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Solutions for Assessment of Materiality and Audit Risks to Enhance the Audit Quality of Some Independent Audit Firms, Vietnam

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Abstract:

The paper researched the relationship between materiality, audit risk assessment and the improvement of audit quality. Studying and surveying the situation of materiality, audit risk assessment and audit quality of a number of independent Vietnamese audit firms. Based on the analysis and evaluation of existing problems, the paper proposed a number of solutions to complete the methods in assessment at independent audit firms in Vietnam.

Keywords: *Materiality, audit risk, audit quality, independent audit firms*

1. Introduction

Currently, financial audit services are still a service accounting for a large proportion of the total revenue of independent auditing firms in Vietnam. Financial audits provide a reasonable assurance of the truthfulness, reasonableness and legality of the financial statements. From there, the information on the financial statements will be guaranteed that there are no material errors that affect the decision of the user.

In line with the trend of regional and international integration of accounting and auditing services, the requirements from management practices have required the improvement of the quality of services provided by independent audit firms in Vietnam. An important factor that contributes to enhance the quality of an audit is to assess scientifically and accurately the materiality and risk audit. However, these assessments still have many incomplete points. Therefore, the author carried out this research at some independent audit firms in Vietnam.

In terms of auditing, materiality is a frequently mentioned concept, especially in auditing financial statements. Materiality is a concept that indicates the importance of accounting information which, in certain cases, is misrepresented or omitted to change the information users' decisions.

According to International Auditing Guidelines No. 25 (IAG 25) on "Materiality and risk in audit" drafted and published The International Federation of Accountants (IFAC): "Materiality is a concept of the size and nature of the error (including omission) of financial information, either singly or as a group, which in the context of this information is judged inaccurate or draw wrong conclusions".

Vietnam Standard on Auditing No. 320 also defines materiality: Information that is materially significant means that the lack of or inaccuracy of such information will affect the decision making of users. Materiality depends on the importance and nature of the information and is assessed in specific circumstances.

Materiality is a threshold, a point of separation, not the content of required information. The materiality of information must be considered both quantitatively and qualitatively".

2. Methodology

The study has applied technical methods such as statistical surveys, comparisons, synthesis, surveys, practical analysis. Data used in the study include both primary and secondary data.

- Primary data is collected mainly through survey methods. Investigation activities of the author were conducted under two main subjects: Audit firms and Audited units.
- Investigation method: The author send questionnaire to individuals to collect information. In addition, the author also conducted direct interviews with members of the board of directors and auditors of some independent auditing companies based on the contents of the questionnaire.
- Analysis method: The study used SPSS software to analyze data on the assessment materiality and audit risk in relation to factors: audit firm size, members of international auditing firms, audit experience (establishment time), quality of the team of auditors (number of employees with Certified Auditors)
- Secondary data was collected through audit reports, audit documents, research results and other available documents

3.Result and Discussion

3.1. Practice in Assessing the Materiality and the Audit Risk

3.1.1. Risk Assessment in Accepting Audit Contract

The risk assessment of accepting audit contracts is done by the audit firms during the pre-audit period, before signing audit contracts with clients. Auditors assess the risk of accepting a new client. The survey results showed that most of the answers suggested that in order to assess the risk of accepting an audit contract, the auditor must collect background information about the client. Background information collected by auditing companies includes: type of business, business sector, organizational structure, technology process, current performance of clients, clients' problems with the law.

The auditor collects information based on the following sources: auditor's experiences and understanding of the client's industry and sector; Find out through press, mass media, audit profiles of the previous years (if this is a regular client); Discuss with the board of directors, chief accountant or employee in the client company; Exchange through documents with clients' related parties to collect background information about clients; Collect memorandums of the Board meeting provided by the client; Gather related legal documents such as : business operation license, decision on establishing enterprises.

