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**School of Management**

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**Enhancing the effectiveness of budget expenditures by the  
means of auditing**

**A case study of State Audit Office in Vietnam**

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**Hanoi, 2012**

## **ABSTRACT**

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Title: Enhancing the effectiveness of budget expenditures by the means of auditing.  
A case study of State Audit Office in Vietnam

Master's thesis: 69 pages

Date: February 2012

Keywords: public expenditure management, budget expenditure auditing, state budget

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Public expenditure is a financial concept embedded in Government management role and related to economic, politic and social areas. The effect of public expenditure management driven from actual requirement is that despite the limited financial resource, the necessities to achieve economic, politic and social management liability of the Government must be well satisfied.

The Supreme Audit Institution (SAI) is an instrument to control State finance and to implement the people's rights. The expression of state audit opinion, and state audit confirmation, comprise of assurances of the reliability of financial and budgetary information. The SAI would significantly contribute to the improvement of the quality of financial and budgetary operations; the SAI is a vital tool for people to supervise the process of national development and Government.

In order to promote public awareness of the role of SAI in enhancing effective public expenditure, as well as in sharing experience and information in state audit sector in general, and in public expenditure auditing in specific, the SAI needs to improve its qualifications and its operational quality. It also has to develop auditors of good professional morality, knowledge and skills in order to meet the job requirements. It should also share experiences within the framework of the action programs of international organizations and the co-operation agreements between the State Audit agencies.

Based on this ongoing process, this study aims to explore how auditing enhances the good planning and management of the public expenditures, and how it plays its important role in the public sector. The data collection methods used includes academic documents and interviews with managers in charge of State Audit Office of Vietnam and financial experts.

The findings of the study reveal that enhancing the effectiveness of State Audit plays an important role in public expenditure management. A key conclusion reached is that the improvement of the effectiveness of State Audit in public expenditure auditing is a necessary issue in order to increase the transparency and accountability of public expenditure management.

## **Acknowledgements**

There are many persons who have contributed to the process of completing my thesis. I would like to take the opportunity to express my gratitude to all those who have helped and supported me.

I would like to thank the Supervisors of this thesis, Professor Pertti Ahonen of the University of Helsinki and Professor Lasse Oulasvirta of the University of Tampere for their valuable support and comments.

My colleagues and leaders of the State Audit Office of Vietnam have allowed me to organize my work during the past months in a flexible manner, enabling me to take the time to complete the thesis. Thank you for your understandings.

I would like to thank Ms Truong Trinh and my sister for their time and interest in the thesis. Their insightful comments, continuous encouragement and careful revisions of English of the thesis have helped me a great deal along the way.

Finally, I would also like to thank my parents, whom I cherish and have great respect for. They encouraged and inspired me and helped me a lot in my process of research and study. They helped me to take care of my two children and with the housework so that I got more time for research work. I also thank my dear two children, who were disadvantaged when I did not have much time to take care of them. Thank you for all your love and support.

Hanoi, March 30, 2012

Nguyen Kim Chi

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## **Chapter 1: Introduction**

### **1.1. Research topic**

Budget expenditure is the needed expenditure to support the operation and to ensure the functions of the government. As the financial resources of the government are limited, yet the expenditure's requirement to meet various targets is continuously increasing, the effectiveness of public expenditure has a direct effect on the success of implementing the economics and social functions of the government. Therefore, managing public expenditure is one of significant importance; especially, controlling public expenditure, ensuring public expenditure is for right purpose, economizing and the effectiveness are the keys.

In the world, for each country, the Supreme Audit Institution (SAI) holds different legal status, role and responsibility, but they all have one thing in common, that is, they assist the government in auditing the public expenditure. With the basic functions of auditing, approving, assessing and advising, SAI helps to ensure the transparency of the economy and the effectiveness in allocating, managing, utilizing the government resources (*Vuong, 2009*).

On public expenditure, the role of the SAI in preventing loss, risk management is indicated in three basic roles of audit namely confirmation, assessment and consultancy, in three types of audit: financial report, compliance and performance. More importantly, it also provides the Government with recommendations and local authorities with some measures, and management policies which make the spending more effective. The SAI reviews and gives options on whether legal documents regarding adjustment of public expenditure are reasonable. The consequence of unreasonable public expenditure policy, incompatible with monetary policy, foreign exchange, may lead to high risk of budget structure. Audit of budget expenditure gives recommendations of policies to ensure a harmonious cooperation, effect between the fiscal and the monetary policy.

The Government Audit Institution of Vietnam (called the State Audit Office of Vietnam-SAV), established in 1994, is the important instrument in inspecting public finance of the State; it operates independently and is responsible under the National Assembly. With its basic functions as inspection, evaluation and consultancy, the operation of the State Audit is to ensure the clarity, allocation, management and use of the State financial resources and public property in an appropriate, economical and effective way. The hundred year history of establishment and development of the State Audit (SAV) in the world affirms that the State Audit is the effective instrument in inspecting and controlling economic and financial activities of the State, and an indispensable part of the State's juridical mechanism. All activities relating to the State's financial resource and property, all agencies, organizations and units using the State's financial sources and

property must be under the inspection of the State Audit. Besides main functions and tasks, the State Audit also implements the audit of obedience, economic features, effectiveness and effect of management, use of the state financial sources and the state property (Tran, 2009)

This study discusses the public expenditure auditing of SAI with State Audit Office of Vietnam as the case study. Research on published literature, collected data from interviews has been conducted to form the opinions that are presented within the study.

## **1.2. Research problem and aims**

### **1.2.1. Research problem**

With the high demand for expenditure, the ability of meeting current demand is limited, then strengthening the state budget management, limiting losses, improving efficiency of using the state budget are really important to implement planned socio-economic goals, to improve the efficiency of using the state capital and property.

Budget audit results contribute to financial transparency and help to fight against corruption, wastefulness and negative phenomena in the area of public expenditure and public finance management, ensure and improve efficiency, effectiveness of the budget expenditure in controlling of receipt, disbursement, manage state fund, public financial resources, contribute to a clean state.

Recent years, the use of budget in Vietnam as well as the management of public expenditure has resulted in many shortcomings and weaknesses leading to the loss, waste, embezzlement, corruption in several areas and locals around the country.

*“Operation of the State Audit is to validate the correctness and truthfulness of the revenues and public expenditure from the State Budget in the financial reports; compliance with law, economics, efficiency and effectiveness of the use of the State’s money and property of the audited units, organizations audited” (Law on State Audit of Vietnam, 2005).* Audit, the management and use of budget expenditure, is one of the main tasks of the State Audit and it has contributed an important part to enhance the efficiency as well as the effectiveness of the public expenditure.

To strengthen and further develop State Audit’s role in public expenditure audit aimed at ensuring the disclosure and transparency of the state budget, this became an important problem that many researches mentioned of. From the necessity and reality of the auditing in public expenditure in Vietnam, I would like to choose “Enhancing the effectiveness of budget expenditures by the



means of auditing. A case study of State Audit Office in Vietnam” as research subjects for my master's thesis.

### **1.2.2. Research aim**

In Vietnam, the State Audit’s function is indicated clearly in the Law on State Audit (2005): *“The State Audit activities are to help the Government in inspecting, monitoring the management, use of budget, cash and the Government’s assets; to contribute a saving way in practicing, preventing corruption, loss, overspending, detecting and preventing activities violating the law; to enhance the effectiveness in use of budget, cash and the State assets”*. This is an important role of State Audit in budget expenditure audit.

The purpose of this research is to analyze and describe the public expenditure management and the operation of the State Audit in the budget expenditure auditing, to make clear the role of SAI as well as the impact of budget expenditure auditing to social economic development and national finance, to evaluate the contributions of the State Audit in reducing corruption and in increasing the transference of the Government to citizens. Then, this research analyzes the limitations and difficulties in operation of SAV to propose solutions and suggestions to improve the effectiveness and efficiency in budget expenditure audit.

The research problem can be summed up to the following research questions:

The main research question: How should the effectiveness in budget expenditure audit activities of State Audit Office of Vietnam be improved?

Then sub questions are as follow:

1. What is the current state of the effectiveness of the planning and execution of budget expenditure in Vietnam?
2. What is the current position of the State Audit Office of Vietnam?
3. How is the effectiveness of the planning and execution of the public expenditure audited by the State Audit Office of Vietnam?
4. Which measure and solution could/should be taken in order to improve the contribution of the State Audit of Vietnam to the effectiveness of public expenditure in the country?

### **1.3. Research scope and limitations**

State Audit of Vietnam (SAV) is a tool to test the highest public finance, for the purpose of inspection and control of Congress, the State Audit’s operation scope is vast, covering all revenues and expenditures of state budget and it also has to implement many other tasks. Therefore,

in this thesis, I would like to research, review budget expenditure audit of SAV, analyze and evaluate achievements as well as existences in budget expenditure audit. And then, I evaluate the causes as well as limitations in auditing operation. With my knowledge and understand based on collected data and practical operation of SAV in budget expenditure auditing in Vietnam, I would like to recommend and propose the suggestions to enhance the role of SAV in public expenditure audit.

Due to limited research time, research method is new for me and public expenditure management and auditing in this area is a fairly complex problem, I just took research on audit of public expenditure in general, did not go into detailed contents of this field such as recurrent expenditure auditing, capital expenditure auditing, government debt auditing.... Therefore, in further studies, going into research issues, specific details are very good and necessary to help come up the results and solutions to further improve effectiveness as well as efficiency in public expenditure of the State Audit Office of Vietnam.

## **1.4. Research methodology and research data**

This section aims to present and justify the research strategy, methods and design used to accomplish the present study.

### **1.4.1. Research method**

In this section, it is described that research method was selected and the issues that justify this choice.

The research method used for this thesis is Qualitative research. The theoretical framework is formed by collecting relevant research literature connected to empirical data in public sector. The empirical material consists of legislation documents and subsidiary governance documents, instructions and decisions...and some data are collected from other sources. Besides, evaluation of the current real expenditure will be analyzed through the economic and financial reports in Vietnam.

Silverman (2010) distinguishes three different types of dissertations, in which each of them implying the use of certain methods. The three types are: theoretical (systematic analysis for theory development), methodological (development of a new method) and empirical (analysis of a specific body of data related to real world problems). The present thesis is primarily characterized as an empirical piece of work since it searches for empirical evidence from primary data sources in order to answer questions posed on a real and contemporary phenomenon.

Another aspect that influenced the choice of research methods for this work is the nature of the data to be collected. Required data to identify the current roles designated operating activities and actual current performance of State Audit Office within the public financing space could be collated from relevant legislations, research papers and news articles.

Creswell (2005) presents some key factors that should be considered during the process of choosing a qualitative approach. The first factor relates to the essence of the research problem, a qualitative approach should help to get a deeper understanding through exploration rather than searching for a specific trend or explanation by means of a quantitative approach. This factor is intimately related to the objectives of this study as it helps to understand a complex process that is underexplored.

Creswell (ibid) emphasizes the importance of the familiarity of the potential audience with the chosen research approach. As this study aims to shed light on a topic that is of relevance to several people such as financial experts, managers at Government budget funded institutions and policy-makers, it is important to clarify to the readers the basic characteristics and limitations of the study. A qualitative approach requires gathering data skills through observing or interviewing individuals and also on the interpretation the material.

Given the nature of research questions posed for this study and the reasons explained above, a qualitative research was deemed the opportune approach. The study aims to undertake explorative research as a way to shed some light on a current underexplored situation. A qualitative approach is considered to be the appropriate one to research the topic as it permits a closer exploration of how a common factor may have different effects depending on the circumstances of the elements under analysis, case study design is envisaged to collect and analyze primary data through in-depth interviews and documents review.

#### **1.4.2. Research instruments**

Interview and documentary data analysis will be two main research instruments. Data will be collected from many sources such as documents of State Audit Office, Ministries, Government, audited agencies, other stake holders, audit reports, academic articles and books, etc.

I take sample of interviewing 5 persons (They are experts in economics, leaders of State Audit...) to know their opinions on the fact of budget expenditure audit. Then, I analyze achievements and limitations of SAV in budget expenditure auditing in Vietnam (the figures and data obtained from collected evidences).

As another technique for the empirical research, content analysis is widely used in this research; content analysis can be used as a part of archival research. The process of content analysis

involves breaking the written materials down into researcher's selected categories or units. Method used is as one part of research. A case study is an empirical inquiry that investigates a contemporary phenomenon within its real life context (*Silverman, 2010*). The nature of the case study in the research is instrumental. Instrumental case studies are used when the researcher wants to gain greater insight into a specific issue. In this particular situation, the case study is expected to contribute to a greater understanding of a topic of interest. The subject of the case itself is of secondary interest; examining the case improves understanding of the phenomenon, not the case (*Creswell, 2005*).

### **1.4.3. Research design**

The research is organized in two stages of data collection and interpretation: Stage 1 is aimed at identifying the relevant documents on studied public expenditure audit. Stage 2 shows a qualitative analysis of collected data from the selected documents in order to provide a represented overview of the public expenditure auditing. Additionally, a qualitative study being based on in-depth interviews selected with key managers was performed with the aim to clarify the ways by which the public expenditure auditing had an impact upon public expenditure management. It is believed that this design can produce the necessary data to answer the posed research questions and to draw related conclusions.

The two above mentioned stages permitted to gain insight on the background and context of the public expenditure auditing with special emphasis over the technology transfer perspective. Based on this foundation, in-depth interviews with key managers from the SAV were foreseen with the purpose to acquire a deep understanding on the core issue of the thesis: how to enhance the effectiveness of public expenditure auditing.

The interviews are undertaken following a semi-structured format (*Maxwell, 1996*). The choice of a semi-structured format is justified since the interview is not highly structured as in the case of closed-ended questions nor is it totally unstructured incurring in the risk of losing focus on the issues of interest. A semi-structured approach then, offers the possibility to guide the followed interview on the proposed theoretical framework in use.

After extensive contacts via e-mails, the interviews were carried out through telephone, over the internet and each lasted in average 60 minutes averagely. Face-to-face interviews were initially considered very important that associated the case studies, but mobility costs hindered this possibility.

A semi-structured approach to the interviews was considered to be the most appropriate approach since it enables interviewees to respond in an open-ended way making it easier to identify

different interpretations and opinions amongst the participants over the same issues. The semi-structured approach is perceived to be more effective since it combines the structure of the issue under analysis blended with the flexibility need to explore different patterns. It also allows the interviewer (researcher) to react promptly over emerging important issues. In order to extract the desired information, an interview guide containing open-ended, theory-driven questions was used in the same version for the interviewees (*Maxwell, 1996*).

The selection of interviewees was based mainly on two factors: the deep understanding within the State audit activities and holding a position that enables a comprehensive overview of all its dimensions. These two criteria naturally led to the necessity to interview one of the officers with a coordinating role.

## **1.5. Organization of the study**

This study is organized into five chapters. The main idea behind the division is the logical presentation and movement from theory based on information within context of budget expenditure audit of SAIs. Each of the five chapters covers an entity that builds theoretical and empirical knowledge about SAV in a continuing pattern.

Chapter one introduces purposes of the development of this thesis. Chapter two presents theoretical foundations used for the analysis. It pays special attention to determining factors that contribute to good public expenditure management (PEM) and expenditure governance, the role of audit and control in public expenditure. Chapter three describes the role of auditing and criteria for efficient and good state auditing especially regarding PEM. It mentions theory and context of State Audit, introduces the State Audit's operations and the role of budget expenditure audit in budget management. Chapter four is the chapter for case studies in Vietnam. This chapter describes SAV, its functions, powers, resources, personnel, rules and standards of state audit; it also describes the SAV's score with the criteria of efficient audit of PEM. This chapter also includes an analysis of the challenges that SAV is facing, and step needs to be taken to make the SAV better in PEM. Chapter five gives a summary on important findings and conclusions of the research, which includes conclusion of PEM and SAV in Vietnam.

## **Chapter 2: theoretical framework- basic concepts**

### **2.1. The State budget**

#### **2.1.1. The concept of the State Budget**

A country's State Budget is as old as the country itself appears. State establishment requires concentration of economic resources, especially the financial resources to do the physical means to cover the cost of the machine and perform social economic functions. With its power, the State is engaged in the distribution of social product in many different forms (the most important of which is taxes) to create a focused financial fund called the State Budget (*Duong and Pham, 2005*).

State Budget is for revenues and expenditures of the State (usually defined in a year) to be codified in law. According to the State Budget Law of Vietnam, determined in the Article 1: "The State Budget comprises all revenues and expenditures of the State, which have been decided by the competent state agencies and implemented within one year in order to ensure the performance of the functions and tasks of the State"

State budget expenditure is the distribution and use of state budget funds to ensure implementation of state functions according to certain principles. State budget expenditure is the redistribution of financial resources that has been focused on the state budget and put them to use. Therefore, the state budget expenditure must be specific on the allocation for each objective, each activity and each job that follow function of the state (*Bowyer, 2005*).

