasury, Spending Agencies, State Auditor General’s Office, State Inspection Office, with the view of streamlining their control systems and procedures.

- Establish internal audit functions, initially at ministerial level, to gradually replace the present inspection function at each ministry. This internal audit department would, in addition to its traditional oversight responsibility, adopt the modern approach to internal auditing. By so doing, it would act as an independent, objective assurance and consulting activity designed to add value and improve the ministry’s operations. It would help the latter accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, internal control, and governance processes.

- Adopt a modern internal control framework appropriate to Vietnam.

2.39 There are several models of internal controls that are commonly used. A modern internal control framework that is increasingly being used in other countries is COSO. The COSO Framework provides management with a reasonably comprehensive tool to manage and sustain an effective internal control system in a modern environment. It expands management’s view beyond that of traditional control, to deal with the “soft” issues of control. Internal control, in the past, tended to concentrate on “hard” controls, such as formal processes, policy, procedure, and organizational structure. Modern control, besides the hard controls, also deals with softer but strategic issues such as shared values, competence, trust, strong leadership, openness, high expectations and ethical standards.

2.40 The Framework thus could provide management with a methodology for adding significant value to the organization, and at the same time, satisfying the requirements of Good Governance (see Annex 4).
3. INSTITUTIONAL FRAMEWORK FOR SETTING ACCOUNTING AND AUDITING STANDARDS

3.1 The Government of Vietnam is the process of upgrading and improving national accounting and auditing standards to international levels. The objective is to provide investors, regulators and the public with reliable financial information. This is critical for private sector development and implementation of the government’s reform strategy.

The Vietnam Accounting Association (VAA)

3.2 After its 2nd Assembly, VAA elected a new Central Committee, ratified a new charter, and confirmed its objectives, operation and responsibilities, and organization and membership criteria. VAA’s main challenge is its financial situation. Out of a total number of 6,000 members, only 3,000 regularly pay their fees. There are about 250 local CPAs in Vietnam. VAA membership is not open to foreigners. VAA collects revenue from several sources: i) Membership fees of VND 12,000 (US cents 85 a year), for a total of VND 36 Million; ii) Consulting and training, which is unofficial and minimal, amounting to only VND 50 million; and iii) Grants from other organizations, including MOF, but none from international organizations.

3.3 Total annual expenditures amount to VND 250 million. There is a deficit of about US$12,000. Membership in international organizations such as IFAC and AFA requires payment of fees as well as attendance at annual meetings, causing another drain on VAA’s meager resources.

3.4 Out of the total number of 55 VAA Standing Committee members, 15 hold doctorate degrees and are professors or deans of a department in a university. The VAA appears to have members who are qualified to train others.

3.5 Scope of possible Technical Assistance. There is no educational institution in Vietnam specialized in training students for the CPA examination. The universities teach accounting, not auditing. They award degrees, not professional qualification. At the moment, those who wish to sit for the CPA examination undergo two months of intensive coaching, and that is the only preparation course available to them. VAA wishes to establish a school that would train students in accounting and auditing, a very specialized line of expertise. As a pilot test, VAA has successfully conducted a course in Hai Phong for chief accountants.

3.6 Code of ethics and code of conduct. VAA should have the authority to issue a code of ethics and a code of conduct to maintain moral integrity and professional excellence amongst its members, especially in the private sector. At the moment, these matters are mentioned in related decrees and regulations for the public sector, but there is no separate document for VAA members in the private sector.

Implementation of Standards

3.7 Accounting practice in Vietnam faces many challenges. Financial reporting is driven by tax reporting. In this respect, Vietnam, as do many other transitional economies, uses the
same rules for financial accounting and tax reporting. It uses a rigid chart of accounts for accounting and bookkeeping. Vietnam currently lacks an appropriate legal and legislative framework for setting accounting and auditing standards.

3.8 The Ministry of Finance has developed a comprehensive plan for issuing accounting and auditing standards (see Annex 5). The following four draft standards were prepared during the last year. VAS 2 Inventories, VAS 16 Fixed Assets, VAS 18 Revenue and VAS 38 Intangible Assets. The National Council for Accounting, chaired by the Vice-Minister of Finance with 15 members from VAA, MOF, the Universities, VCCI and the big five audit firms, made pronouncements on the drafts to the effect that they are mainly based on International Accounting Standards, with only minor differences to accommodate certain Vietnamese features. These four draft standards were issued at the end of last year.

3.9 The Government’s accounting and auditing reform strategy for 2001-2010 requires a tremendous amount of technical assistance. The government has requested technical assistance from The World Bank. An IDF grant has been approved with two main objectives: i) to support reform of the institutional and legal framework for setting accounting and auditing standards, regulating, and overseeing the profession in the private sector, and ii) to help accelerate improvements in financial reporting and auditing standards and practices both in SOEs and in the private sector. Activities supported by the grant are the following:

- Reviewing the accounting and auditing law and all related legislation, decrees, and regulations to improve and streamline the overall legislative and regulatory framework for accounting and auditing and to make it consistent with international best practices.

- Developing new accounting and auditing standards consistent with international standards.

- Harmonizing the accounting and auditing standards and related laws and regulations applicable to SOEs with those for the private sector.

- Enhancing the role of the Vietnam VAA and the National Accounting Council (NAC).

- Training accountants and auditors on international accounting and auditing standards and practices, and training management and boards of directors of large SOEs and private enterprises on audit committee and corporate governance best practices.

3.10 The inflexibility of the present chart of accounts impedes the practical application of the standards. The use of a national chart of accounts is not consistent with IASC framework. The VAA can play a critical role in providing clarification and practical guidance to the users, in addition to the training that is a critical factor for success.
3.11 For implementation of the new standards, VAA is considering the following steps: review the present state of accounting in the private sector; prepare manuals and training materials; and conduct pilot courses in Hanoi and Ho Chi Minh City. The experience derived from these courses will serve as input for improvements in the course materials. It would, however, be more expedient and less costly to adopt international accounting standards rather than devise local standards.

3.12 It is recommended that further assistance be provided to the VAA to assist it in better fulfilling its role as a professional body. This technical assistance could include:

- Establishment of a VAA Training Institute to train VAA members in accounting and auditing. This could include preparation of manuals and training materials, pilot courses in Hanoi and Ho Chi Minh City, and courses to familiarize VAA members with the new standards.

- Development of a plan to make the VAA financially self-sufficient and sustainable.
4. FINANCIAL REPORTING AND AUDITING PRACTICES IN THE PRIVATE ENTERPRISES AND SOES

Financial Reporting of Private Enterprises

4.1 The Vietnam Accounting System (VAS) is being developed and is not yet fully consistent with international standards. It has a rigid chart of accounts and is mainly a bookkeeping guide. It does not highlight basic principles such as going concern. Financial reporting is driven by tax reporting. (e.g. Full provisioning is not allowed.) All SOEs are required to comply with the VAS. The Government is implementing a comprehensive plan to improve accounting standards. Making them consistent with international standards with appropriate modifications to suit Vietnam’s environment.

Box 2: Guidelines on Implementation of the Vietnam Corporate Accounting Regulations on Foreign Direct Investment Enterprises

This draft Circular requires all foreign invested business entities operating in Vietnam to comply with the Vietnamese Accounting System (VAS) unless there are valid reasons for the application of another commonly recognized accounting system. In that case, valid reasons must be given to and approval issued by MOF.

It should be noted that VAS is a system of accounting and not a set of standards, and that its main purpose is to outline in detail a set of documentations, including a Chart of Accounts and accounting recording methods.

In 1998, MOF agreed to grant an extension to a number of foreign invested companies to allow them to retain their own accounting systems until the end of year 2000, when they needed to transfer to VAS. As of the present time, 100 foreign companies continue to enjoy this exemption until the end of 2003, on the grounds that the Vietnamese Accounting Standards are gradually being issued based on International Accounting Standards, i.e. the same Standards on which their systems are currently based. If they transferred to VAS now, they would have to reconvert to their present standards after the Vietnamese Accounting Standards are promulgated. Software conversion is the biggest problem, especially in the case of multi-national companies.

The Circular reconfirms the government’s position and clarifies which provisions the companies have to comply with and which ones they could request for exemption. MOF can approve companies’ request for extension of the deadline to the end of year 2003 on a case by case basis.

Private Sector Audit

4.2 The auditing practice in the private sector faces several challenges. These include unfamiliarity with International Accounting and Auditing Standards; most of the staff at enterprises and government agencies are still not quite conversant with international standards. This is a very young market and the need to educate clients is more acute. Between early 1996 – 1998, the European Union (EU) provided technical assistance for
accounting and auditing in Vietnam. An independent evaluation of this project in May 1998 indicated that the project had successfully initiated a process for adopting international accounting and auditing standards. Among the activities carried out were workshops held in several cities, a series of five fellowship programs in various EU countries, and eight study tours involving about 80 senior Vietnamese civil servants. Such activities facilitated a better understanding of international accounting and auditing standards, leading to the development of several draft standards. The project also helped initiate a process for establishing the legal structure for accounting and auditing in Vietnam.

4.3 To open an auditing firm in Vietnam by a foreigner, one has to apply under the Foreign Investment law, and comply with its requirements as well as with professional requirements such as the need for a minimum of 5 staff with CPA qualifications. The market is saturated for the time being, and MOF does not encourage foreign firms to enter the market. Time is needed for the Vietnamese firms to grow and be able to compete. There are a total of 22 audit firms operating in the country consisting of 5 international firms, 1 joint venture, 6 local SOEs, and 12 local private firms. There is no ceiling on the fee structure, except in certain special cases or for individual projects. For contracts above VND 300 million, bidding is required.

