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## Transnational Audit: The Differences of National Environments Have Challenged the Auditors in Providing Quality Auditing

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### Abstract

Audit quality plays a major role in safeguarding public trust and building investor confidence in trustworthy company reporting. The differences between national environments have a significant impact on audit quality. Therefore, auditors must be aware of the factors that affect them while performing transnational audits to maintain high-quality auditing. This paper ascertains the national environment affecting the political, economic, and business environments, the legal framework, and culture in developing a quality audit. In producing a quality audit, professional skepticism is an essential component. The auditor examines the reliability of the audit evidence acquired as well as management's judgements on accounting estimates and treatments. With this understanding, the recommendations are proposed to improve the audit quality. Additionally, this paper provides ideas and areas for improvement for related parties in enhancing their understanding and sharing practical experience and knowledge with audit firms. This study contributes ideas for auditors and regulators to be aware of the national environmental factors that will impact audit quality to ensure that audits are conducted with the highest level of quality and integrity in the future.

**Keywords:** Audit Quality, National Environment Effect, Political, Economic & Business Environment, Legal Framework, Culture.

### Introduction

Multi-National Companies (MNCs) have become veritable and most vital instruments and institutions for economic development, social change, technology, dynamism and in essence, new ideas. MNCs operate within the contexts of environmental variables in locations other

than their home-base countries. In today's tight business world, accounting and audit firms keep up with this competitive environment by expanding their operations worldwide due to globalization (OECD, 2009). This issue raises challenges for audit quality and consistency by an auditor when there is a difference in the national environments. Despite the significant contribution of archival and other studies that have looked for systematic evidence that audit quality is influential in audit contracts from a rationalist economics perspective, few studies have argued that this approach disregards the wider social, political, and historical contexts of auditing (Humphrey & Owen, 2000), whilst Elmghamez (2022) studied on audit quality from cultural, educational, legal and political factors. This study focuses on the national environment affecting the political, economic, and business environments, the legal framework, and culture in developing a quality audit.

A transnational audit is the process of examining the financial statements and accounting practices of a multinational corporation. The process entails analyzing the company's financial records, internal controls, and other pertinent information to ensure compliance with accounting rules and standards in each country in which the company operates. According to Naik (2021) transnational audit describes an audit of financial statements which are or may be relied upon outside the audited entity's home jurisdiction for purposes of important lending, investment or regulatory decisions. This would include audits of all financial statements for companies having publicly traded equity or debt, as well as other public interest companies that attract special public attention due to their size, products or services provided.

Individuals often refer to the reliability of audited financial statements in terms of whether the audit report accurately represents financial statements that are free of material misstatements when they discuss audit quality. Focusing on the quality of audit process inputs and what auditors must do to provide an appropriate professional opinion on a specific set of financial statements is one way to make the concept of audit quality better. The Institute of Chartered Accountants in England and Wales (2010) reports that audit practitioners, standard-setters, and regulators have taken major steps in recent years to strengthen confidence in the quality of financial statement audits. Further explained by Australian Securities and Investments Commission (2022), the quality of financial reporting is critical for markets and investors to be confident and informed. The goal of the independent audit is to develop trust in the quality of financial reports. Therefore, this paper specifically looks at the challenges posed for the difference of the national environment towards audit quality. The analysis of national environment differences is not meant to be conclusive; rather, it is supposed to stimulate discussion and debate about whether and how differences are being addressed. The auditor is also required to review analyses of significant issues in financial reporting and judgments made in preparing the financial statements, including the effects of alternative GAAP (Generally Accepted Accounting Principles) methods. This discussion may also be held during the review of the quarterly financial statements. It is also significant to auditor to sure the standard and regulations is followed as per required. Therefore, we discuss and point out areas where auditors can take action. This study will be help auditor to aware the current issues is related with compliance.

