

PERFORMANCE AUDIT OF CREDIT RISK MANAGEMENT ACTIVITIES IN VIETNAMESE COMMERCIAL BANKS CONDUCTED BY INTERNAL AUDIT

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Abstract: Commercial banks are financial institutions, with strong financial leverage, and own high-risk financial assets such as loans and derivatives. Therefore, banking business is always controlled by the strict management of the law, the central bank policies of each country and the commercial banks themselves need to strengthen risk management of their activities in general and credit activities in particular. Risk management activities in commercial banks are carried out directly by the first and second line of defense: the first one is the departments and branches of the bank that directly perform transactions and activities in the banking business; The second one is the risk management, inspection and compliance control department directly under the General Director of commercial banks. As the last line of defense in the model of three lines of defense for risk management activities, the Internal Audit of commercial banks assesses the adequacy, efficiency and effectiveness of risk management activities in general and credit risk management in particular. For Vietnamese commercial banks, this content has not been properly interested by Internal Audit. The article would like to mention "Performance audit credit risk management activities in Vietnamese commercial banks by internal audit".

• Keywords: performance audit, risk management, internal audit.

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Tóm tắt: Ngân hàng thương mại là tổ chức tài chính, có đòn bẩy tài chính mạnh và sở hữu các tài sản tài chính rủi ro cao như các khoản cho vay và các tài sản phái sinh. Vì vậy, hoạt động kinh doanh ngân hàng luôn được kiểm soát bởi sự quản lý chặt chẽ của pháp luật, chính sách ngân hàng trung ương của mỗi quốc gia và bản thân các ngân hàng thương mại cần tăng cường quản lý rủi ro đối với hoạt động của mình nói chung và hoạt động tín dụng nói riêng. Hoạt động quản lý rủi ro trong ngân hàng thương mại được thực hiện trực tiếp bởi tuyến phòng thủ thứ nhất và thứ hai: tuyến thứ nhất là các sở, ban, ngành của ngân hàng trực tiếp thực hiện các giao dịch, hoạt động kinh doanh ngân hàng; Thứ hai là bộ phận quản lý rủi ro, thanh tra và kiểm soát tuân thủ trực thuộc Tổng giám đốc các ngân hàng thương mại. Là tuyến phòng thủ cuối cùng trong mô hình 3 tuyến phòng thủ đối với hoạt động quản lý rủi ro. Kiểm toán nội bộ ngân hàng thương mại đánh giá tính đầy đủ, hiệu lực và hiệu quả của hoạt động quản lý rủi ro nói chung và quản lý rủi ro tín dụng nói riêng. Đối với các ngân hàng thương mại Việt Nam, nội dung này vẫn chưa được cơ quan KTNB quan tâm đúng mức. Bài báo xin đề cập đến "Kiểm toán hiệu quả hoạt động quản lý rủi ro tín dụng tại các ngân hàng thương mại Việt Nam bằng kiểm toán nội bộ".

• Từ khóa: kiểm toán hiệu quả, quản lý rủi ro, kiểm toán nội bộ.

1. Overview of the audit of credit risk management activities in commercial banks conducted by Internal Audit

Performance audit is a type of audit that brings added value to an organization. When operational audit is performed in commercial banks with credit risk management activities, internal audit will independently evaluate the adequacy and effectiveness of policies, procedures and processes in credit risk management from the design, operate and maintain in practice.

The objectives of performance audit in credit risk management activities should be determined in association with the contents and processes of credit risk management based on the guidelines of Basel II and of the Institute of Internal Auditors (IIA) during the audit. According to the guidance of the Financial Services Guidance Committee of the IIA (2016) and the requirements of Basel II on credit risk management, it is required that the internal auditors need to collect knowledgeable information about the business processes and areas of the bank partners and activities of commercial banks that give rise to credit risks and clearly describe credit risks (concentration, from the counterparty side,

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information, documents, operational risks); Identify functional parts related to credit risks and risk management activities; Assessing audit risks as a basis for audit planning. On that basis, internal audit needs to develop and agree with the audited entity on criteria used in the audit.