A government budget is a legal document that is often passed by the legislature, and approved by the chief executive-or the President. For example, only certain types of revenue may be imposed and collected. Property tax is frequently the basis used as for municipal and county revenues, while sales tax and/or income tax are the basis for state revenues, and income tax and corporate tax are the basis for national revenues (*Duong and Pham, 2005*).

In the case of the government, revenues are derived primarily from taxes. Government expenses include spending on current goods and services, which economists call government consumption; government investment expenditures such as infrastructure investment or research expenditure; and transfer payments like unemployment or retirement benefits (*Syllabus of public financial management-Hanoi, 2007*).

Budgets have an economic, political and technical basis. Unlike a pure economic budget, they are not entirely designed to allocate scarce resources for the best economic use. They also have a political basis wherein different interests push and pull in an attempt to obtain benefits and avoid burdens. The technical element is the forecast of the likely levels of revenues and expenses (*Duong and Pham, 2005*).

### 2.1.2. The Nature of Public Budgeting

According to Allen Schick (University of Maryland Professor), on the trends and developments of the last 20 years emerges Schick's view of the nature of the remarkable human institution that we call budgeting, the way governments organize the mobilizing and spending of public resources. What is budgeting about? What might we ask or expect of it? What is good budgeting?

Budgeting, first and foremost, is about people, policies, and politics. Schick's characterization is worth quoting in full: *"The word "budget" conjures up images in many people's minds of thick documents crammed with obscure jargon and thousands of numbers, and of debates over accounting conventions and performance indicators. These are manifestations of budgets, of course. But this is not what budgeting is all about; it is about the interplay of people and their ideas and goals"* (Schick, 1998, p.28).

Budgets are statements of the limits and allocation of financial resources which governments will use in providing assistance and services to improve the social and economic well-being of people. Budgets are the result of a compromise amongst alternative views of the desirable size and composition of government activities. Budgeting is a reconciliation process whereby people ministers, members of the legislature, public servants and others engage in a debate on the relative merits of these various views and arrive at the allocation of resources. Budgeting is also a process which governs the behavior of public servants in actually managing and delivering assistance and services to the public, and in the subsequent accounting for public monies used and results achieved (Caiden, 2010, p.5).

Budgets, therefore, are decided by people and their government. They are instruments of economic and social policy, so budgetary values may need to be served to more important social values, social stability, compassion for those who are unable to care for themselves, justice, and equity. The processes of budgeting are also important because they relate outcomes. Budgeting is about rules and routines that may promote management improvement and program effectiveness bring focus to decision making, protect operational rights. Yet it is also constrained by the need to meet deadlines, by the built-in costs of previous expenditures, by inadequate information, and by the very routines of the budget cycle. It may also be an inward-looking process in which insiders communicate only with each other within the confines of government. Can inherited budget processes respond adequately to the strains and expectations of contemporary democratic government? (Schick, 1998, p.353-358)

Budgetary control can be defined as *"the establishment of budgets relating the responsibilities of executives to the requirements of a policy and the continuous comparisons of*

*actual with budgeted results either to secure by individual action the objective of that policy or to provide a basis for its revision*". It should be pointed out that there is no significant difference between the principles of budgetary control in either the public or private sector: The statement implies that, as budgets are established for various elements of the organization, managers are given responsibility for the management of budget resources in those areas. A system requires information which has to be related to the delegated responsibilities within the organization (*Coombs and Jenkins, 2002, p126*).

## **2.2. Public sector spending and expenditure**

Public sector spending is certainly attractive for politics. There is no doubt why public finance devotes substantial time and effort to this area. As public finance is part of economics, its main interest goes to total spending, i.e. the government's part of the economic cycle. It does not care too much about public sector corporations, as they are usually part of the larger private sector corporations. Neither gives too much interest to international organizations, which simply represent part of the exchanges with foreign entities. Perhaps this section should be called government spending rather than public sector spending. However, as we shall see, the suggested impact of the scope issue is far larger than it should be. Other shortcomings include the delimitation between consumption and investment (*Bergmann, 2009, p.126*).

This distinction leads to another one: expenditure and expenses. Expenditure is an outflow of cash or cash equivalent, while expenses are any kind of consumption or outflow of assets or increases in payables, depreciation, raises in obligations etc. Obviously, the concept of expense is an accrual concept, while expenditures are in the cash basis world. At this state, considering public sector spending, we have to reckon that the traditional concept of public finance is based on expenditure, but this is falling short of the entire economic reality (*Bergmann, 2009, p.126*).

## **2.3. Public expenditure analysis**

The governments collect revenues through taxes, fees and charges, royalties on natural resources, and the sale of goods and services. They also receive incomes from investments and often from borrowings. These revenues are used to make transfer payments to individuals and businesses, pay interest on accumulated debts, and general expenditures. Both spending and revenue-raising activities of governments tend to alter the relative economic position of individuals and families often by design, because income redistribution is one of the main functions of government activity (*Ruggeri, 2005*).



Distribution process is the process of allocating funds from the State budget to form the funds before they are used; Using Process is the direct spending money allocated from the State budget without having to go through the formation of the funds before they are used (*Ruggeri, 2005*). State expenditures are classified under two headings:

### **2.3.1. Revenue expenditure (Recurrent expenditure)**

Revenue expenditure takes place from this budget. Salaries of government employees and military staff, perks for ministers, office furniture, grants to local bodies, subsidies, interest to be paid on loans taken, and pensions are all accounted for here and referred to as revenue expenditure. Any expenditure for the normal running of the Government, which does not lead to the creation of assets, is called revenue expenditure. This expenditure must be financed from revenue receipts that the Government earns. The Government earns revenue in the form of corporate taxes, income taxes, duties (excise, custom etc.), receipts, fees and interest (if the Government makes investments) (*A. Hall, 2004*)

### **2.3.2. Capital expenditure**

Capital expenditure refers to the money spent on creating assets (roads, highways, and dams), buying land or building, purchasing machinery and equipment (*A. Hall, 2004*).

Within the private sector, a fixed asset is defined according to the nature of the expenditure, its materiality and whether it confers benefits beyond the current accounting period. In the case of local government, a similar approach is taken, which capital expenditure being regarded as any outlay which is of value to the authority in the provision of its services beyond the end year of account. It is then recorded as a capital asset provided there are no legal constraints, but are not depreciated (*Coombs and Jenkins, 2002, p 208*).

Within central government, assets are currently not recorded as such in the organization's account there is no charge for depreciation to the revenue accounts of the component departments. Expenditure for capital and revenue purposes is strictly segregated and serves primarily for the allocation of distinct and separate capital and revenue funding to organizations (*Coombs and Jenkins, 2002, p 208*).

Nevertheless, a clear distinction between current and capital expenditures is necessary, for analytical purposes, transparency, and policy decision-making. In the first place, the distinction is needed for an assessment of the operating costs of government and the efficiency of government activities. Moreover, investment expenditure generates a stream of future costs and benefits and is analytically and financially different from expenditure whose effects are extinguished within a short

period. Finally, developing a performance-oriented approach requires a separation between running costs and capital expenditures (A Hall, 2004).

Broadly speaking, the terms ‘revenue expenditures’ and ‘current expenditures’ are used interchangeably just as the terms ‘capital expenditures’ and ‘investment’. The correlation, however, is not exact. There is some investment expenditures on revenue account (basically capital expenditures), which are required for carrying out general administration of the State, such as housing for civil servants. Likewise, current expenditures shown up on the capital account. Formally, the difference between revenue and capital expenditure is determined on the basis of whether the expenditures are financed from revenue or capital receipts (A Hall, 2004).

## **2.4. Management control, audit and evaluation of public sector financial management**

### **2.4.1. Management control**

Management controls, (also called “internal controls”) *“means any systems, measures or processes in order to ensure that public sector financial management operates in an efficient and effective manner, as well as in full compliance with any standards or laws”* (Bergmann, 2009, p.115). They are the policies and procedures put in place by the managers of an entity to ensure the proper and effective operation of the entity. There are many kinds of management controls. Developing an effective system of control requires, first, a careful assessment of the risks facing the organization. Policies and procedures can then be selected to control those risks effectively and at reasonable costs (A Hall, 2004).

Public sector governance encompasses the policies and procedures used to direct an organization’s activities to provide reasonable assurance that objectives are met, and operations are carried out in an ethical and accountable manner. In the public sector, governance relates to the means by which goals are established and accomplished. It also includes activities that ensure a government’s credibility, establish equitable provision of services, and assure appropriate behavior of government officials - reducing the risk of public corruption.

The activity of management control responds to the social demand for sound government. Control of public decisions can’t be restricted to political elections, in which there are other issues at stake apart from the efficient allocations of public resources – such as social demands dealing with the general orientation of public expenditure, the amount of taxes that society is prepared to endure, or the institutional design demanded by the people. We require from the public

administrations an efficient allocation of those resources that society considers must be managed collectively (*Crespo, 2005*).

Furthermore, the best institutional design has found economic efficiency to be the key criterion and public control institutions are key elements that can help in achieving efficient administrative structures. These institutions exercise several functions, two of them of particular relevance: they carry out the essential function of audit, and they can be used as potential sources of information for policy makers (*Crespo, 2005*).

#### **2.4.2. An audit systematization of public sector**

Considering the body that exercises it, control can be external or internal. Internal control is carried out by specialized organisms that belong to the structure of the audited institution (*Crespo, 2005*). Internal audit is part of an organization's management control structure. It performs audits of lower level units on behalf of the top management of the entity. Some of its most important functions are to test the management controls themselves and to assist management in assessing risks and in developing more cost-effective controls (*Bergmann, 2009*). Reports coming from this kind of control remain within the internal domain of the institution and are rarely made public (*Crespo, 2005*).

In the case of external one, audit of the government is typically performed by a separate organization, the SAI, which usually reports its findings to the legislature and/or the public, as well as to the audited entity itself (*Bergmann, 2009*). The institution in charge of control is independent from the controlled entity. External audit reports, usually made public, are destined for parliaments and governments (*Crespo, 2005*). As the external auditor, the SAI has the task of examining the effectiveness of internal audit. If internal audit is judge effective, efforts shall be made to achieve the most appropriate division or assignment of tasks and cooperation between the SAI and internal audit, without prejudice to the right of the former to carry out an overall audit (*INTOSAI, 1997*).

SAIs may perform several types of audits, including ex ante audits, compliance/regularity audits, financial (assurance) audits and value-for-money (efficiency) audits. The appropriate audit emphasis depends on the particular circumstances of each country. Weak or non-existent management controls in government organizations may require the SAI to conduct extensive auditing of individual transactions in an ex ante or compliance/regularity mode. However, this is an inefficient use of audit resources. An SAI in this circumstance should work with the legislature and the Ministry of Finance to implement a coherent strategy for building effective systems of management control (*Bergmann, 2009*). Before the management of public resources was considered one of the objectives of control, the activity of SAIs was restricted to the assessment of

formal, procedural and financial legality of public expenditure. However, a good legality audit- either pre-audit or post-audit- can contribute to the improvement of management in public administrations. Thus, pre-audit of public works contracts and acquisition of goods and services usually has an important preventive effect (*Crespo, 2005*).

The information that public managers must provide to the control body contains both financial and management components. In this respect, there are two criteria when presenting accounts: the criteria of authorization to allocate resources and the criteria of property control (*IFAC, 1996*). According to the first criteria, the accounts only take into consideration those resources in the form of liquid funds, and the audited entities are those financed mainly through the budget; that is, the budgetary sector. According to the criteria of property, all resources under the responsibility of the government are included in the accounts; the audited entities are those belonging to or controlled by the government, including therefore both the budgetary and non-budgetary sectors (*Montesinos, 2000*).

### **2.4.3. Evaluation of public expenditure management**

When dealing with management control, three basic principles (the so-called “three E’s”) are usually mentioned: effectiveness, efficiency and economy. All these principles are integrated in the doctrine of control and, either totally or partly, recognized in law; they are not always given the same meaning. The effectiveness control ascertains the degree of achievement of objectives and the relation between established objectives and results (effectiveness in relation to objectives). Efficiency control (also known as performance or productivity control) checks the relation between provided goods and services and resources employed to do this. Finally, economy control examines cost minimization of acquired or allocated resources in terms of quality, quantity, price and opportunity of its acquisition (*Moukheibir and Barzelay, 1995*).

Control, and management control, is dynamic by nature and therefore feedback becomes a key element. The sequence of the control process is as follows: analysis of public management- carrying out of audit- evaluation of audit findings- effects on public management- changes in management. In order to make feedback work, it is evident that the SAI must have a remit to make recommendations, either to the Parliament or to the government.

When information coming from public managers is taken as a basis for decision-making, the accounts must be included, besides conventional financial information, specific management components (*Crespo, 2005*).

## 2.5. The budget expenditure management

### 2.5.1. Budget expenditure control

The key goals of overall economic policy are conventionally defined as growth, equity, and stability. It has been well understood that these three goals are complementary over the long-term. Economic growth provides the resources needed for poverty reduction, but cannot be sustainable if it is not accompanied by sufficient stability and equitable policies. Unstable economic and financial circumstances are inimical to growth, and typically hurt the poor most (*ADB mission statement, 1999*).

But stability in a context of persistent economic stagnation and poverty is hardly a desirable outcome. In the short-term, however, these goals may be mutually conflicting, and a sound resolution is required (and hence a robust institutional mechanism) that takes all three into consideration in a coherent policy package (*ADB mission statement, 1999*).

As noted, public expenditure management is instrumental in nature. As a central instrument of policy, it must pursue all three overall economic policy goals. **Financial stability** calls, among other things, for fiscal discipline; **economic growth** and **equity** are pursued partly through allocation of public money to the various sectors. All three goals require efficient and effective use of resources in practice. Hence, the three goals of overall policy can be translated into three key objectives of good public expenditure management: fiscal discipline (expenditure control); allocation of resources consistent with policy priorities (“strategic” allocation); and good operational management. The latter two objectives are easily recognized in the traditional economic as allocate efficiency and use efficiency (*A Hall, 2004*).

There are linkages between the three key objectives of PEM, their corresponding major function, and the government level at which they are mostly operative. Fiscal discipline requires control at the aggregate level; strategic resource allocation requires good programming, which entails appropriate cabinet-level and arrangements. It should be stressed, however, that fiscal discipline and operational management are amenable to “technical” improvement more important than is the strategic allocation of resources.

In turn, good operational management calls for both efficiency (minimizing cost per unit of output) and effectiveness (achieving the outcome for which the output is intended). Management consultants and organizational theorists have popularized the “Three Es” of Economy, Efficiency, and Effectiveness, where economy is defined as minimizing input cost. Economy has administrative utility because it is linked largely to the procurement function and hence to a major potential source of waste and corruption. However, it is not independently useful for economics or policy making, as

it is subsumed into efficiency, which entails minimum cost per unit of output (*Bergmann, 2009, p.54-55*).

Our focus on public expenditure management should not lead us to forget the essential link between revenue and expenditure. The triad of PEM objectives can easily be expanded into a triad of fiscal objectives. Fiscal discipline results from good forecasts of revenue as well as expenditure; strategic allocation has a counterpart in the tax incidence across different sectors; and tax administration, of course, is the revenue aspect of good operational management of expenditure.

The PEM system must be accountable both for the use of public money and its results. Even though, a strong internal accountability between budget system personnel and their superiors may be necessary, “overhead” PEM activities (e.g. policy advice, macroeconomic forecasting, etc) have the main responsibility for providing services to the public.

For the later, external accountability is needed as well. With the dramatic improvements in information and communication technology (see below), feedback from service users and the citizenry can now be obtained at low cost and for a greater variety of activities, and is an essential adjunct to improving efficiency and effectiveness of service delivery. Strengthening external accountability is especially necessary in the context of initiatives for greater decentralization or managerial autonomy, when new checks and balances are required to assure that access to and quality of public services is not compromised as a result (*A Hall, 2004*).

### **2.5.2. Aspects of public expenditure management**

The relevance of concepts to the various aspects of public expenditure management will be brought out throughout this thesis. A few generally applicable considerations are provided below to ensure a good governance of PEM.

Lack of **predictability** of financial resources undermines strategic prioritization and makes it hard for public officials to plan for the provision of services. Predictability of government expenditure in the aggregate and in the various sectors, is also needed as a signpost to guide the private sector in making its own production, marketing, and investment decisions (*A Hall, 2004*).

**Transparency** of fiscal and financial information is a must for an informed executive, legislature, and the public at large (normally through the filter of competent legislative staff and capable and independent public media). It is essential not only that information be provided, but that it be relevant and in understandable form. Dumping on the public immense amounts of raw budgetary material does nothing to improve fiscal transparency. Moreover, “this principle requires clarity, not complexity, in regulation, so that people understand the problem being regulated and how the regulation solves the problem” (*Bourn, 2007, p 181*).

Appropriate participation by concerned public officials, employees and other stakeholders is required for the sound formulation of expenditure programs; participation by external entities is for the monitoring of operational efficiency; and feedback by users of public services, for the monitoring of access to and quality of the services.