4.4 Three types of licenses exist: i) licenses given to foreign-owned audit firms under the investment law (this allows provision of services only to foreign invested enterprises); ii) licenses given to SOE audit firms (no limitation of scope of work); iii) licenses given to private audit firms, usually small firms, by people’s committees in respective cities or provinces (again no limit on the scope of their work.)

4.5 Internal audit: Most SOEs do not have the resources to establish an internal audit unit. Even for those that have one, the quality is not up to the international standards, and their work cannot be relied upon by the external auditors. However, there are a few exceptions: the Vietnam Petroleum Company, for example, has a very capable and experienced Internal Audit department.

4.6 Quality control: There are peer review processes for the foreign firms. For VACO, there is a peer review once every two years. For other firms, MOF sends a quality control team. In other countries, however, this quality control function is normally carried out by professional institutions rather than the Government.

4.7 On December 29, 2000, the MOF issued and made public six Vietnamese auditing rules (standards) as follows: i) Rule No. 250-compliance with the law and regulations on auditing and financial reporting; ii) Rule No. 310-knowledge of business; iii) rule no 500-auditing evidence; iv) Rule 510-auditing for the first year of business operations-opening balance; v) Rule No. 520-analysis process; and vi) Rule No. 580-directors’ report. These rules apply to independent auditing of financial statements conducted by auditors and auditing companies lawfully practicing in Vietnam.

5 The project aimed to i) set up the legal framework and institutions for accounting and auditing, ii) support the development of an accounting profession, iii) training accounting and auditing experts in international standards and practices, and iv) develop and improve the quality of the audit and consultancy services on accounting.
Financial Reporting of SOEs

4.8 The Finance Enterprise Department of Ministry of Finance (FEDM) is responsible for overseeing and undertaking financial analysis of all commercial enterprises, including SOEs but excluding banks, financial institutions, and FDIs.

4.9 FEDM focuses its supervision on SOEs for essential services (central SOEs), leaving the oversight role on local SOEs to the provincial Department of Finance. FEDM has 2 key functions relating to SOEs: i) monitoring financial performance of central non-bank SOEs through analysis of financial statements of large SOEs and overall review of smaller SOEs and ii) monitoring all enterprises (including non-state enterprises) through analysis of the sector. In practice little is done about the non-state enterprises, as the new Enterprise Law does not require non-State enterprises to send their financial statements to MOF.

4.10 In 1995 the National Assembly approved an SOE law and regulations on accounting and management of SOEs. In 1999, the National Assembly approved a new Enterprise Law, effective from 1 January 2000 and the Foreign Direct Investment (FDI) law. However, the intention is eventually to have just one law for all commercial enterprises, i.e. no FDI and no SOE law. This is a move in the right direction as there should be no difference between how public and private sector commercial enterprises are regulated financially.

4.11 Monitoring of government investments in joint venture companies is very limited at present. The ministry is in the process of working out how to manage and monitor financial performance of these organizations. There is a risk for governments to be involved in joint venture companies without adequate mechanisms to provide management with guidance on what is expected in terms of operational scope and direction as well as financial performance.

4.12 FEDM receives reports on local SOEs from local finance departments. However, due to limited resources and lack of necessary skills at local and central finance, only cursory consideration is given to these reports at both levels. The same applies to central SOEs located in provinces: although these SOEs are required to send the same quarterly reports to both central and local finance departments, this duplicated reporting simply means more paperwork is generated rather than that any serious financial monitoring being carried out. The MOF should act as a resource center, giving advice to lower level finance departments and issuing guidelines on accounting policy and financial reporting requirements. This means a more efficient use of the limited skills and resources. Such an arrangement would also provide an opportunity to facilitate better financial reporting in this sector, and to enable the MOF and local finance departments to have a better understanding of the financial performance of individual SOEs. Another benefit of the recommendation would be the potential to improve the accounting and financial management skills of the staff in SOEs as well as those who are responsible for financial monitoring at all levels.

4.13 Central and ministerial controlled SOEs are required to send quarterly reports to the department, namely Profit & Loss, Balance Sheet, Cash Flow Statement and Explanatory Notes in accordance with Regulation 1141. In practice, the cash flow statement has become optional and in fact not many SOEs comply with this requirement. This is a deficiency that
needs to be rectified as international experience has shown that cash flow information is a very important management tool.

4.14 SOEs are required to submit their quarterly and annual accounts 20 and 30 days for independent SOEs and 45 and 90 days for General Cooperations respectively after the end of the relevant period. However, many large SOEs cannot meet the deadline as there are delays in collecting reports from their branches/subsidiaries. The other issue is that many of these reports are compiled as an aggregation of the financial accounts of the subsidiaries/branches rather than as proper consolidated accounts of the group. A serious problem with aggregation is that the resulting reports tend to overstate the volume of transactions and hence the operating results since they do not eliminate inter-company transactions and balances. Although the VAS does require recognition of intra-group transactions and balances, the need to eliminate these items is not clearly stated.

4.15 The Vietnamese Accounting System (Decision 1141 VAS)\(^6\) allows for reserves on inventories, on investments and on bad debts for financial reporting purposes. The MOF guidelines that supplement Decision 1141 are strict. Bad debt can be write off only when it is certain that it is uncollectible, with supporting evidence provided to authorities and often only after being overdue for 2 or more years. The provision for bad debts is assessed annually by management in accordance with MOF guidelines. The unused portion from the preceding year has to be reversed as extraordinary income for the current year. In the case of state-owned banks, loans are classified as overdue for 1-360 days after the maturity date on which principal due remains unpaid. Loans are classified as bad if they are overdue for more than 360 days and the bank has started legal action to recover its interest and principals. The State Bank of Vietnam (SBV) has to approve bad debt provisioning.

4.16 To improve financial reporting, transparency, and monitoring of SOEs, the Government should consider taking the following steps:

- Accelerate issuance of improved accounting and auditing standards consistent with international standards.
- Apply the improved accounting and auditing standards to private enterprises as well as large SOEs as early as possible and require SOEs to be annually audited by independent auditors.

\(^6\)Decision 1141 issued on November 1, 1995, pertains to Accounting System for enterprises including SOEs and Foreign Direct Investments. This decision is mainly applicable to profit making enterprises.
Decision 167 issued on October 25, 2000, focuses on the uniform financial reporting system of enterprises, which will replace reporting system covered in Decision 1141 but still use the accounting system of Decision 1141.
Decision 214. issued on December 28, 2000 pertains to enterprises, or bodies having investment activities (with PMU or without PMU). It’s chart of accounts is the same as in Decision 1141. This mean enterprises can still use the accounting system of Decision.1141 to account for investment project. However, all enterprises and Spending Units of the Government with investment projects (Project owners should change to comply with Accounting System under Decision 214.
• Require large SOEs (General Corporations) to undergo annual financial independent audits in accordance with international standards.

• Make FEMD into a special unit with responsibilities of monitoring financial performance of central and ministerial controlled SOEs as well as government investments in joint ventures through establishment of clear requirements concerning the corporate governance regime, accounting policy and financial reporting, rate of return and dividend policy. This special unit should act as a resource center to assist lower level government agencies in monitoring their local SOEs and improving accounting and financial management skills locally.

• Review the adequacy and appropriateness of the current VAS with a goal of replacing it with introduction of internationally accepted accounting and financial reporting standards for all enterprises in both the public and private sectors. The World Bank has recently approved an Institutional Development Fund (IDF) grant to help improve financial reporting both for private and public enterprises.

The above recommendations are in line with those of the Public Expenditure Review, but are more elaborate.7

External Audit of SOEs

4.17 SOEs are subject not only to auditing regulations issued by MOF and SAV but also to audits and inspections by various government agencies. This results in delays in finalization and issuance of their final accounts. Some SOEs employ resources to achieve a variety of social objectives in addition to their commercial objectives. For those SOEs, supplementary requirements might be necessary as an addition to the requirements applicable to all private sector enterprises and SOEs.

4.18 SOEs are subject to external audit and inspection by three government oversight agencies. Since these agencies have overlapping functions, duplication of scope has occurred, especially in the finance, accounting and budget areas.

4.19 Recently, however, this problem has become less acute. In accordance with an understanding between the three agencies, if one of them has conducted an inspection or audit on any particular entity in any given year, the other two would refrain from conducting a similar operation at that entity. Moreover, the overseeing agencies regularly communicate their annual program to avoid duplication of work.

4.20 Nevertheless, there is still room for improvement since all three agencies focus on compliance and not the efficiency and effectiveness of public administration. For instance, none of these agencies review the quality of services that the government provides to its citizens. Therefore, the objectives of the audit on SOEs should be expanded to cover not only

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compliance but also economy, efficiency and effectiveness of the operation itself. The Government should review and streamline the role and responsibility of the three oversight agencies and revise the Decrees on the State Auditor General’s Office by expanding the oversight responsibility of this Office to include evaluation of the entity’s internal control structure, and the economy, efficiency and effectiveness of its operations. The specific steps should include:

- Issue addenda to the laws on SAV, SIO and MOF to reflect the streamlined and expanded roles of these agencies.
- Train the auditors and inspectors in attestation audit of public enterprises, performance audit techniques, and review of the economy, effectiveness and efficiency of the auditee’s operation over time.