When performing risk management audits, internal auditors need to implement a comprehensive credit risk audit program by focusing on assessing the first line of defense (bank branch directors, credit department heads, credit department members) from approving, disbursing and monitoring loans according to the appropriate risk appetite, strategic goals of the bank and the second line of defense (including credit risk management committees under the General Department of Finance manager). Internal audit collects evidence to answer the question: To achieve greater efficiency in the decision-making process, can commercial banks allocate responsibilities in the credit committee's risk management based on material risk exposures on the first line of defense? Internal Audit needs to evaluate the process of monitoring and measuring credit risk: Evaluation of the effectiveness of credit risk measurement and monitoring programs should include criteria such as quality of guaranteed assets, unpaid interest rate, economic changes, grading agencies which can all affect a borrower's worthiness. Therefore, institutions need a well-designed risk rating system to monitor credit risk in different investment portfolios through the credit rating system.

During the completion phase, the Internal Auditors follow the guidance of Standard 2400 - IIA on Communication of Results and Standard 2410 - Criteria for Communicating after Audit Completion "Opinion at the collaborative level can be a rating, conclusions or other descriptions of the results". Recommendations should be aligned with the objectives set forth in the audit planning phase.

2. Actual performance audit of credit risk management activities in Vietnamese commercial banks conducted by Internal Audit

Circular 13/2018/TT-NHNN requires Vietnamese commercial banks to develop and implement risk management assessment on the following aspects in Clause 2, Article 23 of the Circular: (i) Built in accordance with the business strategy business, control culture, human resources, IT conditions and management information system of commercial banks; (ii) Risk situations, violations

of risk management must be reported promptly and fully to the Board of Directors, Board of Members, Supervisory Board, parent bank; have a handling mechanism for risk management violations. In Clause 1, Article 71 of Circular 13, the Internal Audit is required to do the following activities with risk management: (i) Independently inspect and evaluate compliance with internal mechanisms, policies and regulations on supervision of senior management, internal control, risk management and internal assessment of the adequate capital level of the Board of Directors, Board of Members, General Director (Director), individuals, departments, including the identification of existence, limitations and causes; (ii) Independently review and evaluate the suitability and compliance with the laws of mechanisms, policies and internal regulations on senior management supervision, internal control, risk management and internal assessment of the level of management sufficient capital, including identification of existence, limitations and causes; (iii) Proposals and recommendations to competent authorities and relevant departments to handle shortcomings and limitations.

Most of Vietnam's commercial banks have now built and are continuing to complete the risk management framework according to the requirements of Circular 13/2018/TT-NHNN. Internal Audit of Vietnamese commercial banks has paid attention to the assessment content of risk management and risk management framework. According to the summary report of the Supervisory Board of Vietnamese commercial banks (publicly published on the banks' websites from the General Meeting of Shareholders) on the strategic shift in audit content and related issues to the internal audit conducted by the Internal Audit in the period 2014-2020, from traditional compliance audit to performance evaluation audit, and process system audit, including credit risk management activities, but still few. Specifically: MSB evaluates the effectiveness of risk management activities (in 2015-2017); VIB evaluates the effectiveness of risk management activities (in 2016-2018); Vietcombank audits the risk management framework, audited the quantitative risk measurement model (2017-present), performed audits on risk management and assessment data, reviewed the minimum capital adequacy ratio, audit the default probability model of the small and medium-sized customer segment, evaluate the system and data for preparing financial statements (in 2019, 2020); BIDV's internal auditors

audit some risk management contents according to Basel II (2016 - present), audited head office departments on some contents in risk management, assessed operational risk management and issued warnings post-audit risks (in 2019). Thus, in recent years (from 2015 to present), the internal audit of a number of Vietnamese commercial banks has paid attention to assessing the effectiveness of credit risk management associated with bad debt settlement, however, the frequency is not at high level, and the level of performance also varies. Most of the internal auditors of Vietnamese commercial banks use Circular 13/2018/TT-NHNN to conduct audits and assessments on credit risk management, some Vietnamese commercial banks internal audit assesses credit risk management according to Basel II (BIDV, Vietcombank) but not yet fully audited the contents, but only focused on: Evaluation of credit risk management policies and procedures, calculating RWA, capital according to regulations of the management agency (Circular 41); Asset management, with customer groups and asset classes; Checking the classification of debts and making provisions; Check the process and personnel in debt collection; Check if the methodology and process for credit line establishment are established and documented; Review the credit line structure to assess the adequacy of the limit system; Check the timeliness and completeness of credit risk management reports to the Board of Directors and management and related departments to ensure timely decision making; Review the credit risk reporting system. When auditing information data risk, Internal Audit performs inspection of the following contents: checking data sources, data processing code, creating new data processing code and comparing with existing data to see whether there is any difference.