### **Background of Study**

The purpose of this study is to improve international understanding of the issues created by differences in national environments in order to promote international consistency in audit quality. It gives guidance by addressing how national differences affect standard application, particularly auditor interactions with audited entities. The International Forum of Independent Audit Regulators reports that of 47% of files, there was at least one inspection finding (Knechel and Ghandar, 2021). Further, it was reported that over the years, PCAOB inspections have regularly had a 30% to 35% incidence of inspection findings Knechel and Ghandar, 2021). As audit regulation has matured, one might expect that the collective inspection of audits over many years will have fostered an increase in audit quality.

According to Forum of Firms (2010), the definition of a transnational audit, as described in ISA 600, should be applied to the whole group audit, which includes all components whose financial information is presented in the group financial statements. If the component fulfills the criteria, the audit of an individual component of a group could be transnational without the group audit being transnational. Features of the political, legal, and business environments can have an impact on the quality of audited financial statements and provide audit issues.

Based on our study, we have discovered the most accurate and unbiased list of accountants and auditing service providers when it comes to the top 10 audit firms in Malaysia 2022, with Ernst & Young (EY), Deloitte, and KPMG at the top three. Each audit business offers companies tax, accounting, auditing, consulting, and financial advising services (YH Tan, 2022). Recent case of Serba Dinamik and KPMG is popular in Malaysia where Serba Dinamik alleged that KPMG had owed and breached its statutory duty under Section 320 of the Capital Markets and Services Act 2007 (New Straits Times, 2021).

In the context of a quality, quality could be subjective and depends on an individual perspective. Instead, it depends on how an individual perceives a topic when standards are being defined. This study focuses on the difficulties presented by the different national environments with regard to audit quality. Further explained by IFAC (2022), IFIAR's 2020 survey of global regulators stated, "the recurrence and degree of findings indicated in the survey continue to show a lack of consistency in the implementation of high quality audits and the need for a continuous focus on continuing improvement". As a result, the issue of how different national environments have challenged auditors in providing quality auditing has arisen in this study.

### **Problem Statement**

Improving and sustaining audit quality is critical for promoting trust and confidence in financial reporting. The statutory audit reinforces confidence because auditors are required to offer an unbiased opinion on the preparation and presentation of financial accounts. According to the guidance statement issued by the Transnational Auditors Committee (TAC), as defined in ISA 600, transnational audit means an audit of financial statements which are or may be relied upon outside the audited entity's home jurisdiction for purposes of significant lending, investment or regulatory decisions including audits of all financial statements of companies with listed equity or debt and other public interest entities where it should be applied to the whole group audit, including all the components whose financial information

is included in the group financial statements. Since transnational audit is about the auditing in the cross-national boundaries, it is essential for the audit practitioners to have a well understanding of the national environments to ensure the audit resulted in a quality report where most people are relied. The environments could be in forms of political, economic, legal, education and business environment. These environments would be different from that of the origin country where the financial statements are being audited since it was governed by a different style and set of norms. Existing work in international accounting, according to Briston (1978), suggests that the strength of accounting quality is primarily influenced by critical environmental factors such as economic forces, social forces, legal system, culture, and political system. Therefore, this study is being conducted to demonstrate how auditing in a different national environment is likely to present difficulties for maintaining an international standard of audit quality by emphasizing on the national environment factors and proposing recommendations for the auditor on what they can do to deal with those challenges.

### **Gap In Research**

Auditors are challenged to keep up with the complexity and ever-changing environment in which they must conduct audits in order to keep up with such changes while keeping a high level of quality in their work. In order to support this idea, a few studies and research regarding the problems with international auditing have been released. Merve (2022), to examine whether the national culture of an international parent audit firm's home country or the national culture of its affiliates' host country has a greater influence on the financial reporting quality of audit clients, a study is conducted and it is evident that the cultural aspects of the parent audit firm's home country have a significant impact on financial reporting quality of audit clients than those of the affiliate firm's host country. Additionally, the acceptance and implementation of international accounting standards have been impacted by these cultural and ethnic differences, according to the journal "Going International for Accounting and Auditing Standards," which noted that each country's distinct accounting rules and regulations are a result of its cultural, economic, political, and legal systems (Murphy et. al., 2008).