Financial Accountability Issues Relating to SOEs

4.21 The audit objectives for auditing of financial statements of government business enterprises are similar to those for private sector entities. As such, the same standards should apply to SOEs regardless of their ownership by the Government. This is due to the fact that application to SOEs of the same auditing standards used for private enterprise only meets the minimum requirements of transparency, and SOEs should be subject to even more rigorous disclosure to the public. Users of financial statements are entitled to a uniform quality of assurance and would not be well served by the application of differing standards. Thus, audits of financial statements of government business enterprises should conform, in all material respects, with those of the private sector.

4.22 In Vietnam, there are two sets of standards for SOEs and the enterprises in the private sector. The Government should consider taking the following steps:

- Conduct a thorough and comprehensive review of the auditing standards applicable to SOEs and the private sector and streamline the auditing standards applicable to SOEs with those of the private sector, with a goal of merging the two sets of standards into one (use of International Auditing Standards (IAS) are strongly recommended).
- Issue a combined set of auditing standards for both SOEs and the private sector.

4.23 In Vietnam, the draft law on SOEs provides for the Board of Management to set up a control committee to assist it in controlling and supervising the work of the Director and the enterprise apparatus in financial operations and in assuming their compliance with the law, the rules, regulations and decisions of the Board.
4.24 International standards\(^8\), however, place SOEs in the same risk category as enterprises in the private sector, and emphasize, besides financial and compliance audit, an audit of the internal control structure in the modern sense, i.e. an evaluation of the economy, efficiency and effectiveness of the entity’s activities, as well as its risk management structure (whether the operating goals and objectives will be met).

4.25 The objective of reform in this area should be to change the law on SOEs by expanding the oversight responsibility of the control committee to include supervision of the entity’s internal control structure, and the economy, efficiency and effectiveness of its operations. The Government should consider revising the Law on SOEs with an expanded role of the control committee and train the members of the control committee of the large SOEs in adequately fulfilling their role.

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\(^8\) The new international public sector accounting standard requires SOEs to adopt and follow international accounting standards applicable to private enterprises.
Box 3: Song Da Construction Corp. (SDCC)

**Organization.** There are 95 General Corporations in Vietnam. To be classified as a general corporation, a company should have a capital of not less than VND 500 billion US$ 36 Million, and satisfy certain conditions on the number of staff and the type of business. Song Da Construction Corp. (SDCC) is classified as a General Corporation.

**The Audit Committee of the Board at SDCC** consists of 5 members: a member of the Board of Management as chairman and four experts from MOF, MOT and this corporation itself. All large general enterprises must have by law an audit committee of the board. There is an Internal Audit Unit at the headquarters. Similar units used to exist in all of SDCC’s subsidiaries, but these have now been withdrawn and are merged with the headquarters’ unit.

SDCC, according to the SOE law, must follow the Vietnam Accounting System. But it has, on its own initiative, further refined the financial statements under the guidance of MOF and with technical advice from the Finance Department and Technology Department of the Ministry of Construction. SDCC is subject to inspection and audit by up to six parties: i) the State Auditor General’s Office; ii) the Inspection Office of MOF; iii) the State Inspection Office; Iv) the Tax Dept; v) its own Audit Committee of the Board; and vi) the Independent External Auditor that it may hire.

At the end of the fiscal year, SDCC sends draft financial statements to concerned authorities (i.e. Tax Office, State Auditor General’s Office, MOF). These parties then conduct an audit or an inspection of SDCC and issue comments and recommendations on the statements. SDCC consolidates the recommendations, discusses them with the concerned parties to try to reach consensus, and arrives at a final set of financial statements. According to government regulations, only one audit or inspection needs to be done every year by any of the six oversight parties and even in the case that several audits are carried out, subsequent audits must use the information obtained by the previous one as starting point. In practice, SDCC has to accommodate all requests for checking and audit by the oversight bodies, although an agency may not plan an audit every year. An audit may take up to 5 months. As a result, financial statements are usually finalized up to two years after the end of the fiscal year. For instance, as of September 2000, only one body (the tax authorities) has completed its verification of SDCC’s FY1999 accounts.

**Management Letter.** A management letter is issued by the external auditor, but it is optional for SDCC to follow its recommendations. Its contents focus mainly on the traditional control activities, while neglecting the important aspects of control environment and risk management.

**Accounting matters.** The accounts of SDCC and its subsidiaries are aggregated and not consolidated, because the standards for consolidation are not yet issued. Accounts receivable are classified into three categories: due, past due and difficult to collect. However, there is no standard that defines the latter category. There is a legal channel for collection: The Economic Court usually issues a judgment within one month, but in practice it is impossible to realize the debt, as land is not a chattel in Vietnam and no mortgage process exists. Provisions for losses are not usually done. Although MOF requires these provisions, not many SOEs follow MOF’s instructions because doing so reduces profit and would have unfavorable consequences for the corporation. In addition, no standards on this matter have been issued.

The case of SDCC demonstrates the urgent need to streamline the auditing and inspection processes and accounting and auditing practices of SOEs, and strengthen internal controls by introducing a modern internal control framework that emphasizes economy, efficiency, and effectiveness in operations.
ACCOUNTABILITY OF BOARDS OF DIRECTORS AND MANAGEMENT OF SOES AND PRIVATE ENTERPRISES

Overview

5.1 Vietnam is transitioning from a state-controlled to a more market-oriented economy. State Owned Enterprise (SOE) reforms and private sector development are the cornerstone of the Government’s reform strategy. This reform strategy recognizes the importance of improved corporate governance, reliable financial information, and adequate disclosure in Vietnam.

5.2 There are two legislations, the SOE Law governing SOEs and the Enterprise Law governing private enterprises. Under the new draft of the SOE Law, the Prime Minister approves the establishment of new SOEs on the basis of an application by line ministers or city and province chiefs and the recommendations of an Appraisal Committee. A person authorized to act on the establishment of the SOE is also identified as part of the approval process. This person is authorized to appoint and dismiss the Chairman and members of the Board of Management (BOM). The BOM in turn appoints the Director General of the SOE. Authority to appoint, discipline and dismiss the Chairman and members of BOM may be subsequently delegated to line ministries or provincial People’s Committees.

5.3 In Vietnam both internal and external monitoring mechanisms are weak. Boards of directors do not effectively exercise their oversight of the management. Members of the boards of directors are not independent. Shareholders in private enterprises are not aware of their rights. In summary, the corporate governance system of the SOEs has the following shortcomings:

- Lack of transparency exists in the financial reporting and disclosure, particularly among the SOEs;
- Boards of directors of SOEs are not effective as the roles and responsibilities are convoluted. There is no requirement for the board of directors of private enterprises to have outside (independent) members;
- Although shareholders’ rights are extensive under the Enterprise Law, shareholders are not aware of their rights and are not exercising their rights;
- Corporate culture lacks an orientation towards corporate performance. Operational efficiency needs to be measured against profit benchmarks, but measurements are distorted by the use of the Vietnam Accounting Standards (VAS) in lieu of the International Accounting Standards; and
- Corporate governance is compromised by a lack of clarity as to the roles and responsibilities of the owners, the Board of Management and the control committees.
The Control Committee in SOEs

5.4 The oversight function in SOEs is exercised by the Board of Management (BOM), which represents the shareholders, and a control committee, which is appointed by and accountable to the Board. The control committee Chairman must be a member of the BOM. One member of the control committee can be a representative from the labor union. Other members may or may not be members of BOM. The functions of the control committee are to assist the BOM in inspecting and supervising the enterprise’s management in financial operations, and in complying with the law, the rules and regulations of the enterprise and the resolutions and decisions of BOM.

The Control Committee in Private Enterprises

5.5 The control committee in private enterprises, however, has a different if somewhat broader function. It is appointed by the shareholders’ meeting and made accountable to it. BOM members and the General Director or his/her close relatives or chief accountant cannot serve in the control committee. All control committee members are supposed to be from outside. One of the control committee members must be a graduate in accounting.

5.6 Its functions are to:

- conduct inspections of the truthfulness and legitimacy of the company operations;
- investigate the annual financial statements of the company;
- notify the BOM and report to the shareholders’ meeting the results of its activities; and
- make proposals to enhance or improve the company’s operations.

5.7 The functions of an audit committee of the board in the modern market economies of some other countries are much more focused and control oriented. The functions include:

- Serving as an independent and objective party to monitor the company’s financial reporting process and internal control system;
- Reviewing and appraising the audit operation of the company’s independent auditors and internal auditing department; and
- Providing an open avenue of communication among the board, the independent auditors, the internal audit department, and the financial and senior management of the company.
5.8 More specifically, the audit committee of the board assists the board in fulfilling its oversight responsibilities by reviewing—together with independent auditors, the internal audit department, the financial and accounting personnel—the following:

- the reliability and integrity of the company’s financial reports and other financial information;
- the adequacy and effectiveness of the company’s systems of internal controls regarding finance, accounting, legal compliance and ethics that management and the board have established; and
- the company’s auditing, accounting and financial processes generally.

5.9 The SOE Law of 1995 as well as its revised draft of 1999 described the control committee’s dual function of oversight and supervision. These two functions are distinct and, when combined, lead to confusion in accountability. Moreover, the responsibilities of the committee are not clear and not sufficiently specific to provide an effective guidance. The committee has a limited role, confined to financial operations and compliance with rules and regulations.