The survey results show that the content of evaluating the effectiveness and efficiency of risk management activities/Risk management framework for credit activities (18.48% of internal auditors of Vietnamese commercial banks are of interest). However, the internal auditors focus on examining and evaluating the appropriateness and adequacy in building internal mechanisms, policies and regulations in credit risk management of commercial banks in comparison with current regulations and objectives, plan in credit risk management (risk appetite). Vietnamese commercial banks have built an audit process for credit risk management activities, but the criteria established to evaluate the adequacy, effectiveness

and effectiveness of credit risk management activities are unclear.

The State Audit has audited Vietnamese commercial banks in the matter of handling bad debts according to Resolution No. 42/2017/QH14 with the approved audit outline No. 590/QD-KTNN dated March 29, 2019 on the implementation of the audit, accounting at 2 state-owned commercial banks (Vietinbank, BIDV) and 18 joint stock commercial banks. The results of the State Audit according to the Summary of audit results for the 2018 accounting year at No. 44/BC-KTNN dated May 11, 2020) show that the bad debt settlement is still slow (quantity, the ratio of bad debt settlement records, the ratio of bad debt recovered/Total bad debt excluding provisioned portion) is very small and faces many difficulties. Thereby showing that the internal audit of Vietnamese commercial banks has not been fully implemented to provide solutions to support bank administrators in minimizing bad debts as well as in the collection and handling of bad debts of the bank.

Thus, the effective audit of credit risk management activities has been interested by the internal auditors of Vietnamese commercial banks, but is in the first basic steps of reviewing the process, and is associated with bad debt settlement. However, the number of internal audits participated is low. Therefore, it is necessary to complete this audit content in Vietnamese commercial banks to meet Basel II requirements.

3. Improving solution Audit of risk management activities in Vietnamese commercial banks conducted by Internal Audit

When performing the operational audit with credit risk management, the internal audit of Vietnamese commercial banks needs to identify the objectives associated with the organizational structure, regulatory processes, and information technology related to credit risk management activities. Specifically as:

- Evaluation of the performance of the credit risk management function (the appropriateness of the organizational structure, functions and decentralization for the risk management department and related departments);

- Assess the appropriateness between the risk appetite, changes in the risk appetite, decisions of the credit risk management department with the strategy of the bank administrator;

- Assess the adequacy of the credit risk management system (processes and policies to

identify, measure, evaluate, control, respond to and report on risks in the banks);

- Assess the bank's capital allocation for credit risk;

- Evaluate the effectiveness of the credit risk management reporting process;

- Assessment of measures applied by the banks to reduce risks: Relevancy and updating of collateral value; Relevancy of the internal credit risk rating system; The adequacy of the loan risk provision; Bad debt recovery and handling.

- Assessing the adequacy of credit risk management in the information technology application environment for credit activities.

In the process of planning the performance audit for credit risk management, the head of the internal audit department needs to understand the risk management strategy, capital planning with credit risk and other types of risks in the banking business. To understand credit risk, auditors need to collect the following information:

- Charter, policy, risk appetite statement and information on establishing credit risk management strategies, policies and procedures.

- Policies and procedures related to all stages of the credit process from review to collection (find information through a credit officer).

- Credit risk modeling results.

- Evaluation of the sufficient level of loan risk provision for inefficient loans.

- Reports containing bad debt results for the credit portfolios.

- Allocating capital for credit risk, expenses for credit risk management.

When identifying risks in credit risk management activities, the Internal Audit can choose different approaches:

- Internal Audit can approach the system according to the steps of portfolio management including credit processes from credit approval, disbursement, post-disbursement credit risk monitoring and measurement to selection product depending on volume.

- Internal audit approaches results through examining loan risk provisions by sector, industry group (textile, livestock, construction, seafood processing, banking business...) or risk, risk by size (credit to corporate customers or retail credit).

- Internal audit approach to review underperforming loans (NPLs) may include

examining how branch/unit accounting makes estimations, valuation of portfolios, recoverability debt for provisioning.