In this step, a very important source of information that can be accessed is talking to the predecessor. However, the communication between auditors and their predecessor has not been considered seriously (especially between auditors of audit companies these are competitors in the market). Due to the law enforcement of Vietnam regarding the responsibility of the predecessors is not high, and also due to the competition among audit companies in the market, it is very difficult for auditors to get sources of information from predecessors. Due to the law enforcement of Vietnam regarding the responsibility of the predecessors is not high, and also due to the competition among audit companies in the market, it is very difficult for auditors to get sources of information from them. Assessing the risk of accepting audit contracts is a complex, judgmental work of auditors. Therefore, in most independent audit firms in Vietnam, this assessment is usually assessed directly by the members of the Board of Directors or by senior auditors and with the approval of the Board of Directors. This demonstrates prudent principles in auditing to ensure quality control. Assessing the risk of accepting audit contracts is a complex, judgmental work of auditors. Therefore, in Vietnam, this assessment is usually assessed directly by the members of the Board of Directors or by senior auditors and with the approval of the Board of Directors

3.1.2. Evaluation the Materiality

At present, professional standards have hardly provided specific guidance on materiality assessment. The actual survey results show that independent audit companies often provide guidelines, directions on the implementation process to support auditors in the audit process and the implementation of regular audits by the experienced auditor.

In practice, in order to assist the auditors in evaluating this materiality, Vietnamese independent audit firms are often based on requirements of the International Auditing Standards and Vietnamese Auditing Standards and experience of international auditing firms to develop guidelines on the selection of criteria. Most of the Vietnamese independent auditing firms have developed these detailed guidelines as a basis for auditors in determining the initial estimation of materiality. Like other independent auditing firms in the world, the criteria is selected by independent auditing firms such as: total assets, total revenue, net income before taxes, total equity.... etc. However, the method of using original numbers and ratios applied to calculate the initial estimation of materiality for each auditor is different.

Normally, the materiality level must not be higher than the above rate. On the contrary, in special cases, it may be assessed at a lower level, depending on the judgment of the auditor, but it must be approved by the auditor's director.

In the auditing practice, the original number is selected by the auditor to determine the common materiality is still the value of the revenue target because this indicator is usually stable over years. This is also an important indicator that is paid attention to by many users. For audit firm which is a branch of multinational companies, the materiality is usually built on the revenue but always be lower than level of parent company.

For auditing firms with instructions on how to calculate materiality using intervals based on criteria as original numbers.

An independent auditing firm has the Guiding document for evaluating materiality in the financial statements audit, the indicators are used as the basis for the initial estimation of the materiality and the corresponding proportions are:

- From 4% to 8% of profit before tax
- From 0.4% to 0.8% of total revenue
- From 1.5% to 2% of total current assets
- From 1.5% to 2% of short-term debt
- From 0.8% to 1% of total assets

Revenue (USD)	Ratio (%)
To 500.000	3,0
600.000	2,5
700.000	2,3
800.000	2,0
900.000	1,8
1.000.000	1,7
2.000.000	1,6
6.000.000	1,5
10.000.000	1,2
15.000.000	1,0
30.000.000	0,9
50.000.000	0,8
100.000.000	0,7
300.000.000	0,6
1.000.000.000 and more	0,5

*Table 1: Determination of Material Importance by Turnover
Source: Author Collected from Audit Firms*

For each specific client, after collecting information about client, auditors preliminarily analyze the financial statements and make a Materiality Estimation table

No	Items	Ratio %		Amount	Estimated materiality	
		Lowest	Highest		Minimum	Maximum
1	Profit before tax	5	8	15,9	0,636	1,272
2	Revenue	0,5	0,8	149,5	0,598	1,196
3	Current assets	1,6	2,1	144,8	2,172	2,896
4	Short-term debt	1,6	2,1	108	1,62	2,16
5	Total assets	0,9	1,1	214,8	1,7184	2,148

Unit: VND billion

*Table 2: Materiality Estimation of Audit Firm
Source: The Collection of Author*

After calculating the indicators in the table, the auditor will select an important level according to his or her discretion.

* For audit companies that do not make an initial estimation of the importance of materiality.

In order to estimate the total number of infringements in each indicator, these audit companies have the following general guidelines:

- Infringements with indisputable evidence: The infringements which are lower than 2% of the materiality level and not systematic, they do not significantly affect on the financial statements, the auditor may ignore and not make any aggregation.