5.10 The Enterprise Law for the private sector is somewhat more specific and less confusing. It refers to only one oversight function: that of review, inspection and reporting. Like the SOE Law, however, the functions of the control committee need to be expanded and further clarified to conform to international best practices. The reform strategy should focus on: i) subjecting SOEs and private enterprises to one set of laws and requirements on roles and responsibilities of line management, the general director, and the board of directors and control committee, in conformance with international best practice. ii) revising the SOE Law and the Enterprise Law to redefine and upgrade the function of the control committee to the level of audit committee; and iii) strengthening the internal control systems in SOEs and enterprises by adopting a modern internal control system and enhancing the internal audit function.

5.11 In order to improve the effectiveness of control committees, the Government should consider taking the following steps:

- Consider drafting a combined law for SOEs and non-SOE enterprises so that the same requirements on internal monitoring and oversight are in effect for both types of enterprises. Subsequently, improve the accountability of Board of Directors and General Director under the combined Enterprise Law by bringing this law up to the minimum international best practices.
- Consider the establishment of an Institute of Directors as a professional body to enhance the skills and knowledge of members of Boards of Directors and management. Train accountants, auditors, members of control committees and company management on the enhanced role of the control committee.
• Consider the establishment of an Institute of Internal Auditors as a professional body to upgrade the skills and knowledge of internal auditors and provide them with a career as internal auditors.
6. REMAINING AGENDA

6.1 Efforts to improve financial accountability in the public sector need to focus on upgrading the government financial management system, streamlining processes and procedures, and rationalizing and strengthening institutions responsible for ensuring accountability. There is also an urgent need to improve financial reporting and audit as well as corporate governance of private enterprises and SOEs.

6.2 However, experience has shown that stand-alone measures to strengthen financial accountability are not effective. These need to be complemented by parallel measures that form part of a comprehensive reform addressing issues such as human resources, compensation structure, performance measures, and legal reform. The government should adopt a multi-pronged strategy that encompasses reforming public administration, strengthening the oversight capacity of the legislature, introducing an integrated financial management system, and building capacity and strengthening institutions responsible for ensuring accountability. In the public sector, technological changes should follow the process of administrative reform and the streamlining of processes and procedures.
Annex 1

BUDGETING, ACCOUNTING, AND REPORTING PROCESSES IN THE PUBLIC SECTOR

MOF/STATE BUDGET DEPARTMENT (SBD)
BUDGET ALLOCATION TO MINISTRIES/PROVINCES

Central

Ministry of
Finance

SBD
Approve budget ceiling
(BC) and expend. plan
Notify BC to CST

MINISTRIES
Prepare expenditure plan
Allocate BC to lower spending units

Provinces: prepare expend. plan for approved subsidy

Central State Treasury
Note BC and expend. plan of SUs, and provinces.
Pass relevant BC and expend plans to Province ST

Pemd
Receive expend. plan
Check against budget approval

Ministry’s expenditure plan
(mthly/quarterly)

Spending units
Prepare expend. plan within BC

Province’s expend. plan for subsidy

Spending units
(SU) expend.plan

Province ST office
STATE BUDGET DEPARTMENT
PROVINCIAL BUDGET ALLOCATION

Province

MOF/SBD
Notify subsidy

People Council
Approve budget

Finance Dept
Allocate subsidy to districts and BC to provincial depts

District Finance:
prepare expend. plan for subsidy

District subsidy expend. plan

Provincial ST
Notify District ST of BCs and expend. plans of lower level SUs

Provincial Depts:
Prepare expenditure plan
Allocate BC to SUs

Depts’ expend. plan

SUs prepare expend. plan

SUs expend. plan in mthly/qltrly

District ST

18
STATE BUDGET ACCOUNTING SYSTEM - REPORTING

Ministry level 1: summary of qterly expend. and BC

Ministry L 2: report on aggregated expend. and BC

Ministry level 3: SUs keep records in a/cdance with MoF Reg 999

PEMD
Check actual expend. and BC request for next quarter 10

SBD
Receive reports Approve next quarter BC

District Finance: send aggregated mthly report after agreeing revenue and expend. totals with district ST

Province ST: send aggregated mthly report after agreeing revenue and expend. totals with province ST

STATE TREASURY SYSTEM

ST processing (11) Daily reporting

Payment orders Cash withdrawals

Central State Treasury Summary of daily flash reports 12

MoF/ SBD Receive daily flash report

Payment orders Cash withdrawals

Provincial ST Summary of daily flash reports 12

Prov. finance dept: receive daily flash report

Payment orders Cash withdrawals

District ST Issues daily flash reports 12

District finance dept: receive daily flash report
STATE TREASURY SYSTEM – MONTHLY REPORTING

Central ST prepares summary report 13, 14

Provincial ST prepares reports for SUs and Finance 13, 14

District ST prepares report for Finance and prov. ST 13, 14

Level 1 SUs 13

Prov SUs and level 2 SUs 13

District SUs and Level 3 SUs 13

Commune Finance dept: receive budget report

Finance dept: receive mthly report Approve next quarter BCs 14

District finance dept: Approve next quarter BC Receive mthly report

Finance dept: receive mthly report Approve next quarter BCs 14

SBD: receives ST mthly report Approve next quarter ministries’ BC 14

PMD checks report against approved BC and process ministries BC requests

Provincial depts prepare quarterly report 14

District depts quarterly report 14

Ministries provide quarterly report 14
NOTES

1. The State Budget approved by the National Assembly has few details on recurrent expenditure. The National Assembly approves recurrent expenditures in several broad categories (i.e., education and training). In accordance with the Government’s instructions, the State Budget Department (SBD) allocates a total budget amount to each ministry and subsidies to province. The ministries and provinces are then notified of the amounts, and expenditure plans are prepared into a minimum of 11 items, and up to 23 allowable items, by spending units of each ministry for approval by the Public Expenditure Management Department (PEMD) and the SBD of the Ministry of Finance (MOF). The expenditure plan also has to be broken into monthly and quarterly amounts. A similar process is required of provincial Finance Departments for payment of subsidies from the State Budget. The expenditure plan for each spending unit (SU) would then becomes a Budget Ceiling (BC) within which each SU is authorized to incur expenditures and to make payment.

2. Ministries (level 1) authorize BCs to SUs at level 2, normally located at provinces; level 2 SUs then in turn pass BCs to level 3 SUs. These SUs are directly controlled by an SU at a higher level.

3. PEMD checks each ministry’s aggregated expenditure plan against the Budget approved amount and notes the analysis of line items before passing it on to SBD for approval. SBD then forwards the approved BCs to the Central State Treasury (CST) for funds availability. Expenditure plans are considered approved after 15 days of the ministry’s submission date if no response is received from PEMD/SBD.

4. On a quarterly basis SUs are required to send their budget spending plan to the Treasury office in the area. In addition, the SUs at higher levels, after receiving BCs from the finance office, start allocating BCs to SUs at lower levels so that the State Treasury can transfer funds to Treasury offices in local areas.

5. CST notes BCs of ministries and provinces before passing on BCs to relevant provincial ST that in turn forward some BCs to relevant district ST offices (i.e., level 3 SUs expenditure plans.)

6. The provincial People Committee receives a subsidy from the State Budget if its budgeted expenditure, within the economic parameters set by the Government, exceeds its budgeted revenue. Provincial budgets have to take into account the needs of district budgets within the province. The same process as described previously is repeated for each level of government.

7. The Provincial ST plays the role of CST to district ST offices for the distribution of BCs to lower level SUs. In some districts, using daily transaction notices received from district STs, the district Finance department records on its computer system revenues and expenditures undertaken by the communes within the district. This facilitates the-end-of-month reporting reconciliation and the reporting deadline required by Ministerial Instruction 999.

8. Each spending unit and higher-level authorities in the public sector (including communes and district and provincial finance departments) are required to keep accounting and financial reporting records in accordance with the Finance Minister’s Instruction No 999-1996 titled Public Expenditure Accounting System. The chart of accounts used for this purpose requires SUs to
record assets, depreciation, payables, receivables, source of funds, budget revenue and expenditure, and off balance sheet items. Transactions are required to be recorded daily, with monthly reports submitted to a higher level authority that in turn aggregates these reports with those of the spending units at the same level for reporting to the next level up to PEMD/ SBD of the MOF.

9. The 999 Instruction specifies the format and content of each accounting record and ledger to be kept when using one of the three allowable bookkeeping systems, and of each report to be prepared by SUs and successive levels of authority. The Instruction also requires double entry bookkeeping for each transaction.

10. Given the essentially manual nature of record keeping activities of public sector agencies, it is understood that the majority of spending units cannot comply with the monthly reporting requirements of Instruction 999; thus in practice, the majority of SUs only report quarterly on actual budget expenditures (and total revenue where relevant). This report is submitted together with the SU’s request for the next quarter BC with the under spending automatically rolled into the following month/quarter, except for end of year when different procedures apply. The requirements of Instruction 999 are complied with at the end of the year when revenue and expenditure are reported in accordance with the state budget classification framework (i.e., chapter, category, group, subgroup, items and sub items).

The annual accounts are submitted to PEMD which in turn passes them on to SBD where the data is aggregated using the State Budget Accounting System to prepare the final accounts of the State Budget for reporting to the National Assembly.

It is understood that information on fixed assets is passed to the Investment Department of MOF for asset management purposes. Data on ministerial controlled commercial activities (e.g., the Finance Publishing House of MOF) is forwarded to the Finance Enterprise Department for monitoring purpose.