**Accountability** is needed both for the use of public money and for the results of spending it. The concept of social political and financial responsibility of public managers reinforces and widens the content of public accountability. Public audit must also verify the compliance of public managers in relation to their responsibilities and the justification of their performance. The features of this accountability are currently being thoroughly revised in order to ensure its effectiveness, with transparency of information being one of the basic parameters in this reform of public management (*Crespo, 2005, p.10*). As with all other elements of the auditor's task, the auditor begins by understanding the business of regulation. Regulation should be accountable to those who are affected by it, regulation is not an end in itself and those regulated should have opportunity where appropriate to have a say in the regulatory framework and its ongoing development (*Bourn, 2007, p 181*).

### **2.5.3. Corruption and public expenditure management**

Defining corruption is not the simple task that it might initially appear. Corruption is similarly hard to define, and there are differences between the legal definitions that apply and those that might be applied socially, culturally or politically: "*Corruption is the offering, giving, soliciting or acceptance of an inducement or reward which may influence the action of any person to behave dishonestly*" (*Bourn, 2007, p 262-263*).

Although corruption in government is often identified with large procurements and major public works projects, public expenditure is hardly the only source of potential corruption. Tax administration, debt management, customs, ill-designed privatization, the banking system, etc., can be equally troublesome in that respect. But certainly, one major route to improving PEM (and, of course, improving the quality of governance as well) is to reduce the opportunities for corruption in the process and to punish corruption when it occurs. The reverse is also true: a major way of reducing corruption is to strengthen PEM. Quite aside from any moral or legal consideration, corruption weakens fiscal discipline; distorts the allocation of resources; harms operational efficiency and effectiveness; and, obviously, is antithetical to due process (*A Hall, 2004*).

#### **2.5.4 Public expenditure and trends**

Together with taxation, public expenditure is one of main instruments of national financial operation; public expenditure has two main functions: social function and economic function. According to viewpoint of Keynes school, “*public expenditure ensures a certain social harmony and plays a certain role in stabilizing the economy. Public expenditure is a gathering of expenditure items in order to ensure the State to operate and implement its functions of economic and social management*”.

Public expenditure depends on the scope of public activities or of public administrative agencies. Normally, scope of public administrative agencies includes: Central public administrative agencies which have its role and competence at the national level (the government and other agencies under the central administrative apparatus, public non-productive units; local public administration agencies (local authorities, local public non-productive units). Public expenditure and public sector are two different concepts. The state enterprises do not belong to concept of public expenditure, even when total capital of these enterprises is of the state. Public expenditure does not include expenditure items of organizations and individuals whose capital for operation are funded by the State, however, such expenditure items are auditing subjects of the State audit. Meanwhile, public expenditures also include a vast variety of government expenditures such as: recurrent expenditure, expenditure for development investment (capital expenditure), other expenditure (support, assistance ...) (Vuong, 2009).

Together with the economic development, functions and tasks of the State increases rapidly. Therefore, the state public expenditure tends to rise continuously and has two main characteristics: (Tran, 2010).

Firstly, spending increases more and more rapidly and powerfully; secondly, there is a threshold effect: spending increase occurs in series of sudden mutation. However, speed of increasing public expenditure is different among countries, depending on social-economic structure, the State's interference and risk socialization.

These changes in the management of public entities have a notable influence on public audit, for different reasons: the scope of control is enlarged; there is a stronger interest in knowing the results of public performance, which in turn leads to the effectiveness of their internal controls; priority is given to the investigation of fraud and corruption; and audit reports are expected to be clearer and more timely (Crespo, 2005, p.10).

Limitation in financial information of an entity causes difficulties in obtaining accurate understanding of its current performance. To gain adequate financial information, it is necessary to have in place a set of financial indicators as part of the company's analytical accounting system. The



indicators should allow the entity to evaluate the effectiveness, efficiency and economy of its performance. Improvement in quality of acquired information is inevitably the prerequisite for effective performance monitoring. However, legislation in some countries affirms the need to carry out effectiveness, efficiency and economy monitoring controls before the public administration has developed the corresponding information gathering tools, which renders more difficulties to auditors in completing their tasks (*Crespo, 2005, p.12*).

With the trend of continuous increase of public expenditure in the world, as well as critical and low appreciation on positive impact of public expenditure, a better management of public expenditure needs to be put in place.

#### **2.5.5. Management of public expenditure and risks of public expenditure management**

There are two main management methods of managing public expenditure: input management and output management (also called management of operation result). Input management focuses on strictly controlling of input expenditure of units according to standards, norms and regime towards spending regulated by the State. The advantages of this management method are: simple, clear and easy to control spending through the comparison of actual expenditure with the spending norms of State regimes. However, shortcoming of this method is: it can not appraise the target performance measure, hardly encourages the units to use budget effectively. To overcome this situation, since 1950s, developed and developing countries have carried out many reforms of public expenditure in the way of loosening input checking and expense checking and tightening output checking. Output management is the management method of public expenditure which is newly applied and developed from the concept "result management", from private sector to public sector, with the change of the management form "order and control" into "boost and support." Output management attached allocated budget with output results; or increase of the budget leads to increase of result. Output management helps control and appraises expenditure properly and operating performance of government agencies based on the objectives, assessment criteria which are made in operation plan and budget estimates. However, in fact, running this method is complicated, requiring time, resources, tools and certain conditions to be successful. (*Vuong, 2009*)

In public expenditure management, there must be recognition, analysis and assessment of risks that may be encountered in the public expenditure. Studying risks of public expenditure management in the world is often divided into four risk groups according to specifications: legal direct liability, ethical direct liability, legal contingent liability and ethical contingent liability (*Polackova, 1998*).

Legal direct liabilities are liabilities which are committed clearly by the Government in laws or in the contracts and are surely occurred in all cases. With this feature, these liabilities are regarded as "hard" expenditure items, for example, salary of state officials. They can be estimated before making the plan and budget estimates. Most of liability expenditure items are aimed at ensuring the operation of the government and authorities of all levels; and risks relating to them are not high (*Polackova, 1998*).

Ethical direct liabilities are also liabilities which are certain to occur in the future, but are not committed by the Governments. However, these liabilities may cause big consequences to the society so government must interfere and solve. The difference between these liabilities is that: the government does not commit its liability in laws or in contracts. For example: spending for job support, spending for social security programs. Risks relating to these liabilities are not high because they can be predicted (*Polackova, 1998*).

Legal contingent liabilities are payment commitments of the government when any event happened, such as, the government's guarantee for debts which are not under the responsibility of the central authorities (usually the creditor is local government, state-owned enterprises, or even non-state enterprises), government's guarantee for policy loans (such as lending to support enterprises of public benefits, supporting students, supporting agriculture, etc.). The bigger scope of this guarantee items is, the higher the possibility of these legal contingent liabilities become real legal contingent liability, therefore, budget risk level gets higher. So the government needs to restrict loan guarantee through applying strict conditions on policy loans and competence in marking guarantee decisions (*Polackova, 1998*).

Ethical contingent liabilities are liabilities which the government does not commit to implement but still do so in case of occurring risks due to many different reasons. For example, the government can spend to relieve unexpected natural disasters, support farmers in difficulties due to consequences of natural disasters, disease epidemic towards animals, plants... The spending for settling unusual obligations, which is moral and causes worries about the sustainability budget, which is the relief to unprofitable state –run enterprises or re-funding loss-marking state-run commercial banks (*Polackova, 1998*).

Another aspect related to risk in public expenditure management often being criticized, is economic consequences caused by increase of public expenditure in two ways: restricting the development of economy and hardly gaining the given target. Indeed, increase of public expenditure in an unsuitable way, without strict spending controlling mechanism, and competitiveness may lead to ineffective allocation of public resources, restrict the better use of available resources, consequently, restrict the economic development. On the other hand, increase

of public expenditure may lead to the increase of debts or new receipts (tax) that affects savings of households and of enterprises, and reduces investment ability of private section. Economists of free school believe that: increases of public expenditure, especially expenditure items which are of moral liabilities (such as, benefits for job settlement, supporting for loss-making state –run enterprise, etc) hardly solve the target of social affairs (*Hoang, 2009*).

The tasks that all governments face in public expenditure management, thus, are: a) reducing risk associated with public expenditures, b) gaining the ability to meeting rising finance demand for social-economic development, c) facilitating the economic growth while ensuring social security, and d) maintaining the balance of incomings and outgoings. In order to complete those tasks, the governments need to satisfy some of the main requirements of public expenditure management. They are public clarification, explanatory responsibility, positive economic-social effect achievement and society's supervision (*Vuong, 2009*).

Financial transparency has important position in public expenditure management and helps increase responsibilities of the people towards the use of government funds and the quality of financial management, create conditions for the assessment monitoring of government agencies, social organizations and the people regarding allocation and spending of national public resources of the country, increases the effect of public expenditure management (*Vuong, 2009*).

Accountability requires the supervision of not only state agencies but also taxpayers. Transparency and accountability require estimates, balance and audit results of the budget to be timely publicized. Regarding the activities of the government, the government's explanation must include explanations of process and results. Traditionally, the government's explanation is there to check its law obedience and is called the explanation of process. With the trend of moving from traditional management to management by results, focusing on explaining the results gradually becomes a new trend. On the other hand, government activities must be associated with public financial data; therefore, the government's explanations also include financial explanation and operation explanation or operation effect. Being the highest public financial inspecting agency, the SAIs play an important role in solving the problems mentioned above (*Vuong, 2009*).

## **Chapter 3: State audit office and criteria for good state auditing**

### **3.1. Definitions of Auditing**

#### **3.1.1. Definitions of Auditing**

As economic and social development has progressed, financial control and political scrutiny of the budget have become essential components of the democratic legitimization of public expenditure. *“Auditing is a necessary but often unpopular activity in modern society. Grudgingly, most of us accept the intellectual case for auditing, though we do not always welcome the auditor’s attention to our own affairs. Nevertheless, most of us are re-assured when the “watchdog barks”, in cases where accounts are revealed as defective; fraud is detected; and waste in public programs is brought out for all to see”* (Bourn, 2007)

Auditing can be defined as follow: *“The need for financial accountability has existed ever since it became necessary for one individual to entrust the care of his possessions or business to another.”* (Wilson, 1980)

Most practitioners would rather call this auditing than assurance. However, the term auditing is slightly misleading in the public sector context, as the scope of “audit” is generally not the same as that of “assurance” in the private sector. As only relatively few public sector entities make a difference between internal and external audit, the two are blurring. The objective of an audit, taking it from International Standards on Auditing (ISA), is *“to express an opinion whether the financial statements are prepared, in all material aspects, in accordance with an identified financial reporting framework”* (ISA 200). This objective of an external audit is also reflected in various textbooks on auditing (e.g. Hayes, R., Dassen, R., Schilder, A., Wallage, P. (2005) or Whittington, O.R., Pany, K. (2003)). Perhaps the term assurance, which is now also used as a name for the professional service firm’s business line performing audits, is less biased towards external audits and therefore should be used in the public sector. It reflects any measure to increase the confidence of the user in the information provided both financial data and other statements, both internal and external (Bergmann, 2009, p.11).

#### **3.1.2. The types of State Audit**

##### **3.1.2.1. Traditional auditing (financial, regularity, compliance)**

The main purpose of financial audit is to form an independent opinion on the financial statements. Each audit is planned and performed to obtain sufficient, appropriate evidence on which to base this audit opinion, and the form of the opinion depends on the basis on which the financial

statements are produced (*Crespo, 2005, p.45*). Financial auditing requires the auditor to report annually on the Financial Statements and supporting financial and management. The Auditors General usually sign an annual audit opinion stating his or her opinion and being based on his/her work whether the financial statements are true and fair and whether transactions within them have appropriate Parliamentary authority. If a serious misstatement is identified, the Auditor General should issue a qualified opinion (*UK National Audit Office*).

The main interest of traditional auditing (financial, regularity, compliance auditing) is to ensure that public financial transactions have been completed in accordance with the approved standards. It is also to ensure that accounts and financial statements are real and reliable.

This allows giving a reasonable assurance that all financial transactions have been properly accounted for and effectively allocated to the intended destination. This is an undeniably important and valuable contribution to the preservation and control of public finance, particularly with regard to: (*El Midaoui, 2010*)

- Conformity to various levels of public institutions' actions with regard to the laws and regulations applied in the country and to the rules of good management;

- Establishing a culture of external and even internal control, as well as accountability within the different public institutions;

- Maintaining a reliable accounting practice that might retrace the financial transactions and give a real image of the situation of public finances. (*El Midaoui, 2010*)

However, some important issues such as the choice of programs and public projects, the cost and quality of their implementation, or the effectiveness of their response to the needs and expectations of the general interest and the economic and social sectors can not be often treated within the frame of traditional auditing, and therefore require a broader vision with regard to the performance of actions undertaken by public authorities (*Crespo, 2005*).

### **3.1.2.2. Performance Auditing**

In more recent times, value for money or "performance audit" as it is known in some countries, the widely accepted standard definition is that it is about economy, efficiency and effectiveness. A common objective has been to give statutory authority to carry out performance or value for money audits. A value for money study, evaluation or critique is about forming an objective assessment about whether a program, project or activity is designed to, or has achieved, the best use of resources to optimize costs and benefits (outputs, outcomes, quality of service and increasingly issues of equity) (*Bourn, 2007, p.4-6*)

On the other hand, performance auditing aims at analyzing the performance of accomplishments, management, projects execution and results of public institutions' programs, in terms of conformity with the principles of economy, efficiency and effectiveness (*El Midaoui, 2010*)

Performance auditing has also a scope which is far broader than traditional auditing (financial auditing and compliance auditing), since it does not only cover the financial transactions, but all the activities of public institutions, as well as the quality of their achievements (*El Midaoui, 2010*)

### **3.1.2.3. The main interests and benefits of public auditing:**

The effectiveness and credibility of public auditing, including performance auditing, remain to be dependent on the degree of independence, professionalization and analytical capacity of SAIs. This enables these institutions, along with public authorities, to clearly appreciate the reality of public management and provide the necessary support and corrections (*Intosai, 2010*).

At the level of SAIs, performance auditing improves the diversity of approach, creativity, as well as continuous and specific learning. This form of control encourages auditors to discuss, in an analytical and synthetic manner, issues related to economy, financial management and social aspects that are of interest to the community as a whole (*Moukheibir and Barzelay, 1995*).

In addition, performance auditing reinforces the role of SAIs vis-à-vis the parliament, the government, entities subject to control and society in general. Indeed, this audit is, for the parliament, a valuable source of reliable and independent information on the actions. It allows the government to obtain an independent and neutral assessment of the scope and quality of its achievements, and informs the citizens on the ways public funds are managed and public services are provided. It also contributes to reinforcing the culture of transparency and accountability (*El Midaoui, 2010*).

It should be noted that the scope of public auditing is in a constant change, as it is required to adapt to the changing realities of the socio-economic environment in which public entities operate. Its numerous perspectives cover many fields of SAIs' interventions, such as the evaluation of programs and public policies, as well as risk assessment and even more: strategic auditing.

Therefore, the effectiveness of SAIs in the context of new public management (NPM) is determined to a suitable degree by their ability to undertake performance audits of the executive and agencies responsible for the delivery of public services, in addition to more traditional auditing of compliance with formal legal rules and procedures (*Raaum and Campbell, 2006* ). Furthermore, the

effectiveness of SAIs can be measured in both quantitative and qualitative terms. With regard to the former, this can be found to be related in the annual reports produced by an SAI in which it identifies the savings that have been made as a consequence of public sector providers acting on its recommendations (*Norton and Smith, 2008*).

SAIs should contribute decisively to the quality and effectiveness of the auditing process. Audit reports identify shortcomings and recommend measures to improve the management. They thereby help the executive to make the best possible use of public funds; in other words to ensure that the political objectives of the expenditure are achieved at minimum cost and that the accounts drawn up are transparent. Lastly, the publication of audit findings enables citizens to become familiar with and to legitimize the actions of their government and representatives (*Crespo, 2005*).

### **3.1.3. Organizations for Cooperation**

There are supranational organizations acting at different levels and aiming at increasing cooperation between public control institutions. The most important one, open to SAIs of all countries, is the International Organization of Supreme Audit Institutions (INTOSAI), this organization has provided the institutional framework for cooperation in the area of public sector control. As a professional organization of SAIs, it helps its members by providing them with the opportunity of sharing information and experiences in the field of public audit. INTOSAI also puts into the public domain international guidelines for financial management. One of the first tasks of INTOSAI is the training of public sector auditors (*Crespo, 2005*).

The Lima Declaration, adopted in the IX Congress of INTOSAI in 1977, formulates the basic principles to be followed in public control:

- The defense of independence in the area of public control, sanctioned in legislation. This thus expresses the need for the functional, organic and financial independence of SAIs, guaranteed by the Constitution, or by other legislation, in the face of possible interference coming from other State organisms.