Any remaining evidence-related infringements which are higher than 2% of materiality level, they are required to adjust, even if they do not materially affect on the financial statements. In auditors' opinion, although these infringements do not affect significantly, but if not corrected, they can affect the next years and the combination of those ones would have become a big materiality.

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Conservatively, the auditors should require his clients to correct all errors with this specific evidence.

- Infringements without indisputable evidence: the auditor must calculate an acceptable difference. The acceptable difference is the maximum difference between the actual amount and the auditor's estimation, which is acceptable and does not require further investigation. The acceptable difference value is calculated for each indicator. The acceptable difference value will be calculated for each item.

Number of items separated	Detailed examination at a low level (R = 0,7)		Detailed examination at an average level (R = 2)	
	Difference value is acceptable (% MP)	If the balance of the item is larger	Difference value is acceptable (% MP)	If the balance of the item is larger
1	90	4,5	45	3
2	85	4,25	40	2,67
3	80	4	37,5	2,5
4	75	3,75	35	2,33
5	70	3,5	32,5	2,165
6	65	3,25	30	2
7	62,5	3,125	29,2	1,944
8	60	3	28,3	1,889
9	57,5	2,875	27,5	1,833
10	55	2,75	26,7	1,778
11	52,5	2,625	25,8	1,722
12	50	2,5	25	1,667
13	40	2	20	1,333

- If the detailed test reliability R = 0.7, then:
Acceptable difference value = Item balance x 20%.
- If the detailed test reliability R = 2 then:
Acceptable difference value = Item balance x 15%.
R: the detailed test reliability, which is determined after the auditor has assessed inherent risk and control risk

Table 3: Guideline for Calculating Acceptable Differences
Source: The Collection of Author

Some companies also do not make material allocation of items. However, the primary estimation of materiality is used to determine the tolerable error level (Tolerable Error).

Estimated number of errors	Tolerable Percentage
0 - 2	60% - 80%
3 - 5	25% - 40%
≥ 6	15%

Table 4: Determination Tolerable Error Percentage
Source: The Collection of Author

Then, auditor calculates the difference that can be omitted:
Tolerable Error = Materiality Amount * Tolerable Percentage

3.1.3. Audit Risk Assessment

3.1.3.1. Assess Audit Risk on the Entire Financial Statement

The audit risk assessment on the whole financial statement is conducted according to each type of risk. It includes number of steps: Establish the target level of audit risk, Assess inherent risks and Assess the control risks on the whole financial statements. Determine the level of detection risk on the whole financial statements. In principle, the detection risk is determined on the evaluation of the control risk and the inherent risk. However, in fact, due to the lack of attention and improperly implementation of the inherent risk assessment process and especially the control risk, the most independent audit firms of Vietnam have identified the detection risk at middle level without presented on working paper. Accordingly, the design of audit investigation is also done in the direction of focusing on basic tests.

3.1.3.2. Assess Audit Risk on Account Balance and Type of Transaction

After determining the target audit risk level for the entire financial statements, this risk level will be applied to the main items on the financial statements. Therefore, the assessment of audit risks on account balances and type of transactions includes assessing inherent risks, control risks for each item and determining respectively the detection risks for those items

However, in reality, not all independent auditing firms in Vietnam comply with the requirements of Vietnamese Auditing Standard No. 400 on "Risk Assessment and Internal Control". It is to conduct a risk assessment for each management assertion.

In addition, in some audit firms (15 firms), there is no separate assessment between the inherent risk and the control risk. They perform a combination to assess audit risk for each item.

The following is a sample of "Orientation Test Matrix" of an audit firm:

Conduct an initial investigation	Direction of initial inspection	Direct test results		Indirect test results	
		Assets and Expenses	Liability and revenue	Assets and Expenses	Liability and revenue
Debit balance accounts	O	O		U	O
Credit balance accounts	U		U	U	O

Table 5: Orientation Test Matrix

Legend:

- O: Overstatement
- U: Understatement

According to the Orientation Test Matrix above, for asset and cost accounts, auditors will only check directly the declaration in overstatements and will not check directly for understatement.