11. Reporting is hierarchical, with the higher-level authority aggregating lower and same level SUs’ data before a summarized report is produced. SUs and lower level finance departments are required to agree with the relevant State Treasury offices on BCs approved and received during the quarter, expenditure roll-over from the previous period, and remaining BC balance at the end of the period. While this requirement is for quarterly reporting, some districts and provinces report monthly.

12. During the year it appears that there is no meaningful monitoring of budget revenue and expenditures undertaken by SUs, as PEMD only receives abbreviated quarterly reports from ministries. The focus is therefore limited to ensuring compliance with budget limits by several parties: State Treasury at different levels, ministry levels 2 and 1, district and provincial finance departments, PEMD and SBD. This is a weakness that is worth further consideration given that ministries and provincial agencies are allowed to undertake “commercial” activities in addition to their core functions using facilities and resources provided by State Budget.

13. Note 5 above indicates that State Treasury offices record BCs of SUs located in different geographical areas so that funds will be available to SUs as and when required. Thus, ST offices will settle any request for funds from an SU so long as the request is within its BC for the quarter.
Monthly reports issued by State Treasury offices to district, province finance departments, and SBD focus on expenditure by approved line items. However it appears that the information is not used by most recipients; there is no data available from SUs to facilitate reconciliation. On receipt of a payment order from an SU, an ST accountant checks availability of BC and if so, reduces the BC before passing it on for checking and verification against supporting documents by the ST chief accountant. The ST director then authorizes payment through a payment voucher. This voucher has 4 copies distributed as follows:

- 1 for ST record;
- 1 to SBD or provincial/district finance department as appropriate; and
- 2 to the State Bank for payment: one for the bank to keep and the other to the supplier.

If the order from an SU is for cash withdrawal (e.g., for payroll payment), ST only verifies availability of BC before passing 2 copies of the voucher to the ST cashier for payment: one copy for cashier to keep and the other to the SU.

14. A district ST prepares a daily flash report which summarizes revenue and expenditure for the State Budget at the locality, the allocated and remaining balance of budget ceiling from central budget and provincial budget, and revenue and expenditure of the district budget noting subsidy received from higher level government and cash at ST. Three copies of the report are produced: one to keep, one for the district finance department, and one for the provincial ST. The provincial ST prepares its own daily flash report after incorporating information from district ST offices but without the detail on district budgets. The CST daily flash report aggregates data from the provincial report and provides more detail on State Budget revenue and expenditure. This report goes to SBD for monitoring of general cash availability and collections from some sensitive/important revenue items.

15. Two types of reports are produced by the State Treasury system monthly: one for reporting to SUs and the other for SBD and local finance departments. The report to SUs is similar in nature to a bank statement; it sets out each SU’s budget ceiling, payments and receipts during the month, and balance. The reports to SBD/local finance departments are prepared by ST offices using the budget classification relating to the approved line items contained in BCs. No SU is allowed to use a line item which has not been previously approved by SBC/finance departments; any transfer of funds between line items has to be approved by the line ministry and the appropriate SBD/finance department.

16. In principle, SUs are required to submit their quarterly reports to facilitate consideration for approval of next quarter BCs by the ministry of finance. However each SUs should also submit its BC request 5 days before the end of the quarter to the line ministry and in turn, the finance ministry/department, for approval. It therefore appears that there may be some payments being made early in a quarter before BC’s notifications are received by ST offices. The BC notification process is the same as that at the beginning of the year except that an SU’s unspent BC is automatically rolled over to the next quarter BC.

17. Procurement rules are observed before expenditure is incurred, particularly in relation to capital expenditure. Procurement rules apply for capital expenditures over VND 500 million and
administrative expenses more than VND 100 million. The SU director, or delegate, has to authorize the proposed expenditure before commitment is made.

18. SU’s finance section verifies the invoice against supporting documents such as contracts, purchase orders, and goods received and checks accuracy of the invoice before the SU director authorizes the preparation of a payment order issued to an ST office.

19. There are two methods of payment: BC and Payment Order. Both methods can be used by the Budget Department (in the Center) or by the financial department of respective levels of the government. In the BC method, ST performs expenditure control procedures. This includes checking against BC and verifying against invoices and supporting documents. In the case of the Payment Order method, the financial agency performs expenditure control before issuing the payment orders to either pay directly to suppliers or to transfer money into an SU’s account at the Treasury. Once the money is transferred to an SU account, subsequent payments out of the account are not subject to standard checking and verification by ST.

20. The same accounting and reporting arrangement applies at the lower levels of government: communes report to a district finance department that reports to a provincial finance department which in turn reports to SBD of MOF. This also means that while finance departments at all levels use the State Budget classification system in their accounting and reporting, SUs within each area use the Public Expenditure accounting system which has a different focus and a more detailed chart of accounts. Thus it is difficult for communes and SUs at that level to comply with the monthly reporting requirements. For example in Ha Tay province, every month the provincial finance department reports to SBD with actual monthly revenue and expenditure, and total year to date, for the province, districts and some communes in broad categories of salary, capital expenditure, other recurrent expenditure and off budget items. At the end of the year, the final budget accounts contain more details on chapter (organization classification), group and sub group (functional classification) and items/sub items (economic classification). However the final accounts currently include such details for 123 communes and incorporate only the amount of subsidies given to the remaining 201 communes in the province. It is expected that the districts and province will be able to comply with the Budget Law 1997 requirement to include all communes in the final budget accounts in the next few years.

While the province State Treasury office reports monthly to the Ha Tay Finance Department on revenue and expenditure in State Budget classification details, the total monthly actual expenditure in this report should agree with the same expenditure amount included in the report prepared by the provincial finance department for sending to SBD. A similar budget monitoring process applies at the provincial level: there are around 700 SUs and 146 SOEs in Ha Tay (113 provincial and 33 central SOEs). Provincial SUs report monthly the approved line-item details to sector departments that in turn report to the equivalent PEMD within the province. All SOEs report monthly to the SOE monitoring unit within the Finance Department, the relevant sector department, and the taxation and statistical office in the province. It is understood that around 50% of SOEs are profitable; this is due to 2 main reasons:

- lack of appropriate management skill and capacity in SOEs; and
- under capitalization of SOEs so many are unable to compete effectively and to win market share.
The SOE section has 3 key roles:

• provide guidance on financial accounting and reporting;
• check on financial compliance through site visits every quarter; and
• gather information for reporting to MOF.

The District Finance Department performs the function of budget preparation for approval by the district People’s Committee and People’s Council, budget allocation, monitoring and reporting to higher level authorities. In the Hoai Duc district of the Ha Tay province, there are 21 communes and 1 township. The District Finance Department has 7 computers and software provided by MOF, and records of daily transactions undertaken by the communes from transaction reports received from the district State Treasury. As its software uses the state budget classification system, it is in some way duplicating the recording already carried out by the district ST. However, by doing so the District Finance Department is able to meet the monthly reporting deadline (by the 5th of the following month) to the Provincial Finance Department. The district ST office sees that as it is closer to its clients, it is able to provide guidance and closer monitoring of transactions undertaken by communes. In addition there are around 100 spending units in the district with each unit having more than 1 “bank” account with the district ST: one account for budget and the others for project and/or trust monies. There are some cooperatives in the district but they do not use the district ST as they have their own bank accounts with the Agriculture Development Bank.
Current Requirements

Accounting records and processes in use in budget dependent ministries and departments at all levels of government are governed by Instruction 999 (this Instruction issued in November 1999, covers spending units of merely administrative nature, without any investment activities). These requirements are detailed and complex in terms of records to be kept, reconciliation and reports to be done quarterly using a modified cash basis of accounting with double entry bookkeeping for the majority of transactions. The lack of resources and accounting skills at spending units and lower levels of government means that the quarterly reporting requirements specified by the Ministry of Finance in Instruction 999 are not met to enable within year monitoring of the State Budget implementation.

Instruction 999 requires 5 reports and several annexes to be prepared quarterly (and annually) by spending units so that higher level authorities and ministries can in turn compile their reports:

- Form B01 – H List of Ledger Accounts;
- Form B02 – H Aggregated report on Total Expenditure and Expenditure completed for different activities;
- Form B03 – H (annually only) Report on Fixed Assets and movements in year;
- Form B04 – H Report on results of Public Expenditure Activities with revenue;
- Form B05 – H (annually only) Explanatory Notes on Financial Report;
- Form F02 – 1H Detail of Recurrent Expenditure completed and to be accounted for in the reporting period;
- Form F02 – 2H Detail of Project Expenditure to be accounted for in the reporting period; and
- Form F02- 3H Limit of Budget Allocation Checklist.

Only annex number F02-3H, “Limit of Budget Allocation Checklist”, or a simplified version thereof, is regularly complied with as part of the quarterly reporting process to enable the allocation of budget limit for the following quarter for each reporting unit be MOF and province/district finance departments.

State Treasury offices (a department of the MOF) report monthly to the State Budget department of the MOF, and finance departments at province and district levels on actual expenditure and revenues using the State Budget classification system. It is understood that these reports are used mainly for reconciling total revenues and expenditure on an aggregated district/province/central level. Thus there is little “within year” monitoring of spending by budget dependent units except to ensure that the quarterly budget limit for
each unit is not breach. However the current disbursement system via State Treasury offices is so tightly controlled that any breach of budget limit is impossible in any case.