In particular, internal audit needs to identify functional departments related to credit risks and risk management activities to coordinate with other departments for information collection during the audit process:

- Departments related to loan formation: misappraisal of collateral, loan plan (appraisal department, loan officer), loan approval without authority (leader of credit department, branch leader/member unit).

- Department related to loan disbursement: disbursed for wrong purpose, wrong object (accounting department, head of branch/member unit, credit specialist in charge of loan).

- Loan control and management department: credit officer, debt collection specialist, accounting department (back office), risk management department.

When built criteria to be used in the performance audit of credit risk management activities, the internal audit needs to adhere to the criteria used to evaluate the performance of the board of directors in risk management. Specifically, with the development of criteria for evaluating the effectiveness of credit risk management, four criteria can be directed: (1) Timeliness, (2) Completeness in risk assessment and management, (3) Appropriate action plans, (4) Issues are referred to a Board of Directors for appropriate resolution.

When matters identified by the Board of Directors meet these four criteria, the Internal Audit will grant confidence to the Board of Directors. Then the internal audit will turn into the assessment of internal control and the actions of management.

During stage performing of performance audit of risk management activities, the internal auditors of Vietnamese commercial banks should pay attention to the issues of risk management:

- Assess whether the supervision level of the second line of defense with the first line of defense is appropriate through checking the processes, functions and duties of the Credit Risk Management Committee.

- Find out about customers of commercial banks (know your customer - KYC): check customer loan documents, combine with relevant staff interviews, review customer credit history, industry sectors

customer's business, reports and post-disbursement control of the bank branches...

- Evaluate the provision of sufficient relevant and updated information on risk assessment to bank administrators by the Risk Management Committee for material risks.

- Internal audit monitors the performance/ effectiveness of the investment portfolio (profit/debt balance; bad debt/debt balance...) against the plan to identify deviations from which to take timely action.

- Check the frequency, report on evaluating the effectiveness of the first line of defense by the risk management department to review credit policies, monitor the investment portfolio

- Internal auditors select samples to test certain aspects of risk to ensure that risk models comply with regulatory expectations.

- Evaluation of the efficiency of credit risk measurement and monitoring programs should include criteria such as the quality of collateral, unpaid interest, economic changes, and rating agencies that may affect them to the borrower's worthiness. Therefore, institutions need a well-designed risk rating system to monitor credit risk in different investment portfolios through the credit rating system.

Evaluation of analytical models in risk management, internal auditors need to pay attention to:

- Determine the correct model and availability of data for risk management.

- Building models and validating them with appropriate specialized functions.

- Internal auditors conduct continuous assessment of the appropriateness of the models used with commercial banks' strategies to ensure that risk management activities continue to fulfill long-term goals, and if the case is not appropriate, the risk management model does the risk management department propose to amend and adjust in a timely manner.

- If, in the case of some commercial banks, the internal auditors of some commercial banks do not yet have the appropriate skill set to audit credit risk models, the head of the internal audit department may request an examination to verify that all policies and procedures are in place and other documentation related to the model is complete and up to date.

- Using remote monitoring software and connecting information of the risk management department, thereby giving warnings about a high

level of risk to the investment portfolio. The Internal Auditor may also take several samples of loans and review the outputs of the models to ensure the results are reasonable.

In the stage of completing and preparing the audit report, the internal audit recommendations of Vietnamese commercial banks should focus on:

- Recommendations may refer to the effectiveness of the control points of the risk management process in combination with possible risks in credit activities.

- Assess the appropriate level of capital allocation for credit activities and the estimated level of provision for credit activities in accordance with risk appetite.

- Specify the expected impact of the recommendations on credit risk management: issues on thriftiness in the use of resources, operational efficiency, completion of credit operations objectives associated with the strategy, the bank's risk appetite;

- Assess the impact of the issue on stakeholders, and the risks to the environment and society to make appropriate recommendations towards sustainable development.

Risk management activities in commercial banks are the backbone activities in banking business. In which credit activities are the main and main activities of Vietnamese commercial banks today. Auditing credit risk management activities should be of interest and investment by Vietnamese commercial banks in both breadth and depth. To do this, it needs the support of the Board of Directors and the General Meeting of Shareholders of Vietnamese commercial banks to bring added values to the credit risk management activities, contributing to improving the quality of credit activities in Vietnamese commercial banks.

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