Based on the double entry principle of accounting as mentioned above, the declaration under the actual number of asset and expenses accounts will be checked indirectly through the performance of checking reciprocal accounts (the reciprocal accounts can be assets, expenses or liabilities and revenue).

Similar to accounts receivable and revenue, auditors only need to check the declaration directly for understatement items. The overstatement items of these accounts will be checked indirectly through checking reciprocal accounts.

By performing the above, the auditor may examine all account balances on the financial statements directly or indirectly in both forms of the offense. Therefore, the orientation test matrix has helped to overcome the duplication in the audit performance and enhance the audit efficiency.

3.2. Situation of Auditing Quality of a Number of Independent Vietnamese Audit Firms in Connection with Materiality and Audit Risk Assessment

After summarizing and analyzing, the obtained data have obtained some results:

+ 83% of respondents said that independent audit firms in Vietnam still accept to perform audits when the risk of accepting audit contracts is high. In which 15% accept auditing with normal fee, accounting for 68% accept auditing with additional fee. The remaining responses (17%) which are large-scale audit firms will consider the risk factors when deciding to audit.

However, a point to note for this indicator is the significant difference between the information obtained from the auditor directly performing the audit and controllers the audit. The reason for accepting an audit contract when the initial assessment of the risk is considered to be high, according to the survey results, is that the audit firm runs to follow revenue.

There is a difference of opinion between manager who directly assessed the risk and auditors. This shows that this risk assessment is not really close to the situation of the audited units.

According to the survey, there were no cases that the audit contract had to be terminated prior to the deadline, but still about 9% of the audits, the auditor had to refuse the contracts because clients do not provide enough documents for the audit. However, 100% of the respondents said that problem trends to increase and 83% of the respondents believed that the cause of this phenomenon was the poor assessment of the initial risk assessment. Besides, more than 64% of the respondents said that determining the level of detection risks was not suitable for reality. Accounting for 57% respondents said that this level of audit risk determined by the auditor is higher than the actual level while only 7% said that the risk level is often lower than. However, all responses agreed that the main cause of this situation is due to inadequate and inaccurate of inherent and control risk assessment procedures.

Analyzing the situation of the quality for assessing the materiality and audit risk of independent audit firms in Vietnam. The survey results on the analytical criteria are summarized according to Table as follows:

No	Items	Minimum	Maximum	Mean	Std. Deviation
1	Quality of critical assessment and audit risk (points)	22	34	27	3,797
2	Number of years of operation of the auditing company	3	20	10	5,254
3	Clients number	5	968	289	259,166
4	Number of employees with Certified Auditors	3	57	19	15,324
5	Number of employees	8	335	95	91,019
6	Audited revenue in 2018 (million VND)	690	215.637	36.206	48.992

Table 6: Statistics table of Survey Results by SPSS software
Source: The Collection of Author

The analysis results show that the audit companies have an average of 10 years of operating experience, in which the company has the most years of experience, is 20 years. Each company has an average of 289 clients with average revenue of more than VND 36 billion in 2018. The company has the largest number of employees is 335 people and the lowest is 8 people, of which the company has an average of 19 employees with certificated auditors. The results of the key assessment and audit risk average reached 27/40 points, of which the lowest value was 22 points and the highest was 34 points.

- Correlation Coefficient Analysis

Results of analyzing the correlation coefficients between material and auditing risks assessment with indicator on size of auditing firms, member of international auditing firms, years of operation of auditing firms, number of employees with certificates auditors are shown in the following table:

No	Items		Quality materiality and audit risk assessment	
			Correlation coefficient	P-value
1	Size of auditing firm	QM	0,82	0,00%
1.1	Number of clients	KH	0,42	0,88%
1.2	Audited revenue 2018	DT	0,85	0,00%
1.3	Number of professional staff	NV	0,82	0,00%
2	Being a member of an international auditing firm	LH	0,91	0,00%
3	Number of certified employees	KTV	0,76	0,00%
4	Number of years of operation of the auditing firm	KN	0,69	0,00%

Table 7: Correlation Coefficient between Materiality and Audit Risk Assessment with Factors
Quality of Assessment and Audit Risk
P-Value (P-Value)
Source: The Result of Analysis

With confidence 99% (p-value <1%), the quality of materiality and audit risks assessment are closely related to the factors: the size of the audit firm member of international auditing firms, the number of years of establishment and the number of certificated auditors.