Comments and Recommendations

It is generally acknowledged that the current accounting and reporting requirements imposed by Instruction 999 are onerous and complex given the current accounting skill deficiency and inadequate computing resources at all levels. It is also debatable if the requirements are really necessary given that the State/province/district Budgets are prepared and approved on a cash basis. As accounting is only a tool to record and report on economic transactions, a public sector accounting system need to follow the methodology that governments (or people committees) and parliaments (or people councils) plan and manage the allocation and uses of resources through the annual budget process. Thus the use of a simpler system that can provide the necessary information for accountability purposes would be desirable. It is recommended that the record keeping and reporting requirements for spending units and higher level authorities be simplified along the following lines.

- State Treasury offices continue to report (daily and monthly) to MOF/finance departments on aggregated revenues and expenditure only. The requirement to report on monthly expenditure on approved budget items/sub items be eliminated. For explanation please refer to Annex 1 on budget/payment flow chart page 4, note 13.
- It is necessary to have uniform requirements for all spending units. For example, line item classification should be either 11 or 23 items, or any number in between. For expenditure involving the purchase of an asset, this can be recorded in the asset register as a memorandum item.

The agreement of the cash ledger balance with the spending unit’s cash balance at State Treasury should be verified at the end of the month. This proposal would simplify the recording and reporting of public expenditures as currently all receipts and payments received/made by spending units are in cash; for example by cash withdrawals for salaries/wages, or through cheques issued by State Treasury offices on the State Bank, or through State Treasury warrants to settle suppliers’ invoices.

At the end of the month, spending units are required to agree total receipts and payments shown in their ledger with those shown in the “bank” statement issued by the State Treasury. The following format is suggested for consideration:

- Opening cash balance brought forward;
- Plus Budget limit received in month;
- Plus Other revenue received;
- Less Total payments made (see Attachment X); and
- Equals Closing cash balance at ST
The closing balance should agree with the balance as reported by the relevant ST office. Where there are valid reasons for a difference, the reconciling items should be listed and should be cleared before the end of the following month.

- Any cash withdrawals for minor expenditure should be accounted for on a reimbursement basis. Cash withdrawals for payment of salaries and wages should be reconciled with details of any unclaimed wages recorded in an unclaimed wages book. Unclaimed wages should be re-deposited in the ST after say one week unless there are valid reasons to keep them for a longer period; however this should not go beyond the next salary payment date.

- The attachment for payment details may take the following format:

<table>
<thead>
<tr>
<th>Expenditure</th>
<th>Previous YTD</th>
<th>Paid in month</th>
<th>Cumulative YTD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item xxx</td>
<td>Description</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Item yyy</td>
<td>Description</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(…up to 23 approved items)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL PAID</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The total payment for the month should agree with the total payment in the ST “bank” statement. The cumulative year to date total for each item should be an addition of all payments made to date for that particular item.

- For those spending units with revenue from core budget activities, a separate summary statement for all revenues received should be prepared and agreed with the item “Other revenue” shown in the ST “bank” reconciliation. The format of the statement should be similar to that of the payment summary.

- For those spending units with significant “commercial” activities, records relating to these revenues and expenses should be maintained separate from those of core budget activities and should preferably be accounted for on an accrual basis depending on the nature of these activities and the volume of transactions. Where facilities and resources are shared with core budget activities, a “management charge” should be calculated and approved at the beginning of the year by a higher level authority (e.g., by the ministry or the Public Expenditure Management Department of MOF, or the equivalent at provincial/district finance departments). This “management charge” is an expense for the commercial activities and should be accounted accordingly. This proposal will ensure transparency of the result of commercial activities and avoid any hidden subsidy from the Budget.

- Purchases of fixed assets should be recorded in the asset register monthly. A minimum amount for asset capitalization should be established by the Department of Public Assets Management of MOF to avoid unnecessary record keeping of small asset items.
• Reporting to higher level authorities should then comprise of the ST “bank” reconciliation, statements of payment and receipts and a copy of the relevant page of the asset register (for information only). For those units with significant commercial activities, a quarterly financial report comprising the Profit and Loss statement, Balance Sheet and Cash flow statement are the minimum requirement.

The above proposals are sufficiently simple that it is not necessary to have staff with accounting knowledge to maintain the “system”. It is only necessary to employ qualified accounting staff where the agency or the spending unit engages in significant commercial activities. In such a situation, it is reasonable to expect that there should be sufficient revenues to support the employment of an accountant to separately account for these commercial transactions to ensure transparency between these activities, and budget supported operations.

It is also believed that the proposal is simple enough to enable prompt processing and recording of transactions manually so that monthly reports to higher authorities will be accomplished in a timely manner. This would enable regular monitoring of the Budget implementation so that any corrective action can be taken promptly.

Although more work will be needed to specify the details of records to be kept and the format of reports, this can be done fairly quickly so that some training can be given to the relevant staff where this may be needed.
BENCHMARKS FOR THE AUDIT AND INSPECTION FUNCTIONS

Principles Governing the Role of the External and Internal Auditor.

Both IFAC and IIA Standards distinguish between the mission of external and internal auditors. The activities of these two disciplines may overlap in areas such as reviewing the adequacy of accounting controls. Although there is some duplication, the differences are greater than the similarities because the objectives are different:

<table>
<thead>
<tr>
<th>Internal Auditor</th>
<th>External Auditor</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Is an organization employee</td>
<td>- Is an independent party</td>
</tr>
<tr>
<td>- Is independent of the activities audited, but is ready to respond to the needs of the management</td>
<td>- Is independent of management both in fact and in mental attitude</td>
</tr>
<tr>
<td>- Reviews activities continually</td>
<td>- Reviews records supporting financial statements periodically (*)</td>
</tr>
<tr>
<td>- Serves needs of the organization</td>
<td>- Serves third parties who need reliable financial information (*)</td>
</tr>
<tr>
<td>- Focuses on future events by evaluating controls designed to assure the accomplishment of the entity’s objectives</td>
<td>- Focuses on the accuracy and reliability of historical events as expressed in financial statements (*)</td>
</tr>
</tbody>
</table>

Note: The last three characteristics of the external auditor -- marked (*) above--may be modified by the mandate of the government auditor, which requires the latter to be also responsible for fraud and other accountability issues.

Recommended Changes for Vietnam

In comparison with a two-body model for audit and inspection, Vietnam has four entities involved in audit, inspection, and oversight work:

- The State Auditor General’s Office which plays a role similar to that of a supreme audit agency in other countries;
- The Inspection Directorate of the Ministry of Finance, which performs the financial inspection function, covering all ministries;
- The Inspection Directorate at each ministry, which fulfills the performance audit function; and
- The State Investigation Office, which performs the investigation function, a role similar to an Ombudsman.

In Vietnam, audit and financial inspection are split between three separate entities. This renders coordination very difficult, and promotes duplication and overlapping of
work. For instance, the Inspection Directorate of each ministry does little performance audit but is mainly engaged in compliance audit. Likewise, the State Auditor General’s Office and the Inspection Directorate of the Ministry of Finance are both engaged in financial and compliance audits.

It is recommended that a review be carried out in an effort to streamline the roles and responsibilities of various players in inspection and audit with a particular emphasis on streamlining the roles and responsibilities of the Inspection Directorate of the Ministry of Finance and the Inspection Directorates at each ministry.
THE COMMITTEE OF SPONSORING ORGANIZATIONS OF THE TREADWAY COMMISSION (COSO) AND THE MODERN INTERNAL CONTROL CONCEPT

Historical Perspective:

After the Watergate scandal in which illegal payments to foreign governments were uncovered, the US Congress passed the Foreign Corrupt Practices Act (1977). This emphasized internal controls to prevent illegal payments and led to extensive documentation of internal accounting controls. Similarly, the Small Loans and Savings debacle led to the formation of the National Commission on Fraudulent Financial Reporting—led by Mr. Treadway, General Counsel of Paine Weber—known as the Treadway Commission. It called, in 1987, for the sponsoring organizations to work together to integrate the various internal control concepts and definitions, and to develop a common reference point. After several years of research and discussion, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) published its report in 1992. The COSO Report has achieved widespread recognition as an authoritative work on internal control concept and evaluation.

There is, however, a major difference between COSO devised in 1992 and the Foreign Corrupt Practices Act of 1977; COSO goes beyond the financial and accounting aspects of governance to focus also on people, their ethical values, integrity and competence, management’s operating style, risk management, staff training and career development. COSO, which had an accounting origin, has now become a general management framework in its own right.

The COSO Framework. The Framework defines internal control as a process that is effected by people and that provides reasonable assurance regarding achievement of the following three objectives:

- Effectiveness and efficiency of operations
- Reliability of financial data and report
- Compliance with laws and regulations

Under “Effectiveness and Efficiency of Operations”, the Framework includes: compliance with policies, procedures and plans, safeguarding assets, economic and efficient use of resources, reliability of operating data and reports, and achieving goals and objectives.

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1 The original five members of COSO (American Accounting Association, American Institute of CPAs, Financial Executives Institute, Institute of Internal Auditors, and Institute of Management Accountants) continue to work on updating and improving the concept.
The Framework embodies all the traditional concepts of control. However, it adds a new and important concept that internal control is a process effected by people.

For each of the above objectives, there are five components of control:

- A sound control environment;
- A sound risk assessment process;
- Sound operational control activities;
- A sound information and communications system; and
- Effective monitoring.