- SAIs, apart from fulfilling the traditional tasks of the control of legality and regularity of State financial transactions, must also inspect the effectiveness, efficiency and economy of these transactions, both individual and as part of a global activity, in accordance with the audit programmer drawn up by the SAIs themselves.

- The need to cooperate with parliaments, the main beneficiaries of audit reports.

- The need to cooperate with governments that want to introduce administrative reforms, assessing legislative proposals having a financial character and making recommendations aimed at the improvement of financial performance (*INTOSAI, 1977*).

To protect the public interest, every government requires some form of independent audit function, whether through the use of internal and external audit services or through the use of a form that combines the two. The government audit function's mandate should be as broad as possible to enable it to respond to the full scope of the government's activities.

Governments must establish protections to ensure that audit functions are empowered to report significant issues to appropriate oversight authorities. One way of accomplishing this protection is through creation of an independent audit committee. To preserve their independence, government auditors' advisory/assistance services should never assume a management role. Moreover, auditors must maintain independence and objectivity for any subsequent audits conducted where advisory/assistance services have been provided previously (*Crespo, 2005*).

#### **3.1.4. Public sector governance**

*“Corporate governance generally refers to the processes by which organizations are directed, controlled, and held to account.” (Australian National Audit Office, Corporate Governance in Commonwealth Authorities and Companies, 1999)*

Government auditors play an important role in effective public sector governance. The term governance refers to how an organization makes and implements decisions. Because governments throughout the world are structured differently with different and possibly overlapping mandates and jurisdictions – there's no single governance model can be applied to public sector organizations. Nevertheless, certain governance principles are common across the public sector. Common principles of corporate governance encompass the policies, processes, and structures used by an organization (*National Association of State Auditors (U.S.), 2006*):

- To direct and control its activities;
- To achieve its objectives; and
- To protect the interests of its diverse stakeholder groups.

In virtually all jurisdictions, the public sector plays a major role in society, and effective governance in the public sector can encourage the efficient use of resources, strengthen accountability for the stewardship of those resources, improve management and service delivery, and thereby contribute to improving peoples' lives. Effective governance is also essential for building confidence in public sector entities which is necessary if public sector entities are to be effective in meeting their objectives (*IFAC, 2001*).

The principles of good governance transparency and accountability, fairness and equity, efficiency and effectiveness, respect for the rule of law, and high standards of ethical behavior represents the basis upon which to build open government (*OECD, 2005*).



The chief aim of the Lima Declaration is to call for independent government auditing. This independence is also required to be anchored in the legislation. For this, however, well-functioning institutions of legal security must exist, and these are only to be found in a democracy based on the rule of law. Rule of law and democracy are, therefore, essential premises of really independent government auditing and are the pillars on which the Declaration of Lima is founded.

### **3.2. The roles and tasks of Government Auditing**

Most states implement several forms of public sector auditing with varying degrees of independence. Government auditing is a cornerstone of good public sector governance. By providing unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, auditors help government organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders. The government auditor's role combines oversight, insight, and foresight. Oversight ensures that government entities are doing what they are supposed to do and serve to detect and deter public corruption. Insight assists decision-makers by providing an independent assessment of government programs, policies, operations, and results. Foresight identifies trends and emerging challenges. Auditors use tools such as financial audits, performance audits, as well as investigation and advisory services to fulfill each of these roles (*National Association of State Auditors (U.S.), 2006*).

In modern times, auditing has evolved into a technical discipline practiced by professional auditors who provide opinions on whether or not the annual financial statements of an entity comply with set accounting standards (*Ramkumar and Krafchik, 2005, p.5-6*).

Over the years, auditing has retained its significance in public finance and SAI receives constitutional recognition in many countries around the world.

As watchdogs of public finances, the public auditors act as critical links in enforcing the accountability of executive agencies to national and state legislatures and through them to the general public. The public sector auditor reviews financial management of public sector entities to ensure that transactions have been undertaken with due regard to propriety and regularity.

Recently, several public auditors have also assumed responsibility for assessing value for money considerations in public projects and programs in recent years.

However, the role of SAIs as public finance watchdogs is still limited in many developing countries around the world. This state of affairs is the result of several factors, including financial and skill constraints, SAIs' lack of independence from the executive and poor

communication between the SAI and the legislature and civil society organizations (*Ramkumar and Krafchik, 2005*).

Auditing is an integral part of an institutional framework supporting good governance and the realization of a country's welfare measures and poverty eradication goals. Social welfare programs and other targeted poverty eradication programs in developing countries are characterized by their access to limited resources. To achieve their goals, therefore, these programs depend greatly on the efficient and effective utilization of these limited resources.

Within this framework, the role of the public auditor in monitoring the utilization of program resources is critical. A vigilant auditor can contribute greatly to the achievement of social development programs by limiting corruption and strengthening the accountability of responsible agencies.

*\* Enforcing the Executive's Accountability toward the Legislature and Citizens*

In most democratic countries, legislative oversight of public financial management takes one of two forms: ex ante scrutiny and ex post scrutiny. Under ex ante scrutiny, the legislature examines the budget prior to enacting it into law. Strong legislatures, such as those in the United States and Germany, have the power to alter the budget at this stage to ensure that budgetary allocations reflect national priorities. Weak legislatures, such as those in many of the Commonwealth countries, generally do not have the power to substantially alter the budget submitted to them by the executive prior to enacting it. Under ex post scrutiny, the legislature utilizes the audit findings presented to it by the nation's SAI to examine whether the executive has implemented the budget according to the provisions of the law. Most parliamentary democracies, such as the United Kingdom, India, and South Africa, provide ex post scrutiny functions to the legislature or parliament. Under such a system, the SAI reports its audit findings to the Parliamentary Public Accounts Committee, which is then responsible for considering and acting upon these findings. In many countries, audit reports are made available to the public and the media, which can then utilize the findings to demand accountability from the government (*Joachim, 2004*).

*\* Combating Corruption*

Corruption is a plague that is present in all countries in varying degrees. However, it most widely spread and become a major obstacle to socio-economic development in low-income countries. While the causes and impacts of corruption are beyond the purview of this paper, it is sufficient to say that corruption can be controlled and its debilitating impact on an economy minimized by the development of strong institutions of governance. An SAI that retains a clear mandate, possesses independence from the other agencies of government, employs a skilled staff,

and has access to adequate resources is uniquely placed within any governance framework to combat corruption. In fact, it is interesting to note that SAIs in some countries have explicit mandates to report on corruption and criminal activity to law enforcement agencies. (SAIs are required to report on corruption and criminal activity in the following countries: the United States, the Philippines, Bhutan, Indonesia, Malaysia, Spain, Romania, Moldova, China, Estonia, Lithuania, the United Kingdom, South Africa, the Czech Republic, and the Slovak Republic (*Dye and Staphenhurst, 2005, p. 19*).

*\* Facilitating Good Governance*

According to the United Nations Development Program (UNDP), good governance is classified as being participatory, transparent, accountable, effective, compliant with the rule of law, and responsive to the needs of the people. An effective SAI can play an important role in ensuring that some of these key attributes of good governance are maintained by the government. By auditing public finances, SAIs not only demand accountability of the government but in turn adds credibility to the government's public financial policies and practices. By making their audit findings available to the public, SAIs provides a critical window on transparency in public finance management and assesses whether government agencies have complied with national and/or local laws, regulations, and their annual budgets (*UNDP, 2005*).

*\* Aiding Financial Management*

Modern day public auditors perform a variety of audits aimed at satisfying different financial management goals. Financial audits assess the accuracy and fairness of both the accounting procedures utilized by a government agency and the financial statements reported by the agency. Compliance audits assess whether funds were used for the purposes for which they were appropriated and in compliance with relevant laws and regulations. Performance audits analyze cost-effectiveness (economy), operational efficiency, and the general effectiveness of government programs in achieving their objectives.

There has been a trend in recent years among SAIs toward increasing the number of performance audits as these audits are seen as revealing more about the effectiveness of government operations. (*Dye, Kenneth M., and Rick Staphenhurst, 2005*)

However, a comprehensive audit framework requires that all three types of audits (financial, compliance, and performance) be combined to provide a complete overview of public financial management.

In this section, SAIs play a critical role in strengthening a country's governance and the administration of anti-poverty and other social-development programs. For example, SAIs assist legislatures in enforcing accountability from executive agencies by producing audit reports; they

conduct audit tests to detect fraud and misappropriation of public funds; and they make recommendations to public agencies on how to strengthen their financial management systems (Dye, Kenneth M., and Rick Stapenhurst, 2005, p.19).

### **3.3. State Audit of budget expenditure and financial management**

#### **3.3.1. The role of auditing in managing and improving the effect of public expenditure management**

Supreme Audit Agency (called the State Audit) is the important instrument of inspecting public finance of the State. With its basic functions as inspection, evaluation and consultancy, the operation of the State audit contributes to ensuring transparency, allocation, management and use of state financial resources and public property in a suitable, economical and effective way. All activities relating to the State's finance and property, all agencies, organizations and units using the state's finance and property must be under the inspection of the SAI. Besides main functions and tasks being inspection, determination of accuracy, legality of data in report on the budget balance, the State Audit also implements the audit of obedience, economic features, effectiveness and efficiency of the management and use of the State's financial resources and property. The State audit is a tool to control and monitor a process of management, operation and use of state budget. Cash and government's assets must be in the government jurisdiction. Therefore, the State audit is founded in each country to play an important role and is protected by the law to ensure the independency in order to implement this function (*Law on State Audit of Vietnam, 2005*). In Vietnam, it is indicated clearly in the Audit Law: *"The State audit activities are to help the Government in inspecting, monitoring of management, and use of budget, cash and the Government's assets; to contribute a saving practicing, preventing corruption, loss, and overspending, detecting and preventing activities violating the law; to enhance an effectiveness of budget use"*

The role of SAI in managing and improving the effect of public expenditure management is shown in the following basic aspects (*Tran, 2010*):

Firstly, SAI supports the management, and control of public expenditure in both management methods: the cost of inputs and the outputs result. With input cost expenditure management which is used in Vietnam, and most other developing countries, the State Audit inspects, consider way of putting in an estimate for the budget, obedience of standards, norms and regimes as regulated by the State. Regarding the management method of output result, the SAI

inspects and evaluates the effectiveness, effect of using public resources and compare the results with the given target. It is the method of operation audit of the SAI (Tran, 2010).

Secondly, through two methods of pre-audit and post-audit, the State Audit carries out the financial audit, obedience and operation of public expenditure items, contributing to preventing risks, admonishing errors, and improving effect of public expenditure. Declaration “Lima” of International Organization of Supreme Audit Agencies (INTOSAI) already affirmed: *“Pre-audit in an effective way is indispensable for a healthy public economy as an authorizing economy. Pre-audit carried out by the State Audit helps prevent damages before they happen; however, its weakness is causing the overlap and erasing the State’s legal obligations. Post-audit carried out by the State audit clearly shows the responsibilities of agencies which have obligations of marking reports, possibly leading to the refund of occurred damages, and is a suitable task to prevent the repeat of errors. Post-audit is an indispensable task of the State audit, not depending whether there is pre-audit or not”*.

In many countries, the law requires the State Audit to be responsible for auditing the annual budget estimate before submitting to the National Assembly for approval. Up to the political institution and law system of each country, the participation of the State audit in the process of putting an estimate for the state budget is of the different forms and levels, but generally, the State audit provides a critic consultation. Through the audit, the State audit points out shortcoming in determining expenditure items, spending mechanism right in the period of putting an estimate; gives warning of public expenditure that may break the budget stability; as well as consults and suggests methods of allocating the state budget, and property suitably, for rights subjects in order to improve the effect of using the state financial resources and restrict financial risks. Depending on legal regulations of each country, the State audit shall audit law obedience, regimes, standards and norms in putting estimates for expenditure items; adequacy of expenditure items in budget balance, aiming at minimizing faults right from putting estimates, allocating and deciding estimates (Fawcett, 2009).

With its profound knowledge and experiences, State audit can provide the government beneficial advice related public expenditure. Especially, regarding high risk expenditure items, such as spending on funding capital for state-run enterprises or spending on refunding state-run commercial banks, (expenditure items which the State usually issues bonds and pays interest, creating burden for the State budget, and are of high risks if such units run unprofitable business), through auditing the economic units of the State, the State Audit clearly understands the financial situation, business performance, development ability of such units, hence, going the government advice on determining units to fund capital, amount of capital and prior using in the process of capital allocation... (Vuong, 2008, p.89).

Regarding post-audit, it means auditing the financial statements, reports on spending balance of the government, local authorities and the units using the state budget, finance and property towards the obedience of spending regimes, standards and norms prescribed by the state, not only confirms balance data, finance transparency, but also contributes to admonishing faults, corruption and waste in public expenditure. Depending on opinions of the State audit, expenditure items not in accordance with regimes, standards, norms and of wrong using purposes shall be taken back to pay the State budget; individuals who approve wrong spending, shall be considered and settled. Public expenditure data, which is inspected and confirmed by the SAI, is a reliable base for the government to make policies, economic and financial methods; for the National Assembly to decide, approve economic targets, economic and financial policies, and important projects of the nation. The State audit also considers and evaluates legislation, systems of standards, norms, regimes for spending towards strong points, suitability and shortcomings, legal risks, etc. Opinions of the State Audit will contribute to completing the legal system, management policy, norms for budget allocation, norms, standards and spending regimes, and also as a basis for management agencies to give out suitable management methods in order to improve the effectiveness and efficiency of managing and controlling public expenditure (*Vuong, 2008, p.91*).

When the economy develops, the administration model on output result, making the budget in the medium-term expenditure framework, then the State audit, besides carrying out auditing the law obedience, spending standards and norms, implements the performance audit to analyze and evaluate the socio-economic efficiency of using the public sources, especially investment projects and programs for national purposes. However, the performance audit requires auditors to be well-qualified, have wide understanding and be knowledgeable about economics and technique of different industries in order to evaluate accurately and suitably the operation situation of the government agencies. (*Institute of Finance, Hanoi, 2007*)

Thirdly, together with auditing public expenditure items, public debt audit helps the government have an overall picture of revenue and expenditure, government debt, especially all liabilities, thereby limiting the risk of spare obligations (unusual). Auditing to confirm debt data, the sustainability evaluation of government debt compared with GDP, in the relation of ensuring the national finance security, debt structure, the proportion of foreign debt in total debt, mechanism for debt management, use of loans (especially foreign debt), and full transparency in debt ... helps the government have the accurate data and honest situation to give out the overall method to ensure the budget stability in the future (*Ministry of Vietnam Finance, 2010*). With the described functions, audit activities contribute to ensure transparency, distribution, management and use of financial resources and state property in a logical, economical and effective way. All activities related to state

finance and state property of any agency, organization, units that use of state financial resources and state assets are subject to inspection by the SAV (*Decree 93/2003/ND-CP, 2003*).

Fourthly, the SAV is an important instrument to link the fiscal and monetary policy, restrict the unfavorable impact of these two policies. Fiscal policy and monetary policy are two important instruments of management and macro adjustment of which are of close relationship and mutual impact. Synchronic co-ordination to develop a maximum of effectiveness of these two policies is a common issue in the period of inflation and deflation.

In the inflation period, the State implements tight fiscal and monetary policy. Audit activities contribute to make the budget healthy, increase effect of using the budget, save public expenditure, reduce budget deficit, then reduce the burden to make up for the budget deficit, reduce risks of inflation. The State Audit supports management agencies to control public expenditure aiming at saving, fighting against waste, strictly carrying out estimates, regulations and standards and norms; to consider and give suggestions on re-structuring expenditure items, cutting spending on procuring non-urgent public assets, pausing unnecessary projects to spend on effective investment, production and social welfare. Regarding tight monetary policy, through annual audit towards the state banks and several commercial banks, the State audit shall analyze and evaluate the situation of targets on amount of issued currency, printing currency for each period, compulsory reserves, reserved amount of foreign exchange, interest rate of lending and borrowing, total payment tools, and total debit, etc. and then give proposals to the government for methods of tightly controlling amount of money pumped out and in through currency transferring channels, controlling the use of reserves of foreign exchange, implement the policy of suitable, interest rate and exchange rate, enhancing the control of operation control of banks and credit institutions (*Salvatore Schiavo and Daniel, 1999*).

In the period of economic crisis, the State implements easy fiscal policy, monetary policy, strengthens public expenditure, and then the responsibility of the State Audit is much harder in warning, preventing risks during the implementation process of two easy policies. Demand stimulus package are different from specific methods but always relate to increasing public expenditure in different forms and purposes, such as: public investment, credit guarantee, and redemption of important economic corporations in risk of bankruptcy, tax reduction and subsidies for people (*Salvatore Schiavo and Daniel, 1999*).