Test the mean parameter of two samples (two independent samples) by T-test

No	Items	Sample (N)		T-test				
		Group 1	Group 2	P-value	Average difference	Standard deviation of difference	Difference value	
							Min	Max
1	Size of auditing firm	17	30	0,000	5,7756	0,7853	4,19	7,36
2	Being a member of an international auditing firm	18	29	0,000	6,7695	0,5554	5,65	7,89
3	Number of certified employees	14	33	0,000	6,0315	0,6660	4,69	7,38
4	Number of years of operation	21	26	0,007	2,9118	1,0393	0,82	5,01

Table 8: Parameter Testing of Two Samples (Two Independent Samples)

The above results showed that with 99% confidence level (p -value $< 1\%$) showed the difference in the quality of materiality and audit risk assessment amongst audit firms. It is seen that the average difference is relatively large in terms of audit firm size, international firm membership and the number of certified auditors. The firm's operating time indicator also impact on the materiality and audit risk assessment with lower the average difference.

Thus, the analysis results show that large-scale audit firms, members of international auditing firms, have many years of operation and have a larger number of employees with KTV certificates will have quality critical assessment and better audit risk.

3.3. General evaluation on materiality and audit risk assessment process with the connection with the audit quality at some independent audit firms

3.3.1. In Terms Of the Assignment of Work in Assessment Materiality and Audit Risk

During the audit, materiality and audit risk assessment is a job that requires a high level of expertise as well as the judgmental capacity of auditor. Therefore, Vietnamese independent audit firms often assign this task to the audit team leaders for each specific audit. This is a prudent assignment of tasks to ensure that business risk with audit firms is reduced to minimum. However, not all the assessment works are performed by the team leader. For risk assessment may be conducted by key auditors or auditors' assistants and these tasks have been reviewed and concluded by the team leader about audit risk. This is also a requirement of the quality control process. For the determination of materiality, the estimation for the whole financial statements may be conducted by the chief auditor or by the assistant auditor because all of them will be done according to the available formula.

However, the selection of criteria as a basis for estimating materiality for the whole financial statements is usually decided by the audit team leader. For companies making significant allocation of items in the financial statements, that allocation is usually undertaken by the audit team leader. This is also an experience applying to control audit quality. After the audit team leader assesses the materiality and audit risk, the auditor's director reviews again before announcing audit report. For smaller audit firms, members of the board of directors will conduct this. The arrangement of work as above is quite reasonable, ensuring the materiality and audit risk assessment are accurate and highly effective.

3.3.2. In Terms of the Application of the Guidance of International Auditing Standards and Vietnamese Auditing Standards in the Materiality and Audit Risk Assessment

In order to ensure the effectively audit work, the independent audit firms must paid attention to the application of International Auditing Standards and Vietnamese Auditing Standards into their audit practices. Standards were not applied mechanically but researched and applied in accordance with the client company's situation.

3.3.3. In Terms of the Material Assessment and Audit Risk Presented on the Working Paper

Independent audit firms have built a scientific and rigorous assessment process. In order to standardize risk assessment, these companies had questionnaires to evaluate risks during the audit process. The conclusions about materiality and auditing risks assessments are presented by auditors scientifically on working papers. In terms of materiality assessment, the table forms that auditors rely on to calculate created consistently on the audit profile.

3.3.4. Limitations in Material and Audit Risk Assessment

- Firstly, allocating the initial estimate of materiality for items on the financial statements is a complicated and subjective issue of the auditor. In this regard, there is no agreement among independent auditing firms in both guidance and allocation practices.
- Secondly, the auditing firms still use the materiality and audit risk assessment by the traditional approach (Only based on the assessments and conclusions on the specific items on the financial statements). In the meantime, the new International Auditing Standard has been issued the guidance that have innovated their clients' approach to auditing business risks.
- Thirdly, when assessing the inherent risks and control risks on account balances and types of transactions, almost Vietnamese independent audit firms are not interested in each management assertion.