**Assessment of Internal Control.** Internal control can be judged effective if management has reasonable assurance that they understand the extent to which: (i) the organization’s objectives are being met; (ii) financial reports are being reliably prepared; and (iii) applicable laws and regulations are being complied with. This judgment of effectiveness results from an assessment of whether the five components of control are present and functioning effectively. Their effective functioning provides reasonable assurance regarding achievement of the three primary business objectives.

In assessing whether a country (or an organization) needs the Framework and how it would benefit from adopting a control framework such as COSO, the following questions may be asked:

**Control Environment**

- The degree to which managers and employees possess integrity, competence and ethical values;
- Whether the nature of management’s philosophy and operating style is appropriate;
- Whether there is proper assignment of authority and responsibility;
- Whether there is proper organization of available resources; and
- Whether there is proper training and career development of people.

**Risk Assessment**

- Whether management has established a set of objectives that integrate all the entity’s resources so that its parts operate in concert;
- Whether there is an awareness of and ability to deal with the risks and obstacles to successful achievement of business objectives; and
- Whether management identifies, analyzes, and manages these risks.
Operational Control Activities

- Whether management has established and executed policies and procedures to help ensure effective implementation of the actions they have identified as being necessary to address risks and obstacles to achievement of business objectives.

Information and Communication

- Whether the reports that are produced deal with internal and external activities and conditions and events necessary for informed business decision-making and external reporting;
- Whether the entity’s people are able to capture and exchange the information they need to conduct, manage, and control operation;
- Whether information flows in all directions throughout the organization; in particular, whether all employees have the means of communicating significant information upstream; and
- Whether employees understand their own roles in the internal control system, as well as how their individual activities relate to the work of others.

Monitoring

- Whether the entire control system is monitored to assess the quality of the system’s performance over time, with the help of measurable performance indicators, if possible;
- Whether internal deficiencies are reported upstream, with serious matters being reported directly to top management; and
- Whether there are separate, independent evaluations of the internal control system.

Although internal control, according to COSO, provides only a reasonable and not an absolute assurance, it has clearly delineated the roles of various players; management at all levels is directly responsible for internal control. Boards of Directors or their equivalent in the public sector, provide guidance and oversight. The internal audit function does not have primary responsibility for establishing and maintaining internal controls. Internal auditors evaluate the effectiveness of control systems. External parties (external auditors, regulators, legislators, civil society) may have a significant indirect effect on an entity’s internal control, but are not responsible for that process. Responsibility for control rests squarely on the shoulders of management at all levels.

Conclusion

The COSO Framework provides management with a reasonably comprehensive tool to manage and sustain an effective internal control system in a modern environment. It expands management’s view beyond that of traditional control, to deal with the “soft” issues of control. Internal control in the past tended to concentrate on "hard” controls, such as formal processes, policy, procedure, and organizational structure. Modern control also deals with “softer” but strategic issues such as shared values, competence, trust, strong leadership, openness, high expectations and ethical standards.

The Framework thus could provide management with a methodology for adding significant value to the organization, and at the same time, satisfying the requirements of Good Governance.
### SCHEDULE OF PROMULGATING VIETNAMESE ACCOUNTING AND AUDITING STANDARDS

<table>
<thead>
<tr>
<th>Vietnamese Accounting Standards</th>
<th>Vietnamese Auditing Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stage 1</strong>: 4 draft standards were issued in 2000:</td>
<td><strong>Stage 1</strong>: Standards were promulgated in 1999.</td>
</tr>
<tr>
<td>- Stocks;</td>
<td>- CM No. 200 - Objectives and Basic Principles governing an Audit of Financial Statements;</td>
</tr>
<tr>
<td>- Tangible Fixed Assets;</td>
<td>- CM No. 210 – Audit Contract;</td>
</tr>
<tr>
<td>- Intangible Fixed Assets;</td>
<td>- CM No. 230 – Documentation;</td>
</tr>
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</table>

<table>
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<tr>
<th><strong>Stage 2</strong>: 6 Standards will be promulgated in early 2001:</th>
<th><strong>Stage 2</strong>: 6 Standards were promulgated in the 4th quarter of 2000:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- General Standards (Framework for the Presentation of Financial Statements);</td>
<td>- CM No. 250 – Consideration of the Statutory Acceptance during Auditing Process;</td>
</tr>
<tr>
<td>- Cash Flow Statements;</td>
<td>- CM No. 310 – Knowledge of the Business;</td>
</tr>
<tr>
<td>- Construction Contracts;</td>
<td>- CM No. 500 – Audit Evidence;</td>
</tr>
<tr>
<td>- Borrowing Cost;</td>
<td>- CM No. 510 – First Year Audit;</td>
</tr>
<tr>
<td>- The Effects of the Change in Foreign Exchange Rates;</td>
<td>- CM No. 520 – Analytical Procedures;</td>
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<tr>
<th><strong>Stage 3</strong>: 6 Standards will be promulgated by end of 2001:</th>
<th><strong>Stage 3</strong>: 7 Standards are in the stage of compilation to be promulgated in early 2001:</th>
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<tr>
<td>- Contingencies and Events occurring after the Balance Sheet Date;</td>
<td>- CM No. 240 – Fraud and error;</td>
</tr>
<tr>
<td>- Accounting for Income Tax;</td>
<td>- CM No. 300 – Audit. Planning;</td>
</tr>
<tr>
<td>- Accounting for Investment;</td>
<td>- CM No. 400 – Risk Assessment and Internal Control;</td>
</tr>
<tr>
<td>- Accounting for paid-in Capital;</td>
<td>- CM No. 530 – Audit Sampling;</td>
</tr>
<tr>
<td>- Earnings per Share;</td>
<td>- CM No. 540 – Audit of Accounting Estimates;</td>
</tr>
<tr>
<td>- Consolidated Financial Statements and Accounting for Investment in Subsidiaries.</td>
<td>- CM No. 570 – Going Concern Business;</td>
</tr>
<tr>
<td></td>
<td>- CM No. 610 – Using the Work of Internal Audit.</td>
</tr>
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<th><strong>Stage 4</strong>: Standards will be promulgated from 2002 to 2003:</th>
<th><strong>Stage 4</strong>: Standards will be promulgated in 2001 and 2002:</th>
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<tr>
<td>- Presentation of Financial Statements;</td>
<td>- CM No. 220 – Quality Control for Audit Contract;</td>
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<tr>
<td>- Net Profit or Loss. Fundamental Errors and Changes in Accounting Policies;</td>
<td>- CM No. 230 – Materiality;</td>
</tr>
<tr>
<td>- Reporting Financial Information by Segment;</td>
<td>- CM No. 401 – Audit in Information Environment;</td>
</tr>
<tr>
<td>- Preparation of Half yearly Financial Statements;</td>
<td>- CM No. 510 – Audit Evidence – Examination of Particular Items;</td>
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<tr>
<td>- Related Parties Accounting;</td>
<td>- CM No. 560 – Events occurring after Finalization Date;</td>
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<td>- Disclosures in the Financial Statements of Bank and similar Financial Institutions;</td>
<td>- CM No. 600 – Using the work of Other Auditors.</td>
</tr>
<tr>
<td>- Information reflecting the Effects of Changing Prices;</td>
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</tr>
<tr>
<td>- Financial Reporting in Hyperinflationary Economies;</td>
<td></td>
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<tr>
<td>- Discontinue Operations;</td>
<td></td>
</tr>
<tr>
<td>- Property Losses;</td>
<td></td>
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<td>- Unforeseen Properties and Debts Provisions.</td>
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Annex 5
IMPLEMENTATION OF AN INTEGRATED FINANCIAL MANAGEMENT SYSTEM (IFMS) CASE STUDIES

Integrated financial management systems have been adopted in a number of countries with various rates of success. In this annex, we shall first examine the factors contributing to effective and efficient IFMS implementation, then examine cases of financial accountability reform involving IFMS. The following are the critical factors.

Components of an IFMS

An IFMS consists of an interrelated set of subsystems that plan, process and report upon resources, quantifying them in financial terms. The basic subsystems normally include accounting, budgeting, cash management, debt management and related internal controls. These subsystems are able to exchange information with ease and to share commonly used data.

Rationale for an IFMS

An IFMS provides decision-makers with a set of tools to support:

- Controlling aggregate spending and the deficit;
- Strategic prioritization of expenditures across policies, programs and projects for allocative efficiency and equity; and
- Better use of budgeted resources, i.e., to achieve outcomes and produce outputs at the lowest possible cost.

When information systems are implemented as components of separate projects that respond to specific needs, with no consideration given to critical interrelationships of users or beneficiaries, the resulting systems are often disparate and segmented. Since major investments are required to set up a modern computer-based information system, integration is a requirement, not an option. Incompatible or duplicative systems would be wasteful and inefficient and would not provide the information that governments need for effective management.

Traditionally, control has been the dominant, if not the single, reason for developing IFMS. This control will always be central. However, to deliver on the above-mentioned three levels of performance, an IFMS that supports informed decisions and that links information on costs, outputs and outcomes will be essential. Decentralization between levels of government also underscores the importance of adequate IFMS.
Implementation of IFMS

The successful establishment of a functional and efficient IFMS is dependent on a number of crucial factors:

• It should be seen in the context of wider institution building and policy reform;
• The first step towards achieving integration is to develop a conceptual framework that provides an overview of the system network to support financial management. This includes an analysis of basic functional processes and information requirements;
• Computerization is a key issue: the benefits realized from computer systems will depend on the degree of success achieved in strengthening basic functional processes, the regulatory framework and organizational structures.
• Successful implementation of an integrated network of information systems is crucially dependent on cooperation among diverse users;
• The number of technical staff and skills required to set up such systems are considerable; and
• Full integration should be done over time in stages, since varying degrees of partial integration are viable options;

Developing an IFMS requires considerable time and resources and should be viewed as a long-term process. A modular approach will often be appropriate, since most of the elements of a comprehensive system exist in some form in every country. Some countries may be in a position to take advantage of developments in information technology to move relatively quickly from a currently manual system to an automated and integrated system. Automation will not, however, resolve problems associated with structure and lack of discipline on the part of the implementers.
Implementation of Integrated Financial Management Systems

I. The Case of Guatemala

The government of Guatemala has initiated a comprehensive program of public sector reform with the goal of increasing revenues and improving the institutional capacity of the central government. A key element of the reform strategy is the successful implementation of an Integrated Financial Management Project.

