

## SIGNIFICANCE OF AN INTERNAL CONTROL MECHANISM AND CODE OF CONDUCT

### BACKGROUND

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In the context of international integration, it is important that Vietnamese businesses, especially small and medium-sized businesses (SMEs) should improve their management capacity, reform the management systems for effective operation, risk mitigation, and response to unexpected changes in business environment, thus to enhance the reputation of their businesses, and bolster the trust of national and international partners.

The Anti-corruption Law (2018) was approved by the National Assembly on 20 November 2018 and came into force on 1 July 2019. The scope of the Law has been expanded to cover the private sector. Specifically, Section 1 (Article 78, Article 79) of Chapter VI has provisions on the development of transparent business culture, encouraging companies to issue and apply codes of conduct/ethics and internal controls to prevent corruption. It is shown that business activities have profound impacts on the economy. Therefore, businesses should develop a culture of integrity through applying a code of conduct and improving internal controls, promoting the principle of transparency and openness in organization and operation, controlling conflicts of interest, improving accountability, and specifying the responsibilities of heads and deputies in the companies.

### REPORT ON CURRENT SITUATION

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A survey on the current situation of “**Application of internal controls and codes of conduct in Vietnamese businesses**”<sup>1</sup> was conducted and the survey results were published in March 2019. The survey showed that the businesses were basically aware of internal controls (IC) and codes of conduct (CoC) but they had low interest in their application. About 40-50% of the interviewed businesses (239 companies) did not fully or correctly understand the definitions of codes of conduct and internal controls. At many businesses, especially Vietnamese ones, internal controls and codes of conduct were not applied, or had been applied with limited effect. This was partly due to lack of specific guidance and resources for implementation.

Many aspects of IC were not fully applied, for example, the assessment of work performance, risk identification mechanism, resources and staff capacity building for IC. One of the reasons for these shortcomings was the lack of specific guidance and training for staff on the benefits of IC and CoC, and how to effectively apply IC and CoC in their work. Regarding CoC in particular, the assessment of the employees’ compliance with the code was not included in year-end appraisals, which was among the reasons why CoC had not been considered an important part of doing business.

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<sup>1</sup><https://kdcl.vn/an-pham-va-cong-cu/doanh-nghiep-ap-dung-co-che-kiem-soat-noi-bo-va-bo-quy-tac-ung-xu.html>

It is necessary for the businesses to be instructed to implement IC and CoC. A set of related management tools and templates should be provided for effective application by businesses. The goal of the Training Program is that businesses are aware of the importance of IC and CoC application, demonstrated by the high commitment of the business leaders in implementing transparent governance and the active participation of the managers at different levels, officials and all the employees.

## **INTERNATIONAL PRACTICES**

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It is observed from international good practices that most regional and multinational corporates have applied codes of conduct and internal controls.

Good practices in IC have been developed by the Committee of Sponsoring Organisations (COSO) under the US National Commission on Financial Reporting (commonly known as the Treadway Commission) since 1985. COSO has standardised and issued principles and requirements of internal controls in its first report in 1992 (COSO 1992 report). Many laws (such as the US Sarbanes-Oxley Law (SOX)), Law on Enterprises, Law on Credit Institutions, Law on Auditing of different countries and so on), international auditing standards, internal auditing standards, regulations of securities commissions in many countries and so on have taken the COSO 1992 report as a standard for compulsory appliance. The COSO 1992 report is the first step for businesses in development of their internal controls.

Twenty years after the first COSO report was issued (in 1992), globalisation with drastic changes in business environment and development of information technology has substantially affected how businesses operate, identify and respond to risks. In May 2013, COSO issued an updated report, “Internal control - Integrated framework” (also called the COSO 2013 report, effective on 15 December, 2014) to replace the COSO 1992 report, which included a new definition of internal controls as *“a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance”*. Until now, the standards of the COSO 2013 report have been applied in most countries for the design and development of IC frameworks and for detailed guidance on IC, risk management and fraud prevention in order to mitigate fraud risk and to improve corporate performance and governance.

Relating to codes of conduct, the Asia - Pacific Economic Cooperation (APEC) issued a code of conduct in business for the private sector focusing on anti-corruption and principles of integrity and transparency in the private sector (2007). The US Department of Commerce also issued the *“Manual for managing a responsible business in emerging market economies”* (2004), guiding businesses in development and delivery of ethical conduct in compliance with international standards and good practices relating to CoC in business activities.

Therefore, depending on their priority and strategy, each business might structure the CoC in its own way in line with the specific conditions of the business.

## **BENEFITS OF INTERNAL CONTROLS AND CODES OF CONDUCT**

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The development and application of IC and CoC is considered an effective measure for good corporate governance, ensuring sustainable development through realising commitments with relevant parties.<sup>2</sup>

If a business has weak IC and an ineffective CoC, its governance and controls will be less effective, resulting in an increase of the opportunities for fraud or non-compliance with the laws and regulations. On the contrary, strong IC together with a strict CoC will help improve monitoring functions for the timely detection and prevention of fraud/non-compliance.

In addition, effective IC and CoC also enable the board of management to identify risks and responsible parties for improvement and better control of future activities. IC and CoC can help to prevent fraud/non-compliance with the laws (including bribery) by reducing disguised opportunities, controlling motivations and justifications for such acts, and promoting anti-corruption.

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<sup>2</sup> <https://www.unodc.org/unodc/en/corruption/WG-Prevention/private-sector-and-public-private-partnerships.html>