- Fourthly, Vietnamese independent auditing companies have learned about the internal control system, but they often do not trust the internal control system of client and assess the control risk at maximum level, so they bypassed control tests and concentrate on basic tests.
- Fifthly, at independent auditing firms in Vietnam, the method of using flowcharts to describe the internal control system has not been taken seriously. Some companies, if they have research on the internal control system, will only describe it in the form of a narrative sheet or questionnaire about the internal control system.

4. Solutions for Materiality and Audit Risk Assessment to Enhance the Audit Quality of Some Independent Audit Companies

4.1. Complete the Allocation of Initial Estimates of Materiality to Items in the Financial Statements

Independent audit companies need to have specific and reasonable instructions in allocating initial estimation of materiality for items. Basis for the auditor to allocate this material level includes: The overall material level is estimated for the entire financial statements; Nature and scale of items; The assessed level of potential risk and control risk of each item; The auditor's experience and audit costs for each item. A fixed percentage should not be used to calculate materiality allocated to items. When making allocations, the auditor may make allocations to items on the Balance Sheet and the Income Statement.

4.2. Increased Use of the Approach to Assess Risk Accounting Model based on Customers' Business risks

Business risk is the risk that the business objectives of the business will not be achieved. Carry out business risk assessment procedures. Performing audit procedures to find out the state of the business and its business environment, including: Understanding business lines; Nature of business activities of the enterprise; Objectives and strategies related to business risks; Measurement and monitoring of financial activities of enterprises; Learn internal control system; Assess risks of materiality on the financial statements: Understanding the characteristics of industries, Understanding the operating environments and economic activities of enterprises to detect risks; Assess detection risks for each data base;

Examine the scale and nature of the types of risks; Dealing with assessed risks due to the impact of factors, pressures and internal and external conflicts the business. Risk handling on both levels: financial statements and assertion level. At the level of financial statements, auditors need to provide general solutions to the assessed risks. At the assertion level, the auditors need to determine the nature, time and level of next audit procedures;

In order to carry out the above evaluation steps, auditors need to use a flexible combination of technical methods in auditing, and apply new analytical methods such as: SWOT analysis, PEST analysis, Value chain approach, and measurement of non-financial indicators and the use of "Balanced scorecard".

4.3. Complete the Audit Risk Assessment on the Account Balance and Type of Transactions for Each Assertion

When assessing the inherent risk for the assertions, there are two directions. Auditors only need to assess the inherent risks of asset items, the declared expense is overstatement and the liability and revenue items are understatement. That is because, according to the principle of double entry, if an error occurs, it will cause at least two accounts to be recorded incorrectly.

Detailed risk assessment for each data base in the same way will reduce duplication of risk assessment, design and perform audit tests, contribute to improve audit work.

For control risks, the auditor should prepare a control risk analysis table for each assertion of each item specifying each control goal (corresponding to assertions) which control procedures have been designed and see how they operate. The auditor's will give evaluation for the control risk of each assertion.

4.4. Complete Control Risk Assessment

Auditors need to consider and assess more accurately the control risks in order to achieve the effectiveness of their audit. In order to conclude that the risk of control is lower than the maximum level, the auditors must rely on the internal control. To do so requires auditors to carry out controlled tests to check the internal control at a higher level. In short-term conditions, it is possible that the auditors do not have enough time to investigate for all parts, which may be carried out with the parts evaluated as materiality. Meanwhile, the scope of the basic test applied to that part of operation will be reduced and cost of auditing will be saved.

4.5. Use the Flowcharts in Control Risk Assessments

Learning about internal control and describe on the working paper is a basic work step in auditing risk assessment. The techniques for internal control should be expanded to meet the audit needs and improve the audit quality of independent audit firms. This solution should also use the flowcharts to describe because of its advantages. It could be use in combination with other methods above.

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