On other side, increasing public expenditure is to stimulate aggregate demand, helps to bring the economy out of depression. The inspection of the SAI for such expenditure items, both of capital allocation and use of capital in economic units receiving capital is the necessary controls to minimize risks and improve capital efficiency. To supporting, the key tasks of the State Audit is

inspecting “demand stimulus packages” to ensure that they are used for right purposes, right objects, and to prevent abuse and use in an ineffective and waste way. The role of the SAI will be higher and more effective if the State Audit conducts the audit (pre-audit) in the period of capital allocation for methods of the “demand stimulus packages”. During deflation period of implementation the easy and flexible monetary policy, the State Audit will support the government in strictly controlling and in regulating structure of credit, credit debt, increasing level of total payment tools and loan guarantee... contributing to restricting risks, improving effectiveness of monetary policy and effective coordination with fiscal policy (*Institute of Finance, Hanoi, 2007*)

Together with the progress of globalization within the region, public expenditure plays an important role in the implementing macro-adjustment of the state; people’s needs and expectations of the transparency and accountability of the government is increasing; the trend of renovating administrative management method according to the operation result is continuously developing. To better promote the key role in management and improving the effectiveness of public expenditure, depending on features of economic institution, social politics, legal system and specific conditions of each country, the State audit agencies needs to improve their qualification, operation quality and develop auditors of good professional morality, knowledge and skills equivalent to job requirements, while enhancing division experiences within the framework of the action program of the International Organization of Supreme Audit body (INTOSAI), the Supreme Audit agency in Asia (ASOSAI) and cooperation agreements between the SAIs (*Salvatore Schiavo and Daniel, 1999*).

### **3.3.2. Criteria for efficient and good State Audit especially regarding public expenditure management (PEM)**

An effective public sector audit function strengthens governance by materially increasing citizens’ ability to hold their government accountable. Auditors perform an especially important function in those aspects of governance that are crucial in the public sector for promoting credibility, equity, and appropriate behavior of government officials, while reducing the risk of public corruption. Therefore, it is crucial that government audit functions are configured appropriately and have a broad mandate to achieve these objectives. The audit function must be empowered to act with integrity and produce reliable services, although the specific means by which auditors achieve these goals vary. At a minimum, government audit functions need: (*National Association of State Auditors, 2006*).

- Organizational independence. The audit function should be independent from those is required to audit (i.e., the chief audit executive must report to someone outside the line of authority



of the audited entity). Organizational independence allows the audit function to conduct work without interference by the entity under audit. Consequently, users can rely on the objectivity and accuracy of the auditors' results and report.

- A legal mandate. The audit function's powers and duties should be established by the government's constitution, charter, or other basic legal document. Among other topics, this document would address procedures and requirements of reporting, the obligation of the audited entity to collaborate with the auditor.

- Unrestricted access. Audits should be conducted with complete and unrestricted access to employees, property, and records.

- Sufficient funding. The audit function must have sufficient funding relative to the size of its audit responsibilities. This important element should not be left under the control of the organization under audit, because the budget impacts the audit function's capacity to carry out its duties.

- Competent leadership. The head of the audit function must be able to effectively recruit, retain, and manage highly skilled staff. Moreover, the chief audit executive should be an articulate public spokesperson for the audit function.

- Competent staff. The audit function needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate. Auditors must comply with minimum continuing education requirements established by their relevant auditing standards.

- Stakeholder support. The legitimacy of the audit function and its mission should be understood and supported by a broad range of elected and appointed government officials, as well as the media and involved citizens.

- Professional audit standards. Professional audit standards support the implementation of the previous elements and provide a framework to ensure audit work is systematic, objective, and based on evidence. Just as many governments have adopted internal control standards either as requirements or guidance for public sector managers, audit functions should conduct their work in accordance with recognized standards (*National Association of State Auditors, 2006*).

## **Chapter 4: State budget and public expenditure auditing in Vietnam**

### **4.1. Budget and public expenditure in Vietnam**

#### **4.1.1. Achieved outcomes of State budget expenditure**

\* A firm and promising state budget balance is maintained: In a World Bank report (2010), Vietnam is recognized having a cautious fiscal policy with a relatively small deficit and low debt (including domestic and foreign debts) as well as a sustainable public expenditure to GDP ratio. Vietnam's budget deficit was less than 5% of its GDP (the percentage is less than 3% according to government financial statistics). The total national debt as at 31 December 2009 made up 27.2 % of the GDP. By the end of 2009, government debts equaled to 33.5% of the GDP-foreign debt of 20.7% and domestic debt of 20.7% of the GDP; the government has fulfilled all debt obligations as scheduled and committed.

\* The state expenditure structure is reasonably allocated for capital investments, encouraging and facilitating business and production development; the macroeconomic intervention role of the state budget has become more obvious and proved to be more efficient, contributing to obtaining high economic growth in conjunction with implementing social safety policies and poverty reduction programs (*Dao, 2010*). Annual average expenditure growth rate was 18% and the size of the 2009 state budget was four times higher than that in 2001. The allocation structure and use of financial resources have been significantly improved. During 2006-2009, budget revenue (grants exclusive) has set aside 9% of GDP for development investment and debt relief after recurrent expenditures; subsidies were reduced and more funds were put into implementing important socio-economic tasks and addressing highlighted social problems.

Capital investments are always a top priority of the state budget, with an average growth rate of 20.8% annually during the 2006-2009 periods, an even higher growth rate than for recurrent expenditures- equaling to 9% of GDP. Budgets focused on the inter-region and inter-provincial transportation and rural roads to promote an the circulation of goods; the development of socio-economic infrastructures, schools, hospitals, sports and cultural centers; investments to restructure the economy and develop infrastructure in the Centre Highlands and disadvantaged regions, etc. Several large socio-economic works have been completed; the socio-economic infrastructure has been significantly improved.

The State budget was focused on human resource development, including maintaining the expenditure for education and vocational training administration at 20%, while the expenditure on science and technology was 2% of the total state expenditure amount.

Attention was also paid to the enforcement of payroll policy reforms and implementation of civil servant policies for cadres at the commune, ward and town levels in order to increase the real income of those who are paid from the state budget.

The state budget was oriented to poverty reduction and social safety objectives, especially to support people of ethnic minority groups who are living in disadvantaged and remote areas (capital investments for disadvantaged and marginal communes; providing housing, production land, cleaning water for poor people; free healthcare services for poor people and children under six years old; extra allowances for social patron beneficiaries; providing school materials for kindergarten and primary school pupils who come from poor households benefiting under Program 135 and those in disadvantaged villages of region type II; implementing pro-farmer and fisherman policies; free irrigation services, etc ). As a result, the physical and mental well-being of people have improved; the percentage of poor households are decreased and socio-economic conditions have improved in the highlands and remote areas; people of ethnic minority groups trust the Party and state policies; and political safety and national defense are ensured. Thanks to poverty reduction-prioritized policies to promote an even development between regions nationwide, the percentage of poor households has decreased from 15.5% in 2006 (according to the new poverty line) to 12% in 2008.

Central budget is ensured to perform crucial national strategic tasks (investments on important infrastructure works; national defense and security are ensured and national debts are retrieved); implement macroeconomic stability policies (anti-inflation, market stabilization, poverty reduction, job creation, export promotion, etc.); acting as a national financial coordination unit; providing assistance and supporting to disadvantaged regions and provinces to ensure sufficient budget to execute socio-economic tasks in local areas.

Control was granted to local authorities in estimating and approving local budgets; deciding on the percentage of revenue allocated to local levels as well as on mobilizing credits for local infrastructure investments as stipulated in Item 3, Article 8 of the Law on State Budget, which helped to encourage local authorities in actively mobilizing and spending appropriately to meet local needs for socio-economic development.

Budget provision and financial reserves have been strengthened to actively respond to macroeconomic interventions and disaster recovery. In recent years, Vietnam has, in fact, experienced more frequent disasters (including droughts, storms, floods, etc.) which have seriously impacted large numbers of people; resulting in many unexpected needs. Thanks to the budgeted provision and financial reserves, local state budgets are balanced while ensuring general expenditure needs as estimated, providing funds for disaster prevention and recovery, as well as

ensuring funds for the implementation of newly-issued important policies and emerging urgent tasks.

A new financial management mechanism was put in place for administrative units and the state administration; enhancing autonomy; improving operational performance; and encouraging the socialization of financial resource mobilization, management and use in order to broaden and improve the performance of the public administration sector.

#### **4.1.2. Public expenditure in Vietnam**

In nearly a quarter of the past century, Vietnam has already gained important and impressive achievements in continuously completing the quality of public finance governance in general and public expenditure governance in particular, especially over the past decade, since the Law on state budget first issued in 1996. Major achievements, include: meeting the rising finance demand of socio-economic development, facilitating the economic growth and social development, especially alleviating poverty and improving living standards continuously and stably; remaining budget balance and rate of foreign debts on GDP at a safe level, etc.

However, public expenditure governance in Vietnam in the past time shows basic shortcomings according to governance features of modern public sections which is common in the world, such as weak publicity and fairness, weak accountability, socio-economic effect not as expected, and especially, poor participation of the people who are real budget owners. Basically, public expenditure in Vietnam is governed traditionally and canonically but less dynamically and formally. This becomes in the new context when Vietnam integrated deeply into the world economy as a member. There is a need of renovation (*Report of social economic development in 2010, 2010*)

##### **\* Economic efficiency**

Public expenditure includes expenditure for investment and development, and regular expenditure. The two elements of public expenditure are ineffective. Many documents and public opinions mention national disasters as wastage and corruption of public resources, including budget. Furthermore, specialists show that ICOR (incremental capital output ratio) of Vietnam is remarkable higher than that of other countries. ICOR is the ratio reflecting the relationship between incremental investment capitals to make the output. It shows how much capital units is needed in order to create a growth unit.  $ICOR = GDI/GDP$ ; GDI is calculated by dividing total domestic investment capital from all resources for GDP. Although, there are unavoidable shortcomings, ICOR is regarded as a suitable ratio to adjust the efficiency of using capital. ICOR of Vietnam in some years as: 1990:2.48; 1995: 2.77; 2000:4.8; 2001: 4.93; 2002:4.87; 2003: 4.96 (*World Bank Report, 2007*). Obviously, ICOR in Vietnam is rising, not because of spending for technology, but

of wastage and corruption. State investment covers more than 50% of total investment capital but its efficiency is lower than of non-state sectors because of wastage and losses, so ICOR of the state investment is higher than of the whole country, in certain year, it reached 7 (*World Bank Report, 2007*)

**\* Social efficiency**

The State Budget is derived from the public’s tax payment, collecting fees and collecting from funds and other sources; it is used for public purposes, social development by supplying public services that non-state sectors cannot implement. One of the main purposes of the State budget is to ensure social efficiency. Social efficiency is reflected through inequality ratio (gap between the rich and the poor); income allocation and social security and payment ratio for public services between the State and the public (for example, for education and health).

Social inequality ratio: In any countries, there exists social inequality with different levels. To measure the social inequality ratio, GINI is used. (According to the theory, its value is from 0- minimum inequality when all members in society receive the same income to 1 – maximum inequality when only one member receives all income, the rest receives nothing). The bigger value is the higher inequality.

GINI of China in 1981, 1995, 2002, and 2005 is: 0.28; 0.38; 0.44 and 0.47 respectively (*Tran, 2008*). Obviously, GINI of Vietnam and China is the same.

Table 1: GINI of Vietnam

Index	1993	1998	2002	2004	2006
Poverty ratio	58.1	37.4	28.9	19.5	16
GINI according to expenditure	0.34	0.35	0.37	0.37	0.36
GINI according to income	0.35	0.39	0.42	0.41	0.43

*Source: “Magazine of Study and Discuss” of Tran Huu Dung, issue 14, July 2008*

In general, Vietnam’s inequality ratio is relatively high compared to those of other countries in the world, and is on the trend of rising, especially in term of income. This shows that social equality and poverty-alleviation policies are not widely implemented in Vietnam.

Income allocation and social security, situation in Vietnam is reflected through some norms in table 2 as below (unit: thousand VND)

Table 2: Income allocation

Norms	Population divided into 5 levels of income				
	20% of the poorest	20% of the second	20% of the third	20% of the fourth	20% of the richest
1. Income (person/year)	2,000	3,400	4,900	7,300	15,800
% of the whole country's average income (6.1 million VND/person/year)	33	56	81	120	259
2. Income from social security (person/year)	70	140	210	370	660
Compared with total social security of the whole country (%)	6.6	11.2	16.1	27.0	39.1
3. Social insurance for laborers (%)	1	2	4	24	68
4. Social insurance for the retired (%)	2	8	14	29	47
5. Social welfare (%)	15	21	14	29	47
6. Benefit for education (%)	15	12	16	22	35
7. Benefit for health (%)	7	11	15	21	45

*Source: UNDP of Vietnam in 2008: At which level is Vietnam's social security?*

Data in Table 2 shows that:

+ Income: 20% of the richest has income of 8 times more than that of 20% of the poorest, and 2.6 times more than that of average income of the whole country;

+ Social security: it is remarkable that 20% of the richest receiving income from social security of 10 times (660 thousand VND compared with 70 thousand VND) more than that of 20% of the poorest.

In more details, considering all elements of social security program (Social and social welfare), then, the fourth and the richest, of which, the richest receives 45% and the poorest receives only 7%. Benefit for education is similar, the fourth and the richest receive 57% and the poorest receives only 15%. In conclusion, the system of income allocation and social security in Vietnam is not good as expected; it is profitable for the rich, not for the poor.

Payment rate for public services: Market mechanism does not mean that the role of the State in supplying public services such as education, health care and social welfare is dim. The State cannot be replaced by the Market and vice versa in supplying public services. In countries of OECD, the role of the market is rising together with the rising position of the State. (*UNDP of Vietnam in 2008: At which level is Vietnam's social security?*). Reports from the United Nations

comparing expenditure for health services paid by the State from the State budget (numerator) and that paid by the people (denominator) of some countries with that of Vietnam as follows (%): Vietnam 20/80; Philippines 49/51; Thailand 33/67; Malaysia 41/59; and Japan 81/19. (Source: “Finance for health care in Vietnam” 2009), in circulation in June 2003, the United Nations express their concern over the trend of reducing the State investment and increasing fee collection for public service users in conditions of poor social security. Thus, compared to Asian countries, the budget expenditure for health in Vietnam is lowest, even when calculating in the way of percentage of GDP/person.

Similarly, the following data (% over the total) shows that Vietnam is the country having the lowest budget expenditure (numerator) for education, in the world, it means that the most of people in Vietnam have to pay for education themselves (similar with Korea): Vietnam 60/40; America 74/26; France 93/7; Japan 74/26; Korea 59/41; countries of OECD 80/20 (Vu, 2007).

**\* The people’s participation- real owner of public resources**

Vietnamese citizens have their say presented indirectly through their different representative institutions such as the National Assembly, People’s Committees and public unions, etc. Towards the State Budget, the law regulates the National Assembly to decide the budget estimates; the People’s Council decides local budget estimates. Thus, regarding theory, people’s power to the State Budget is sanctioned officially and clearly, and in principles, people have rights to participate in marking decisions on matters relating to receipt and expenditure of the budget depends on real power and ability of such institutions. Benefit conflicts are caused by concurrent holding (over 70% towards National Assembly’s Members) and over 90% towards the People’s Council), quality of elective representatives (*Resolution of the 10<sup>th</sup> National Party Meeting*), especially their positions, knowledge and skills, and serious lack of assistants for the representatives, unclear sanctions about the responsibility of the Standing of People’s Council in budget process, unclear information supply to elective representatives (there are instances when the National Assembly’s members received documents on the budget estimates only one day prior to the session; certainly, making a voting decision in such a short period of time is not uneasy task to do, especially for those who are not good at reading and analyzing financial-budget documents, cannot vote exactly.), shortcomings of organizing budget process (rapid-fire, formal, etc.) are main reasons for eroding position and power of democratic institutions, limiting the people’s participation and opinions in process of making decisions relating to the receipt and expenditure of the State budget. Apart from the National Assembly and the People’s Council, other representative channels such as Vietnam technical and scientific associations, public organizations (women, youth,

war invalids, etc.) do not have chances to take part in the budget process, which is common in many countries (*UNDP of Vietnam, 2009*).

#### **\* Fairness and Publicity**

Publicity is action. Fairness is the goal. In fact, publicity itself does not always lead to fairness. Only when the publicity assures the supply of enough information with details in accordance with Requirement standards so that information can adjust such information, then such publicity meets the requirement on fairness. Information on receipt and expenditure of the State budget is a collective of huge amount of data and not in details, therefore information receivers hardly understand and analyze its nature. Especially, this information lacks the link between the budgets (policy instrument) and socio- economic development (policy goal). Figures of receipt and expenditure of the State budget on websites do not analyze the difference between real expenditure and estimated results, the readers cannot evaluate the efficiency of managing receipt and expenditure of the State budget.