The project, started in April 1996 and costing US$ 10.5 million, is the first phase of a series of measures designed to enhance public financial accountability in the country. Project implementation has been successfully completed. The second phase, starting in November 1998 and costing US$ 18 million, is under implementation, and has now entered its final year, paving the way for a third phase.

Strategy

Major problems identified in Guatemalan public sector financial management included an overly centralized and antiquated system, which contributes to significant deviations of the executed budget from the congressional approved budget, serious shortfalls in planned investment spending, and serious anomalies in accountability and transparency. To address these shortcomings, the project seeks to introduce a modern government financial management system in key areas of budgeting, accounting, cash management, debt management, and auditing and procurement. The project adopted an integrated approach through a commonly shared database, and established an information technology system capable of communicating data across the sub-systems.

Utilizing the principles of regulatory centralization and operational decentralization, the project will facilitate the transfer of financial responsibility and accountability to line ministries. The Ministry of Finance and the Comptroller General’s Office will function as rector institutions to regulate and guide the overall financial operations of the government and assure the integrity of the decentralized operations.

Line ministries will assume greater operational control over their own budgets, supported by internal Financial Management Units. These units will be responsible for budget formulation and implementation, accounting, procurement and cash management. Separate Internal Audit Units will also be established. The reforms were piloted initially in four Ministries and then expanded to the remaining government institutions.

Project Components

The project, designed in the first phase to result in a series of quick improvements in financial management practices, consist of the following interrelated components:

- A new budget classification and a budget manual;
- New chart of accounts, together with accounting manuals and related software;
- A monthly cash flow programming system;
• Simplification of the Treasury payment systems;
• A complete reorganization of the government procurement system;
• An innovative graphic-based information technology;
• Legal reforms through the promulgation of legislation on budget, financial management, ethics and probity, goods and services; and
• Training of over 1600 civil servants.

In the second phase, the project will expand the reforms started in the first phase, and pursue the improvement in financial efficiency and transparency by:

• Restructuring of the Comptroller General’s Office;
• Reforming the debt management and public investment functions; and
• Extending the entire integrated financial management system to all other governmental agencies through provision of computer equipment and training for the decentralized financial management units.

Achievements

With all of its components advancing satisfactorily, the project continues to perform well. The integrated financial management reform has been extended to 32 central agencies and five decentralized entities. Multi-year budgeting has been introduced and performance indicators developed. A new procurement law has been drafted, paving the way for an electronic procurement system. An institutional diagnostic study for the Comptroller General’s Office recommends revision of its structure and function, revision of auditing norms, preparation of a new audit manual, development of an information technology system for external audit, and establishment of a new human resource management system. Reforms in public debt management and public investment are also under way.

Delegations from neighboring countries have visited the project, which continues to be a great success and serves as a benchmark for the region.
Implementation of an Integrated Financial Management System
II. The Case of Bolivia

The government of Bolivia is committed to implementing a sustainable process of self-management in financial administration, while instituting sound financial management standards and systems in a critical mass of public entities.

Strategy

To realize these objectives, it was necessary to establish an Integrated Financial Management System (IFMS) to be operated by the decentralized prefectures, agencies and municipalities. The system which will be linked to the national budget via the central IFMS network operated by the Ministry of Finance.

At the same time, it is necessary to build up a strong public auditing function that, in collaboration with private sector auditing firms, will be able to continuously review and evaluate financial performance and integrity of operations conducted by public sector entities. This includes implementation of uniform professional auditing standards across the public sector, auditing operations of the decentralized regional governments and municipalities, development & execution of anti-corruption forensic audits covering large public outlays and contracts, and quality control of private sector audit standards.

Project Components

There are nine project components that are complementary and reinforce one another in a synergistic effect:

1) Development of a modernized and automated integrated financial management systems for the nine regional prefecture governments, the decentralized entities and municipalities. The major financial functional areas would be designed under information technology platforms assuring their functional integration, so that the final product systems would provide government executives and technical staff with the ability to monitor all phases of public financial management from upstream budget formulation, cash, liquidity, and debt management, to accounting and expenditure monitoring.

2) Linking the both the decentralized and centralized financial and budget reporting systems for the purposes of national accounting reporting and comprehensive public expenditure monitoring at the aggregate national level. This component also allows for remote entry of expenditure transactions to record budget movements on an on-line basis.

3) Linking the public budgetary funds transfer procedure through the private sector banking system, to allow more efficient budget distributions to the prefectures and municipalities.
4) Implementing the central and decentralized IFMS through practical hands-on training in the information technology-based financial systems, and their specific method of application and administrative support in each agency. Supporting this hands-on technical assistance will be workshops at regional and national levels that will disseminate the proper applications, controls, regulations, disclosure requirements, and financial procedures to be utilized under the automated financial management systems.

5) The fifth project component covers the project unit's operating costs, including administrative and project management staff cost.

6) Strengthening institutional capacity as well as expanding the scope and type of public audits undertaken by the Comptroller General's Office (CGO). This component will provide technical assistance to further strengthen CGO's capacity in the areas of: (a) evaluation of private sector audit operations conducted for public agency operations, (b) establishment and institutionalization of procedures for auditing public sector procurement and purchasing systems, (c) building of professional auditing skills and organizational sustainability to ensure long term auditing. This component is critical as it will disseminate and institutionalize the country's public auditing capability in the decentralized sectors.

7) The seventh component focuses on operational type audits that supplement the traditional financial audits by focusing on operational execution and performance, including the evaluation of output results of operations, and the development of audit of information technology systems. This is particularly critical under the decentralized government structure.

8) The eight component includes development and application of forensic audit techniques (anti-corruption and detection methods) that will interface with both financial and operational audits.

9) The ninth component includes training in accounting, auditing and financial management. The above eight components are supported by this component in order to ensure widespread dissemination and sustainability of modern accounting, auditing and management procedures.
Implementation of an Integrated Financial Management Systems

III. The Case of Pakistan

Strategy

The Government of Pakistan has recognized that as it proceeds to open up its economy and free it from regulatory controls, the need for modern financial management systems and good governance becomes paramount. Instead of direct intervention, it has to design appropriate fiscal and monetary responses to changing conditions. To be able to do so, the government has recognized the need for a modern set of tools to provide it with comprehensive, accurate and timely financial information.

As the country strives to attract private foreign investment, the issues of transparency and accountability become even more important in the context of a global economy. Agreeing with the thrust of recommendations of diagnostic work, the government has developed an overall vision statement for financial reporting and auditing. In this statement the Government outlines its intention:

• adopt and implement a modern accounting system designed according to recognized international accounting principles and standards and based on modern information technology;
• implement a governance structure and legal framework for an independent and effective audit function;
• improve the professional capacity of the elements of the civil service responsible for fiscal management; and
• make increasing use of the private sector to supplement public sector resources; and adopt improved standards for private sector financial disclosure.

To address issues in accounting and auditing, the government has agreed to introduce policy changes relating to:

• adopt improved accounting principles and standards for the government sector;
• transfer of responsibilities for government accounting from the Auditor General to the executive arm of government;
• improve independence, standards and capacity for government audit, including greater use of private sector firms in public sector finance; and
• develop the skills and competencies of government finance staff, including revised human resource management and training policies.
**Project Components**

The project comprises components for public sector financial management including accounting, auditing and institutional development, economic policy-making and management.

**Government Accounting and Financial Reporting**

The government has expressed its intention to develop accounting standards, reporting systems and financial administration procedures conforming as much as possible to internationally accepted principles. In view of the very high and continuously increasing volume of financial transactions, a completely manual recording and processing system for the Pakistan Audit Department (PAD)’s accounting and auditing needs is no longer feasible for the delivery of the type of information required for financial management. Therefore, the adoption of some degree of automation is inevitable.

**Government Auditing**

This component focuses on audit systems improvement and systems development. It includes: i) preparation of guidelines for the introduction of international auditing standards; introducing modern auditing techniques and concepts; a review of PAD’s audit policies, processes and procedures, output, workload, efficiency and quality assurance for the audit function; enhancement of PAD’s communications with stakeholders; and the use of automated audit tools and standard audit programs to improve communication of audit results and development of quality assurance programs.

It also includes: provision of hardware and audit software for audit planning, sampling and documentation, and for audit of automated accounting systems, and capacity development efforts to support revised human resource management procedures through international training in a modern financial system environment and through arrangements with other Supreme Audit Institutions.

**Institutional Development**

To apply the above improvements to financial management systems, the project would assist in the introduction of revised human resource management policies, the strengthening of financial management training, the development of a Management Information Systems (MIS) wing of PAD, and the introduction of office automation to assist in the performance of day to day work. It would also put in place project management structures.