According to evaluation of IMF about financial situation of Vietnam in recent years , the budget's fairness in Vietnam is still limited due to some main causes as:

(1) Unilateral budget picture. At present, receipt and expenditure of the State budget have not yet reflected fully in the State budget, so the budget picture is unilateral and ill-shaped. (Main items which are out of the State budget including: fees (school fees, hospital fees and irrigational fees, etc.), charges (collected by authorities such as charges for granting visa/passports), expenditure of agencies of Taxation, customs, the State Bank, loans for re-leading, ODA, government's bonds to supplement investment capital for important infrastructure such as transportation, irrigational works, education, capital mobilization of the local authorities in accordance with Clause 3, Article 8 of the Budget law which are not yet recorded into the budget deficit and posted into expenditure for basic construction of local budget). According to some studies, there are about 30 funds and financial institutions which have not been put in the State budget's balance (*Pham, 2006*);

(2) Budget adjustment method (balance supplementation and planned supplementation) from the Centre to the local is not suitable for requirements on strengthening decentralization for the local. It erodes the budget fairness and stimulates the local's reliability. Here mentions authorities of the legislature (province, district and commune). The people's council does not have juniors and seniors; the people's council at each level is only responsible at such level (*Report of social-economic development, 2010*).



### \* **Accountability**

Accountability requires the clear division of responsibility for each subject and each individual in the public field towards each task and result of implementing such tasks and to be ready to supply information for explanation at the request of the public and taxpayers. Past experiences (for example: Good practices on budget fairness of IMF as mentioned above) show that only when functions and role of agencies relating to the budget are divided separately then the accountability may be achieved. It is the first point in above mentioned IMF's good practice on budget fairness. Accountability for fiscal policy in Vietnam has the following shortcomings:

(1) Division of responsibilities is not clear between the executive agencies and the legislature in the financial – budget field and in other related fields. This is due to the concurrence of elective representatives as mentioned above. This shortcoming limits the accountability of both executive agencies and the legislature; leading to the fact that no agencies are finally responsible to voters for fiscal matters; it erodes the independence, objectiveness of monitoring tasks of elective agencies (*Nguyen, 2008*).

(2) Method of setting and allocating the budget depending on output resources, not on output results, and for every year, not for medium-term plan. Obviously, this method only focuses on the accountability towards law compliance in using allocated resources, and binds of responsibilities towards results of using such resources (*Trinh, 2008*).

(3) Lack of database and Norms for Monitoring and Evaluation based on practical data is the shortcomings that many governing institutions are facing. After the budget law came into effect in 2002, the Standing Committee of The National Assembly No. 387 (Issued on March 17, 2003) showed a great effort to overcome these challenges. However, the process of implementing this Resolution reveals some shortcomings that need overcoming. For example, information required to supply for National Assembly's members is both insufficient and unnecessary, there are lacks of analyses on the relationship between the policy operation and results of implementing expenditure task that The National Assembly already decided, lack of medium-term estimates, lack of analyzes on risks that expenditure task may get, etc (*Trinh, 2008*).

(4) Methods of investigating, deciding and monitoring the State budget of elective agencies also reveals the focus on estimated figures and balance, instead of paying attention to analyzing and setting priorities for pre-estimate policy. After all, the State budget is only a policy instrument. As representative for voters, the main task for elective agencies is to assure the equality, suitability and democracy in allocating and using the State budget, it means policy priorities, not to the figures or fiscal matters which are strong points of the executive agencies (Ministry of Finance, Ministry of Planning and Investment, etc). At present, decisions on the budget are mainly based on

the subjective will and desire, not supported much by objective policy. Strengthening the capacity of analyzing the fiscal policy for National Assembly's members and elective agencies in the local must be paid more attention in the future, especially in the present context of unpredicted changes. Strengthening the participation of outside partners (for example, scientists, public organizations and unions) and improving methodology in order to create for each researching work, are solutions that elective agencies must pay more attention in the future. This instrument helps the legislature to improve the persuasiveness in its adjustment, comment and monitoring. (*Trinh, 2008*)

(5) Budget process (Financial schedule) which is too rapid as that of the present (from middle May to middle December annually) also reduces the accountability on budget because elective agencies do not have enough time to initiatively and effectively participate in budget process as required by the law. According to present budget process, localities are passive in setting estimates as well as allocating the State budget. As a result, in many localities, apart from agencies of finance, investment and planning, the participation of the People's Council is limited. Thus, in many localities, reports on budget estimates, submitted by Department of Finance to the Ministry of Finance, are not passed to the Provincial committee Standing of People's Council and the Board of budget finance as required by the law. (*Speeches of the Standing of the People's Council of many provinces as Nam Dinh, Thai Binh, Thua Thien Hue, etc at the Meeting organized by Committee of Finance-Budget of the National Assembly and UNDP in Ha Tinh province, November 2006*).

The above analyses show that renovation of public expenditure governance to meet requirements of modern public governance (publicity, fairness, accountability, socio-economic efficiency, the people's participation, etc.) is urgent. The matter is how to do and with which roadmap to gain the stable and long result. Over near past ten years, Vietnam has step by step converted the governance into strong decentralization for local authorities, especially in the budget field, empowering units using budget, and piloting the budget according to output (expenditure items) and medium-term expenditure framework, building the database of managing the State treasury and budget, etc. The State Audit Office plays a rising important role in strengthening the publicity, fairness and improving accountability and the people's participation through supply of audit information in order to help elective agencies, the National Assembly and the People's Council carry out the monitoring role better and better (*Trinh, 2009*).

#### **4.2. The State Audit Office and its functions in Vietnam**

The State Audit of Vietnam was established under Decree No 70/CP dated July 11, 1994. It is considered as an independent body and has the duty to report audit results to the Government,

National Assembly or its Standing Committee. It was considered as a department of the Government in monitoring the legal compliance and financial statement preparation.

The law on the State Audit was passed by the National Assembly on 20 May 2005. The law stipulates the State Audit establishment and the Auditor General appointment by the National Assembly, making the State Audit independent from the Government.

According to the Law on the State Audit, the various conditions of service of the Head of the SAV to secure independence are: Immunity/protection from actions by others in its performance of duties and Independence to frame work plans.

Role of State Audit is governed by Law on State Audit: “*State Audit is an agency who is mainly responsible for financial controlling, established by the National Assembly, independently operated and in compliance with law and regulations*”. Role of State Audit is becoming more important and is considered as an independent information channel which enables the process of budget monitoring of the National Assembly and People Council at all levels to be effective and efficient. Besides of the two traditional types of audit: audit of the financial statement and compliance audit, Law on State Audit emphasizes audit of operation: i.e. the audit to check and to assess value-for-money, effectiveness and efficiency in management and use of the state budget, money and assets.

#### ***4.2.1. Powers of the State Audit***

According to the Law on State Audit of Vietnam, the SAV has powers of requisitioning all records of the audited departments/organizations to discharge its mandate. The SAV also has powers to enforce or initiate enforcement action to secure access to needed records which are not produced. The SAV has power to seal, search and seize documents and other related items considered necessary for audit and inspection. It has power to seek testimonials of concerned persons and can seek co-operation of persons other than agencies subject to audit and inspection as per the decree of the government.

The SAV has powers to instruct government investigating agencies to perform activities considered necessary. It has powers to decide on claims of interested persons in connection with official actions, duties and behavior of persons subject to audit and inspection. The SAV has the authority to dispense with, in whole or part, the audit of Federal, Provincial and local Governments accounts and other related matters. The SAV annually selects local government accounts to be audited.

The SAV has powers to take punitive action and/or impose surcharges. The SAV has the powers to access the computer systems of the audited units and download and use electronic data

either in site or off site. It can also review the development of computer systems by the audited units and suggest controls. The SAV has no role in the appointment of the other external auditors engaged by audited units for meeting the statutory requirements but it can supervise them.

#### ***4.2.2. Functions and Tasks of the State Audit***

The functions, tasks, operational expending and organizational structures of the State Audit are prescribed in the Law on State Audit.

The SAV prescribes Financial, Compliance, and Performance Audits in its scope of Audit. The SAV conducts Pre-audit, Concurrence audit and Special Audit. For each type of audit, SAV has built the audit methodology and procedures including the steps of audit planning, exercising and reporting as well as follow up audit.

The SAV does not discharge judicial functions. Based on recommendations mentioned in the audit report that SAV submitted to the government, National Assembly and sent it to the audited units and relevant agencies, SAV re-examines the conduct of these recommendations of the audited units. The SAV is required to follow specific standards, practices and guidelines in conducting audit and reporting. The SAV has set these standards and guidelines in reference to the international standards. The SAV can consult and/or collaborate with other countries, SAIs and international organizations on matters relating to audit e.g. Audit of projects by ADB, WB, etc. The SAV can engage consultants and/or obtain professional services in conducting audit. The SAV reports on the acts that infringe upon State economic interests like mass embezzlements of state assets etc. It does not require that any fraud or embezzlement be reported mandatory by audited units.

The SAV submits its reports to the National Assembly, Prime Minister and sent to the audited units and relevant agencies including findings and recommendation part. The SAV has power to require the audited units implementing the recommendations and follow up the implementation. After formal reporting such audit reports can be shared with public and media. The SAV has powers to amend accounts in case of financial statements. The SAV has an advisory role, before taking a decision involving substantial consequences such as allocation of state budget etc. SAV advises the government on these matters.

***\* The main functions of the State Audit of Viet Nam are as follow:***

- To develop annual audit plans or programs;
- To organize the implementation of such plans or programs;
- To report the results of audits to the Prime Minister, National Assembly or its Standing Committee as required;

- To make comments, assessments or judgments and certifications on compliance with applicable financial and accounting policies, systems and regulations and on correctness, probity and legality of accounting documents and figures and financial statements of audits undertaken;

- To make recommendations on remedial measures to correct weaknesses or irregularities that has been found during the course of the audit in order to strengthen the control of financial resources;

- To take part in developing and promulgating Vietnamese Auditing course of the audit in order to strengthen the control of financial resources;

- To take part in developing and promulgating Vietnamese Auditing Standards and Approaches as well as related economic and financial policies and regulations of the Ministry of Finance;

- The State Audit of Viet Nam is empowered to make submissions of misuse of public funds, irregularities of applicable financial and accounting policies by organizations or persons who are charged with the responsibility for those funds;

- The State Audit of Viet Nam is authorized to provide the legal authorities which are specified in related regulations with audit records, documents and results; and

- The State Audit of Viet Nam may employ certificated public accountants and independent audit firms to help it in conducting audit tasks but it has to bear full responsibility for the correctness of data, documents and conclusions made by the employed certificated public accountants and organizations.

***\* Operational expenses of the State Audit Office***

The operational expenses for the State Audit of Vietnam are funded from the National Budget, on the accounting unit level I of the central budget. Operational expenses shall be estimated by State Audit and requested the Government to submit the National Assembly. The management, allocation and use of operating funds of the State Audit are implemented under the provisions of State Budget Law.

***\* The staff of the State Audit Office***

The staffs are classified as civil public officials under the management of the Government. The total payroll of the State Audit by the National Assembly Standing Committee decided to request the State Auditor General.

***\* The organizational structure of the State Audit***

The State Audit is organized and managed in centralized and unified structure of the executive apparatus. The National Assembly Standing Committee shall specify the organizational structure of the State Audit.

### **4.2.3. State Audit Standards**

On 9<sup>th</sup> November 2010, Auditor General of the State Audit Office of Vietnam (SAV) signed Decision No. 06/2010/QĐ-KTNN on promulgating a Set of State Audit Standards in place of the Set of State Audit Standards promulgated following Decision No. 06/1999/QĐ-KTNN dated December 24<sup>th</sup>, 1999 of Auditor General of SAV.

Over 10 years, the Set of State Audit Standards promulgated in 1999 has promoted the significant effect on reality. It was an important foundation in drawing up principles of professional competence and implementing audits. However, towards promulgation of State Audit Law in 2005 and the SAV's requirements in developing and improving audit methods and professional competence in accordance with the State Audit Development Strategy to the year 2020, the Set of State Audit Standards in 1999 exposed shortcomings and requested to be reformed and improved. Originating from the reality of those requirements, since 2007, SAV has deployed to study and draw up the Set of State Audit Standards, with the support of EC experts, to be in line with international practices and actual practices in Vietnam.

The Set of State Audit Standards in 2010 includes 3 groups with 21 standards having basic content as follows:

General Standards (from Standard No.1 to No. 6) stipulate the essential principles and requirements in audit activities; conditions and requirements about ethical qualities and competence of State auditors in the process of conducting audit activities in order to complete SAV's functions and mission.

Standards of Field Work (from Standard No. 7 to No. 19) stipulate the essential principles and requirements in practicing main professional competence of audit activities, including both management activities and audit implementation.

Standards of Reporting (from Standard No. 20 to No. 21) stipulate the essential principles and requirements about content and form of audit reports; drawing up, promulgating the outcomes of auditing, and reporting the outcomes of audit to ensure quality and validity of audit reports.

This Set of State Audit Standards took effective to implement after 45 days of signed date.

## **4.3. Public expenditure audit in Vietnam**

SAV is the institution of public finance, a tool of the Government in managing, operating budget, contributing to transparent in state budget management. State Audit's activities provide accurate information, reliability for the Government, ministries, localities in the management and use of budgetary funds and state property to ensure savings, effectiveness and

efficiency. At the same time, it provides information to National Assembly, the People's Councils at all levels to consider and approve the state budget, socio-economic development plan. SAV also advises the Government and the Parliament in the process of development, approval and implementation the fiscal and monetary policies (*Law on State Audit of Vietnam, 2005*). In public expenditure audit, evaluation of SAV's efficiency presents on some following aspects (*Vuong, 2009*):

- Firstly, the audit results on the annual state budget levels confirm the total cost and details to each item analyze and evaluate the rationality and sustainable structure in revenue and expenditure and balance. This is also an important element for SAV's presentation to the National Assembly about opinion on the reasonableness and sustainability of the revenues, expenditures and balance between revenues and expenditures in State Budget estimates, plans for distribution coordinating the annual central budget. SAV propose solutions to increase revenues and allocate appropriate budget expenditures for different goals, cutting the recurrent expenditures, investment expenditures for projects that are not necessary, low efficiency to reduce the deficit, focus capital expenditure for the other project (*Vuong, 2009*).

- Secondly, consultant in policy issue and public expenditure management regimes to prevent corruption, loss and waste. During the audit process at the agencies or units that use State Budget, money and state assets, the State Audit find out limitations and loopholes of the current policy on the management, using the public expenditure, thereby proposing the National Assembly, the Government, ministries, branches and localities to repeal, amend and supplement legal documents, policies that are no longer appropriate. In addition, the State Audit also takes part in the participation of the National Assembly, the Government in the construction of legal documents and decides on the project, for capital construction projects of nation (*Vuong, 2010*).

- Thirdly, SAV helps agencies and units in management, using the budget, state funds and assets controlled public expenditure, practice thrift and combat losses and waste, improve efficiency of public expenditure. Through auditing, SAV points out the advantages, problems and limitations in the management and implementation of public expenditure, hence gives recommendations and proposes feasible solutions to manage public expenditure more strictly and effectively. Also, propose handling the collective responsibility of individuals for the occurrence of loss and waste, using less effective public expenditures, prevent recurring violations (*Dang, 2009*).

For capital expenditures, the auditing activities find out the projects that are less effective, less urgent, not eligible to deploy, outdated technology...For recurrent expenditures, audit activities have discovered weakness, unreasonable about current mechanism in the field of management budget, in the enterprise finance, in construction investment, the project, etc...timely

to propose to the Government, National Assembly and agencies to study, modify, supplement or issue legal writing that satisfies the necessary of economic in transition, contributes to improve and enhanced the power of Social Republic of Vietnam (*Dang, 2009*).

Through audit process, State Audit has helped the audited-organizations have more overview and considerable about actual finance, about the quality of financial management, timely prevention, detection and prevent the illegal actions about economic management, effective in funds and assets of the State, contribute positively and effectively to the fight against fraud, corruption and waste, limit the loss of assets, money of the people, of the country (*Le, 2010*).

By auditing, evaluating the effectiveness of the use of loans, aid and donations, the state capital granted in corporations, state corporations, state commercial banks, SAV will make recommendations and propose State agencies for competent layouts, reasonable investments to improve the efficiency of on-lending loans and aid, funding, investment funding from the budget (*Le, 2010*).

- Fourthly, publishing of audit results enhances transparency, publicity, and people's participation in anticorruption and wastage in public expenditure management. People's responsibility for the use of government financial resources and quality of financial management will be enhanced by the impact of public expenditure transparency. That also creates a supervision condition from elective agencies, society, people and organizations on national resource allocation and expenditure. Public expenditure transparency not only ensures financial sustainability but also enhance the effect of financial public management. Within its scope of activity, the State Audit will perform testing, confirming on information and data related to public expenditure to ensure a transparency and responsibility of the Government. Completed and relevant information on public expenditure is announced by the State Audit will confirm the sufficiency of the Government in utilizing the government financial funds, hence eliminatory risks raised due to contingent liabilities (abnormal). Public expenditure data that is audited and confirmed by the State Audit is a realizable foundation for the Government to prepare financial economic measures, policies; for the National Assembly to decide any approval on target and financial economic policy. An audit report confirms general financial status of the Government such as expenditure ratio, debt ratio, which provides useful information to investors as well as creditors in their decisions (*Vuong, 2010*).

Together with the above four issues which directly relate to public expenditure, the State Audit also has an important role in advising the Government on implementing reasonable monetary policies in each period. Through annual audit of the State Bank, state-owned commercial banks, besides the examination and certification of all items on the financial statements, SAV also carries out depth analysis and assessment norms on the issue of money, in each period, the required reserve



funds, foreign exchange reserves, interest rate, loan, total payment, total loans etc. to recommend the government measures on the national monetary policy (*Hoang, 2010*).

To evaluate operative effectiveness of State Audit in the areas of public expenditure auditing, compared to the needed criteria to measure the effectiveness of audit activities as well as function and tasks of the Vietnam State Audit that is specified in the Law on State Audit. Basically, the operation of the State Audit has met the criteria for efficient and good state auditing. However, actually, audit activities are still facing many challenges that need passing to enhance its operative effectiveness in public expenditure auditing of SAV.

#### **4.4. Challenges of SAV in public expenditure management**

##### **4.4.1. The present situation of State Audit in audit activities**

SAV and SAIs in many countries do not have adequate powers to decide what should be audited or how the audit findings should be presented. In many developing countries, SAIs lack skilled staff to perform the tasks expected of a modern auditor, such as detecting fraud using information technology. Similarly, financial constraints on SAIs often mean that they lack adequate infrastructure (office space, computers, and vehicles for transport), which further hampers the effective conduct of their work (*Ramkumar and Krafchik, 2005, p.7*).

Although audit quality is significantly improved, contributing positively to increase efficiency, effectiveness in management and use of state budget and assets, and financial transparency of nation, but compared with the requirements and tasks assigned, the audit quality of SAV is still limited, is expressed through a number of the following (*Vu, 2009*):

(1) There are a notable of audit plans with poor quality and even formalistic, not meeting the increasing demand for audit quality of the SAV.

(2) The audit reports have some limitations to the audit requirements and objectives set out, namely:

- The contents of the report: the audit reports do not give clear and comprehensive opinions, lacking truthfulness and reasonableness of the settlement data of the audited units. Many audit reports also deal with written lists, description of the unit's report number; some reports also give conclusions with lack of evidence etc. This is why audit is not really a powerful tool of government in checking and supervising of state financial resources and in the fight against corruption and waste;

- In presenting the report: Many audit reports presented too long, lists of process and results in budget-financial task implementation, have not the evaluation opinions...

(3) The size of SAV's audit activities are very limited compared with the needs that must be addressed annual of the budget using unit, agency Funded state money and assets is very large, especially in areas of budget auditing so it affects operational quality of SAV in general and in particular audit quality ...;

(4) The implementation of testing and compiling of the results of the audit conclusions and recommendations has been slow.

(5) Thematic audit activities are only beginning to approach and deploy in small scale. Thus audit activities are not in conditions to provide in-depth answers to pressing problems, or to assist in easing public concern regarding negative aspects of management of state assets and funding.

(6) The inspection and monitoring activities of the audit team on the implementation of regulations, processes... of SAV, in order to improve audit quality is not regular, continuous and not focus on the products created by auditors (as audit evidence, certification of audit data, audit records...), mostly control compliance about audit record and forms...

Those are status in audit activities that impact to audit quality of SAV. Therefore, challenges in audit activities should be analyzed and evaluated carefully to limit disadvantages and improve advantages that affect audit activities of SAV.

#### **4.4.2. Challenges of State Audit in public expenditure management**

The public expenditure management is required to identify, analyze and evaluate the risks encountered. Risks in public expenditure management are the economic consequences which can be caused in two ways: (1) hinders of the development of the economy and (2) the uncertainty in achieving the objectives. The increase in public expenditure, together with no mechanism for tight cost control and no competition which may encourages the allocation of resources in a less effective way. Such increase leads to a risk of hindering a more beneficial use of existing resources and hinder for the development of the economy, not achieving the targets. On the other hand, increased public expenditure requires an offset source, which may lead to new increased borrowings or collections (taxes) that affects the savings of households and the cumulative of enterprises, reduces the investment capability of the private sector (*Hoang, 2101*).

To minimize the risk associated with public expenditure, to meet the increasing financial needs for the socio-economic growth, to create conditions for economic growth and ensure the social security, to maintain the revenue-expenditure balance, basic requirements of public expenditure management are: transparency, analysis accountability, socio-economic efficiency and the supervision of the people (*Hoang, 2010*).

Financial transparency has an important position in the public expenditure management. It enhances the people's accountability for the use of government's financial resources and the quality of financial management; it facilitates the supervision of the Government, the National Assembly, social organizations and the people on the allocation and expenditure of public resources of the country, and the improvement of public expenditure management. The accountability requires an effective oversight, not only from State agencies but also from the public and the taxpayers. The transparency and accountability, budgeting & finalization requirement, and budget audit results must be publicized in time (*Bourn, 2007*). As the highest-level public finance monitoring agency, SAV plays a very important role in solving these issues.

In developed countries, SAV has a development history for hundreds of years, the experience of those countries confirmed the presence and activities of SAI being a useful tool in establishing and maintaining financial disciplines, following the State Budget Law, detecting and preventing acts of corruption, abuse, over-consumption of resources of the State and the people. The SAI actually becomes a vital component in the inspection and control system of the State; its effects have been widely recognized by the society and it cannot be replaced by any other authorities in terms of enhancing the control, using rationally and effectively public financial resources. The SAI is confirmed as a crucial tool of the power system of a modern society (*Bourn, 2007*).

In Vietnam, the State Audit Office was established in 1994. It has conducted hundreds of large and small audits across all sectors. Results of the audit reveals a lot of violations of policy, economic management, from which the recommendations to increase revenues, reduce costs and back to the state budget up to several trillion have been given. But the more important thing is the audit report provides the information in a timely, reliable and convincing way to the National Assembly, Government, judicial authority and other agencies of the State for their uses in fulfilling their function; the State Audit has confirmed the role and position in the financial control and inspection agencies system of the State, and the conformity in the administrative reform and the international economic integration in Vietnam today. For the fact of the public finance management, the use of public financial resources in an economical, rational and effective way is one of the fundamental goals of operational activities and management of the State agencies. Also, to meet the requirements to ensure the economic efficiency, and the effectiveness of the economy in the international integration process, the "publicity and transparency" are required to perform, thus the financial information must be audited before the publicity for other countries as well as the residents (*Dao, 2010*). Therefore, the challenges for the State Audit in the management of public expenditure are expressed in the following basic aspects:

Firstly, as an institution, the State Audit is an important tool to help the State effectively manages and administrates its budgets, money and assets. The State Audit not only contributes to the close management of expenses, limiting the losses, but also better uses the people's taxes, to avoid waste and improve the quality, transparency and sustainability of the national finance. Therefore, the task of the State Audit becomes more important in the warning, prevention risks in public expenditure management of the Government (*Law on State Audit of Vietnam, 2005*). This is a requirement set for the State Audit to expand the audit scope and quality to strictly manage the expenses. Initially, as the capacity of the State Audit is limited, the top priority is to choose appropriate audit subject, focus on materiality, and meet the requirements of public expenditure management, and then to expand the size of the audit. If the size of the audit is small, it will affect the representativeness of the findings, quality of conclusions and audit recommendations. So the challenge now for the State Audit is to choose a scope, the annual audit subject and the medium-term plan (*Dang, 2009*).

Secondly, the State Audit in the role of supporting the management and control of public expenditure by the cost of inputs and the outcomes is an important tool for coordinating, coherence fiscal and monetary policies, limiting the adverse interaction of the two policies. In Vietnam and most other developing countries, in the aspect of public expenditure management, the State Audit inspects, considers ways to budgeting process, and ensures the compliance with norms, standards and regulations (*Vuong, 2010*).

To meet this requirement, the State Audit needs to analyze and evaluate policies (especially fiscal policy and monetary policy), analyze and forecast the economy and finance to help the Government to obtain further information during the process of policy building and decision making, to ensure that they sets out a synchronization, comprehensive and efficient solution package which improve quality, analyze and evaluate the State Budget. The State Budget also provides to the National Assembly reliable, independent and objective sources of information to determine the state budgets and the central budget allocation. At the same time, the State Audit needs to give warnings, the sustainable assessment of economic groups, State-owned Enterprises, banks and financial institutions; help those units to overcome their limitations in order to successfully implement sustainable development goals. Therefore, So the State Audit needs to be sensitive to changes, fluctuations trends and of the economy in order to provide timely information to assist the Government and the administrators. This requires the team of auditors to have extensive knowledge in all fields, especially the ability to analyze, synthesize and evaluate the macro-economic policy. Therefore, the challenge for the State Audit is to build and develop human resources (*Trinh, 2009*).

Thirdly, the State Audit contributes to the prevention of risks and errors, the improvement of efficiency in public expenditure when auditing public expenditure items through pre-audit and post-audit. The pre-audit is to prevent the damage even before it occurs, to avoid wasting resources; the post-audit is to specify the responsibilities of reporting agencies which may lead to a compensation for loss occurred, and to prevent relapse later. In addition, the State Audit also considers and evaluates legislation documents, standards system, norms and the expenditure regime on inadequate issues, legal risks, etc., to contribute to the improvement of the legal system, management policy, budget allocation system, norms, standards and expenditure regimes. The State Audit is also a basis for the management bodies to outline appropriate management practices to improve the effectiveness and efficiency of the management and the control of public expenditure. Therefore, it is required that State auditors have expertise, ethics, independence and objectiveness when performing the tasks, so that they can fully outline violations, especially in the increasing trend of public expenditure now when violations are unavoidable. Since the auditing activity is a sensitive area, auditors often face the temptation or bribery from audited units. As a result, the audit risk and ethics of auditors are always a challenge to the State Audit (*Hoang, 2010*).

Fourthly, together with auditing public expenditure, auditing public debts also helps the Government get a comprehensive picture of government's revenues, expenses and debts, especially contingency debts, which hereby limits the risks of provisions. Auditing confirms the debt figures, evaluates the sustainability of government's debt payment possibility compared to GDP, in relation to securing the national finance, debt structure, the foreign - borrowing rate out of total debts, debt management mechanism, use of debts (especially foreign debts), and the transparency and fullness of debts ... In assisting the Government to get practical data on the national debt status, auditing also proposes overall solutions for ensuring the overall sustainability of the state budget (*Nguyen, 2010*).

Fifthly, the publicity of the audit results enhances communicate and disseminates the management knowledge; provides information affecting the society and businesses so that they are more aware of and pay more attention to the prevention of wastage on resource. In addition, audit results also have strong impacts on creating widespread public opinions and encouraging the people to involve in the inspection and monitoring process of economic and financial activities; contributing to the fight against corruption and wastefulness in the use and management of public finance. However, when the publicized audit results places a huge pressure on the State Audit, it is required that audit results reflect the accuracy, truth, and objectiveness; the audit conclusions and recommendations must have a clear, specific and feasible argument. Thereby, enhancing the audit quality is the core issue in the audit activities of the State Audit (*Trinh, 2009*).

Sixthly, through the implementation of the compliance audit, performance audit and other forms of audit, the State Audit will help the Government relieve its responsibility prior to the National Assembly and the people on aspects of: (i) Assessing the development and implementation of operation policies and program of the Government; (ii) Auditing the operations of the Government agencies to evaluate the economy, effectiveness, and efficiency of public expenditure and the use of state property, (iii) Investigating frauds and errors, actively contribute to the corruption combat ; preventing the misuse of public funds and national property, (iv) Advising the audited units in the financial and accounting operation and management (*Law on State Audit of Vietnam, 2005*).

Responding to the above challenges, along with the needs and expectations of the people, the transparency and accountability from the Government has increased, the State Audit is required to: (i) Step-by-step implement its operation audit function, pay more attention to the deep thematic audit. At the same time, the State Audit needs to reach the economic responsibility audit for leaders and heads of economic units, (ii) Improve the operation capacity and quality, develop an audit team with ethics, knowledge and skills in line with the professional requirements, improve audit processes and standards; regularly train auditors; recruit officers with professional qualifications, and have appropriate treatment policies in order to attract talents and retain qualified personnel as well as reduce the brain drain; (iii) Further inspect and control the audit quality for each audit and each auditor ... to best promote the role in managing and improving the effectiveness of public expenditure; (iv) Strengthen and improve the coordination among the State Audit and the National Assembly, Government, Ministries, Localities and audited units, help the State Audit increasingly succeed, improve the audit quality, effectiveness and efficiency and meet the requirements of public finance supervision and socio-economic decisions; (v) Apply new audit methods, involve in transnational audits; enhancing the extensive application of advanced, modern and computerized techniques in audit; comply with the development and integration trend in order to provide reliable, appropriate and timely information as well as better meet the requirements of finance-budget management and administration of the State (*Vuong, 2008*).

#### **4.5. Measurement and solutions should be taken to improve the effectiveness in public expenditure management of State Audit of Vietnam**

##### **4.5.1. Need to amend to the Budget Law**

Functions and operations of the SAV are of causality with operation of the State Budget. Audit is side by side with the revenue and expenditure operation of the budget in each specific field and project to analyze, adjust and discover matters and give out comments.

According to Report on the evaluation of the implementation of State Budget Law (2010) of Financial Ministry, this relationship, with respect of the State Budget, refers the remarkable dependent of audit activities on the budget operation: budget mechanism is not clear; allocation for budget sources is extended; capacity of usage and management and supervision of budget are poor. These inefficiencies cause audit activities to be difficult, leading to rising audit risks. For example, the State Budget Law defines agencies to issue policies on the budget allocation formula mechanism and expenditure norms. However, in practical application, there are still stipulation and guidance provided by ministries and industries that are inconsistent with the Law's stipulations, thereby creating many difficulties for provinces and local in implementation. In addition, some expenditure mechanisms have provided local authorities with greater decision-making power (e.g. in deciding the payroll mechanism for part-time cadres at the commune levels, etc). This practice has led to differences in spending limits and allowances for similar task among locations. Meanwhile, there is a lack of incentives to attract skilled and experienced people to work at local government agencies.

Furthermore, Interviewees agree that spending authority of local government is not clearly delegated: The Law on State Budget only differentiates spending authority between the central and the local government level; the specific resource allocation with each local level is subjected to the context of each province and is decided by local authority. However, in practice, local governments were not brave enough to decentralize and delegate socio-economic managements and budgeting power to the district and communal levels, which reduced the budgeting autonomy at the lower levels and created inconsistency in the level of decentralization among the provinces, for example, there might be an imbalance in the decentralization of spending and revenue, which would lead to a need for extra money from a higher level.

Annual budget is not closely linked with medium-term financial and spending plans, which hindered predictability, prioritization and budget allocation efficiency; approval of annual budget estimation is not performance based.

Low efficiency of state budget usage: The efficiency of the state budget usage was not high in terms of both capital and recurrent expenditure management. Socialization and reform of operational mechanisms in public service delivery units, though, have made some progress, but remain slow with limited results. This has put pressure on the state budget and caused the inefficient use and waste of state budget resources.

In fact, over the past time, allocations for investment capital from the budget are not in the form of equality. Budget expenditure does not really attach with responsibilities, only depends on binds of sanctions which are not strict and effective; capacity of apparatus is poor, etc. These

cause the poor situation of budget operation such as: Wastage, loss of state property, and corruption, etc. This situation, as shown in annual audit report, is worrying. These are objectives of the SAV (*Report of Investment and Plan Ministry, 2010*).

Thus, when discussing the SAV, we must unavoidably discuss the budget situation including the operation mechanism, apparatus capacity, efficiency of revenue and expenditure, requirements and satisfaction, etc. as the most important premise.

Upon the above approach, some leaders of SAV (interviewees) suppose that to improve efficiency of audit activities as task, they need to recognize and analyze causes of audit activities. There are shortcomings in the state budget system. The message is obvious: In the causality between the SAV and the State budget, the operation of the budget and the SAV are two organs of a unified system, thus, efficiency of audit activities must be improved from the budget process. Currently, in Vietnam, amendments to the Budget Law are urgent because of the two following reasons:

With WTO access, the economy turns into a new development stage. Current economic institutions, including most other basic factors such as the Budget Law, cannot fully meet new requirements.

In recent years, there are shortcomings in the State budget's expenditure which aims at boosting and stabilizing the economy for integration into the global economy. The situation of hot growth, ineffective investment causes high inflation and unstable macroeconomics recently and trends of increasing spreading investment, which are even worse than wastage, losses and corruption, etc. It proves that the revenue and expenditure activities from the budget are poor. (*Dang, 2009*)

This above dysfunction is quite serious, and is originated from economic mechanism. Its cause is the suitability of the budget law in conditions and requirements of the economy after 20 years of renovation and successful international integration.

In recent time, the above matter has been a common topic, especially in the National Assembly's forum. However, no noticeable solution has been made to improve the situation reliably and firmly. It seems that discussion; inquiries in the National Assembly's sessions only mention many different aspects of public investment activities and budget expenditure, but not the nature of ineffective situation of the revenue and expenditure activities from the budget (*Vietnam News Newspaper, 2011*)

To consider in the audit aspect, it can be seen that: audit conclusions and comments, which are intended to find out shortcomings in the budget operation, mainly contribute to improving the society's awareness, not yet help changing the practical situation as its role.



The question is: With the amended budget law, in conditions of rising socialist- oriented market economy, why is the operation of the state budget still ineffective?

Above reasons refer that to improve basically the revenue and expenditure of the budget; there are not only separate amendments but also the whole process. The budget law is that institution.

According to strategy for social-economic development of Vietnam through 2020, studying amendments to the Law on the State Budget, the Accounting Law and relevant laws to make them consistent with those of the Law on State Audit concerning such issues as preparation of audit opinions on state budget estimates and tentative plans on allocation of the central budget, time limit for ministries, branches, provinces and centrally run cities to submit their annual budget finalization reports.

With above situations (Vietnam's economy in the integration state, unstable situation of revenue, lack of budget expenditure efficiency), there are reason to confirm that the Budget Law need to be amended thoroughly, not just some specific articles.

Firstly, there is a need to clarify that whether current principles affecting the operation of the budget can meet requirements on budget expenditure in new stage or not?

So far, revenue and expenditure of the budget in Vietnam mainly depend on the principle "revenue marking up for expenditure" and "soft budget system". Is the Law suitable with this principle so during the past five years, the high economy's growth has "rights" to use the budget more, gaining the level of 42-43% of GDP, contributing to boost ICOR to level 6-7 in recent two years- a low expenditure and poor efficiency compared to the state market economy? (*Reported by the National Financial Supervisory Commission, 2010*)

Secondly, revenue and expenditure of the state budget are based on the social functions of the State. What are these functions? And how much does each of these functions spend on social property in total? This matter relates to developmental orientation and the growth model. However, the current Budget Law seems not to take the above element into account.

Thirdly, the first important aspects of revenue and expenditure of the budget are: marking up establishments, fundamental for budget estimates process; determining and regulating conditions and instruments assuring binds of implementing "hard budget".

An expert in economics (interviewee) said that: suggestions on amendments only focus on articles of "technique" and "administration". With this orientation, issuing the new budget law hardly change the situation, it may even cause contrary impacts.

Fourthly, key element of the budget operation is Central-local decentralization. In current context of strong decentralization for local authorities, the performance capacity of local apparatus

is still limited. The current law has many “gaps” so that the local authorities may overspend, over collect, take all or spend all leading the exhaustion of resources to gain short-term achievement and local benefits (for example: reducing land lease price to attract foreign investment). This shortcoming is not just a gap; it is the thought on national right and benefit, and the unity of budget operation (Tran, 2009).

Fifthly, blinds for budget expenditure to implement “hard” budget of the current Budget law is still easy. Conditions of sanctions hardly develop their practical effect. The situation cannot be improved if we do not access the budget regarding its quality (Tran, 2009).

In conclusion, there are many matters of the Budget Law that need to be strictly reviewed. Many ideas suppose that there are bases to build a new budget law instead of amending some specific articles. If yes, the audit operation has bases to re-design equivalent action principles, suitable with new conditions and requirements, then improve the quality and efficiency of the operation. Certainly, to improve the SAV, waiting for changes of the state budget is not a solution. The SAV, itself, must solve matters of power and independence, operation mechanism, international standards, capacity of apparatus, etc. However, firm impetus and assistance from the State Budget and participation from society and strong practical base shall be strong bases.

#### **4.5.2. Step by step change into performance of audit**

In the strategy for development of the State Audit through 2020, the target of SAV is: *“Diversifying types of audit under the Law on State Audit, focusing on financial statement audit and compliance audit and step by step conducting performance audit to assess the efficiency of the management and use of the state budget, money and assets. Perfecting financial statement audit in order to certify the correctness and truthfulness of financial statements, providing information to the Government for its administration, to the National Assembly and People's Councils at all levels for consideration and approval of budget finalization reports and budget supervision: raising the quality of compliance audit, promptly detecting and pointing out errors and violations and violators, clearly identifying collective and personal liabilities and resolute proposing the handling of every illegal act; step by step organizing operation audit, which should become a major type of audit in the future when the economy is more developed, in order to inspect and assess the economy, effectiveness and efficiency of the management of the state budget, money and assets: prioritizing operation audit of national target programs, national key projects and works and some provinces, cities, ministries and central branches with relatively large budgets: step by step raising the quality of comments on the state budget estimates, central budget allocations and projects and works of national importance”.*

Vietnam has shown certain effort to improve the quality of public governance, of which the State Audit Agency plays an increasingly important role in strengthening the publicity, fairness and improving accountability and participation through publication of audit information in order to help elective agencies, the National Assembly and the People's Council carry out the monitoring role more effectively and efficiently. However, the role of the State Audit Agency becomes more important and is facing challenges when Vietnam became a full member of WTO with a goal of becoming a national with income of average level. These are also challenges for public finance governance in Vietnam in the coming years. Many officials suggest a solution in consideration of the State audit Agency, which is to focus on performance audit, and on policy analysis, and relies on practical evidence, pays more attention to public property, builds norms for following and adjusting, and especially studies to build and apply audit indexes of branches/province (Vuong, 2009).

Performance Audit is an operation regulated by the Law on State Audit. However, due to difficulties, over the past years, performance audit is not much of concern. Financial audit and compliance audit are important but sufficient. After all, if the use of public resources strictly complies with legal regulations on public finance, it may not bring the expected socio-economic effect. The evidence is the socio-economic effect of public expenditure is low in spite of high law compliance (as analyzed above). On the other hand, the last target of using public resources is to meet the people's demand on public goods (such as basic services, etc.), not the legal compliance, although they are important conditions for compliance. Firstly, authorities are responsible for taking accountability towards people for meeting necessary demands in legal frame, but not for putting legal compliance first. Regardless of the fact that legal regulation quickly becomes backward compared to reality situation.

However, implementing performance audit is of a great challenge. Finding out faults through financial audit and compliance audit is easier than that of performance audit. Implementing performance audit effectively must meet the following requirements: Output-oriented budgeting means replacing the way of relying on input-based budgeting as applied in previous time, allocating the budget for public expenditure based on expenditure task, using *unit* cost and frame of medium-term expenditure (3-5 years) with norms on budget allocation and annual allocation as that of present; having built database and Norms on Monitoring and Evaluation fully and updated the use of budget for expenditure task, strong capacity of studying and analyzing the policy to supply practical base, findings based on practical study on impact of the policy of receipt and expenditure of public expenditure towards the beneficiaries. Using norms which are applied popularly in the world such as GINI (as mentioned above), other development indexes on humans such as HDI, etc.,

without practical findings from the life as described in the above two tables, then the efficiency of performance audit is still limited and unpractical (*Report by SAV about operative capacity building of SAV, 2011*).

According to the latest study result, not only within audit public expenditure, but also public property, especially immovable, corruption in the field of land accounted for 20.8% of total, highest in all fields, mainly focusing in Ho Chi Minh city (account for 19% of total) and Hanoi (account for 14% of total) (*Report of UNDP presented in Hanoi city, 3/2009, Ho Chi Minh city HCM 4/2009, Danang city and Thaibinh city 5/2009*). Managing other public property in State-run enterprises is limited and of face the risk of corruption. Thus, there needs professional contribution of audit to improving the quality and effectiveness of monitoring activities towards special subjects of the National Assembly and creating conditions for enhancing people's participation.

State Audit also implements the function of coordinating with state agencies in considering, deciding budget estimates, and budget allocation, deciding investment projects under its competence, participating in supervision tasks of People's Council at all levels.

The current State Audit Law only regulates that The State Audit Agencies take responsibility for expressing opinions for the National Assembly so that the National Assembly considers to put in estimates for the budget, allocate the budget estimates, decide national projects under the National Assembly's competence; together with Budget Committee of the National Assembly and other National Assembly's committees consider and investigate reports on estimates, estimate allocation, estimate adjustment and methods of allocating capital for national-level projects, and take part in supervision task of the Economic-Budget Committee and other National Assembly's committee (*Article 15-clause 4,5,6 – State Audit Law*). The Law on State Audit regulates tasks and responsibilities of The State Audit Agency in participating in appraisal, in supervision tasks at Central-level (National Assembly, agencies of National Assembly and Government), but not yet has any specific regulations for local authorities, even provincial authorities. Thus, the role of The State Audit Agency in appraisal (serving for implementing function of decision) and supervision task (implementing supervision function) of the People's Councils at all levels is not clear. This depends on whether the People's Councils require this or not and whether The State Audit Agency can meet such requirement or not.

Thus, most of interviewees suggest that: to strengthen the role, responsibilities of the State Audit Agency when implementing its tasks, there should be regulations on responsibilities of the local State Audit Agency in giving opinions on appraisal of reports on budget estimates, budget allocation, estimate adjustment and budget balance at localities, and together with the People's

Council and Boards of People's Councils supervise fields of finance-budget at request of the People's Councils and Boards of People's Councils.

For SAIs of developing countries, it is obviously important to first develop an effective auditing of regularity and compliance which is a prerequisite for the development of a culture of control and accountability within public institutions. Such an auditing remains essential for the control and traceability of financial flows. It is only in this way that SAIs could proceed gradually towards a more expanded auditing, such as performance auditing.

#### **4.5.3. Ensuring independence in activities of State Audit Office of Vietnam**

The principal task of Supreme Audit Institution (SAI) is to become an effective testing tool and control whether public funds are spent economically and efficiently in compliance with existing rules and regulations. SAI needs to be independent from the entities they audit and must be protected against any form of outside influence. It is also crucial that their audit methods be based on current scientific and technical knowledge and that the auditors have the necessary professional qualifications and moral integrity. Only an independent external government audit function in conjunction with professional staff and methodologies can guarantee an unbiased, reliable, and objective reporting of audit findings. INTOSAI provides mutual support to SAIs and fosters the exchange of ideas, knowledge, and experience among SAIs. It also provides a voice for SAIs within the international community and promotes continuous improvement among its members (*INTOSAI's Strategic Plan 2011-2016*).

The independence of Supreme Audit Institutions (SAIs) is a prerequisite for the effectiveness of public sector auditing. According to the Lima Declaration of Guidelines on Auditing Precepts, the principle of independence is meant to enable SAIs to objectively fulfill their role and act in an impartial manner. To do so, SAIs must be independent from any external influences, including those of audited entities. From this perspective, independence is regarded to be not only a guarantee for the effectiveness of external public auditing, but also an indicator of democracy, as it complies with the principle of separation of powers (*El Midaoui, 2010*).

Independence is the core issue of Audit activity, and need to be understood from two aspects: (1) Audit must be completed independently and objectively in performing duties and (2) Audit must guarantee of independence by regulations of financial institutions to avoid the direct or indirect impact. This means: Audit activity must be regulated in the original constitutional statute; this is in line with the Lima Declaration at the Ninth Conference of the International Organization of Supreme Audit (INTOSAD): *"the Supreme Audit Office can only fulfill their duties impartially and effectively when it is independent from the audited units and guarantees against outside*

*influence.*" This declaration sets out the internationally accepted basic tenets of public sector auditing, including emphasizing the need for SAIs to have independence from the executive, defining the audit powers that should be granted to SAIs, detailing the relationship that SAIs should have with the executive and with the legislature, and explaining the nature of the reporting that should be carried out.

A leader of SAV agrees that the care must be taken to ensure the independence of SAV, especially in making decision on audit plan and audit conduct. Independence is a core issue and the backbone of audit activities. During operations, the auditor must locate full evidence and information sources; be impartial and objective in information collection and evaluation, and then give conclusions, confirmations on the status of economic and financial activities, about the completion and accuracy of the information. Audit activities and audit results reassure users of accounting information by evaluating the conclusions of the audit. The conclusion of evidence is evaluated by National Council and Committees of the National Assembly, the Budget Economic Organizations and the People's Council. To have legal basis to discuss and make resolutions on financial-economic issues, audit findings should be considered as no signs of bias, not partial lack of evidence and lack of objective... There should be a mechanism to ensure and test the independence and objectivity of each auditor in each audit.

The State Audit's function is to audit all agencies in the management and use of budgetary funds and state property, but in fact due to limited personnel, State Audit only conducts annual auditing over 30% of the local budget; audits financial reports of about 20% of ministries, central branches and just to evaluate and examine the contents of a number of budget settlement reports ... SAV itself is not able to cover all operating funds, it still has to ask for help from audit units on transportation, accommodation in the auditing process from the agencies being audited that affects the requirement to ensure independence and objectivity of audit activities (*Report Summary of SAV, 2011*).

Based on the operative criteria of the State Audit mentioned in the legal documents and materials relating to auditing, SAI's independence has always been highly esteemed and considered a major factor that impacts on the effectiveness, validity and result of audit activities.

According to the views and opinions of the interviewees, the implementation of an effective testing tool and control, SAV's independence depends primarily on the achievement of certain basic conditions, namely:

***a- Strengthening SAV's independence:*** An independent Supreme Audit Institution must be provided with the necessary assets at both the institutional and professional levels. At the same

time, the State should ensure adequate funding for the audit activities, and descending toward independent about funding.

***b- Strengthening SAV's institutional status:*** It helps clarify the status of the SAV and its relations with the other constitutional institutions, particularly the Government and Parliament.

***c- Recruitment of qualified staff:*** The quality of the staff that will conduct the audits, particularly performance auditing, is a key element to success. Since this audit covers the areas of intervention of public institutions and the multiple aspects of their management, the profiles and competencies of the SAV's staff should reflect this diversity. The recruitment of qualified staff should be completed through both an initial training in the various aspects of audit and an ongoing training to ensure the constant updating of their skills and competencies. Raising the level of auditor force also plays an important role, deciding the accuracy, truthfulness and full results of the audit report. Not only must auditors perform professionally but they must also have good moral quality to avoid negative behaviors that may occur during the auditing process.

***d- The execution of an effective, professional and stable leadership by SAV,*** mainly through the development and implementation of strategic plans and comprehensive, realistic and priority-focused action plans. These plans must be compatible with the ongoing reforms in the country, in terms of public financial management and with the best practices (e.g. standards and guidelines developed by INTOSAI).

***e- Strengthening relationships with stakeholders:*** to be effective, an SAV should, as its mandate allows it, create close links with stakeholders, and maintain, at the same time, its independence from the Parliament, the Government, audited entities, the media, the public opinion, civil society...

Moreover, the development of public audit and SAVs' capacity building must go hand in hand, in a context that fosters the independence of these institutions. This is certainly a major initiative that is both time and resource consuming. In this respect, it becomes useful for SAV to adopt a progressive approach that would involve the gradual implementation of a developed audit (performance auditing, risk assessment...). This process must be conducted at a reasonable scale, with specific objectives and in perfect correlation with the resources and workforce available to SAV.

From the very beginning, Supreme Audit Institutions will better identify and define the needs and objectives as well as the necessary means and tools for the success of their missions. They are also called to be prepared to cope with the various ongoing changes in their internal and external environment, and develop a culture of accountability and professional ethics which is a prominent guarantee of their success (*El Midaoui, 2010*).

## **CHAPTER 5: SUMMARY AND CONCLUSION**

From the theoretical framework given on public expenditure management and the necessary of the State Audit to improve efficiency in public expenditure auditing, the results of my study are analyzed and evaluated through the situation of public expenditure in Vietnam as well as the State Audit's activities in public expenditure auditing. And then, three solutions are given and discussed to improve and enhance the effectiveness in public expenditure auditing of State Audit Office in Vietnam.

Public expenditure management in efficient way is key factor in contributing to limit inflation and prevent corruption. Therefore, to control inflation, prevent corruption and ensure sustainable growth, there is a need to improve effectiveness and efficiency of public expenditure management. State Audit Office has an important position in the system of financial inspection, it helps to control public spending, strengthen financial discipline, thus contributing to financial transparency of public expenditure.

Developing the State Audit is a necessary need to better serve in management and use of the state budget, money and state assets: contributing to thrift practice, fighting of corruption, loss and waste, detection and prevention of illegal acts: raising the efficiency of use of the state budget, money and assets. Harmoniously combining financial statement audit, compliance audit and performance audit on the basis of best performing financial statement audit and compliance audit, with a view to promoting performance audit to inspect and assess the economy, effectiveness and efficiency of the management of the State Budget, money and state assets, especially in the domains of budget management and use, construction investment and national target programs.

In recent years, Vietnam's public financial system has become more transparent with more disclosure to the public. But with the growth of the economy, there are also more errors in the management and use of budget, higher than in previous years. This situation is clearly reflected in the annual report of the State Audit. For the state budget, just a decision relating to the State Budget is not rightly made, which can lead to significant loss to the public resource of the country. In theory, budget resources should be spent effectively to achieve the desired results, however, in reality, subjective capacity, or bureaucratic, or errors can cause overly expenditure budget. Therefore, the State Audit needs to timely measure any loss, waste, and gaps in public expenditure to take further necessary actions.



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