Although all this research is about analyzing the influence of different national environments on quality of audit, yet it does not explain thoroughly about every aspect of differences, and only a few studies have been conducted to truly understand the fundamental question. Thus, this study aims to better comprehend the topic at hand, which is how national environment variations from business, political, economic, legal, and cultural perspectives present a universal challenge to auditors in providing a high standard of auditing.

### **Literature Review**

#### **Factor That Challenges the Auditors**

##### ***Political, Economic and Business Environment***

The quality of audited financial accounts can be impacted by aspects of the political, economic, and business environment, and these aspects can also present difficulties for the audit. The degree of corporate ethics, the responsiveness and openness of governments, the sophistication of capital markets, the quantity and rights of foreign investors, and the standard of governance in all aspects of economic activity are some of these national differences (ICAEW, 2010)

The incentives of those who prepare information are influenced by the business environment. Businesses that are a member of larger groupings may view a variety of disconnected external reporting requirements as not providing value to the company, which may reduce the incentive for preparers to submit accurate information. Furthermore, financial reporting and the audit may suffer if the ideas of accountability and transparency are not well-established in national institutions. Similarly, a lack of enforcement methods or unambiguous legal obligations aimed at information preparers undermine motivation (ICAEW, 2010). According to Bode (2007), the pride in one's country's sovereignty and its political system are restrained by political barriers. People do not want to give up their national characteristics since they are proud of them. Governments are also hesitant to give up their authority to establish professional standards. Finding a majority in the national parliaments will also be challenging because current national standard-setters or business leaders can put pressure on lawmakers to oppose ISA 600.

The diverse user orientations of financial statements and the stages of technology development are the final characteristics of economic challenges. Since shareholders typically pick auditors, the auditing processes are tailored to the various interests of these investors. Due to the expansion of e-commerce and e-business, auditors in rich nations also require different standards than their counterparts in poor countries (Bode, 2007)

### ***Legal Framework***

Laws are significant in the business world because they regulate how businesses behave and serve to safeguard other parties like creditors and investors. The legal system of a nation can establish guidelines or principles for conducting business and assign obligations to business people. In addition to resolving concerns like property rights, a competent legal framework may also aid in the resolution of disputes (ICAEW, 2010)

The ability of nations to lend domestic legal force to international norms established by non-governmental international organizations may be severely constrained by constitutional and administrative legislation. For nations that have historically relied on rules and regulations, particular problems could develop because new legislative measures might be required to update or adopt a standard. The compliance, monitoring, and enforcement operations are impacted by this because it can be time-consuming and expensive. The quality of audits will also be affected if external quality assurance procedures (run by governments, regulators, or professional accountancy organizations) are not enforced (ICAEW, 2010)

Legal barriers, on the other hand, are mostly caused by variations in national legislation and the legal system. The common law, which predominates in Anglo-Saxon nations, may now be clearly distinguished from the codified law, which is used in many European continental nations. These two legal systems are especially different in how they approach the law and how they decide cases in court. Beyond this, variations in the effectiveness of national laws and regulations, such as those governing auditor liability and accounting standards, also negatively affect the harmonization process (Bode, 2007)

The quality of audited financial statements and the application of international accounting and auditing standards may be impacted by countries with weak, nonexistent, or inconsistent

regulations. Businesses and individuals may occasionally need to rely on alternative methods, and the audit may need to take these alternative methods into account (ICAEW, 2010)

People should be able to enforce their rights (whether they are legal or not), and one way to achieve this is through litigation, which offers a path of action. This, however, can end up being ineffective. It is very challenging to achieve complete openness and audit quality can be negatively impacted in a setting where everything is exposed to the possibility of litigation and legal responsibility is a significant source of risk. For instance, more litigation may lead to defensive auditing and a propensity to apply standards arbitrarily as opposed to using them as guidelines. Additionally, increased litigation may serve as a deterrent to or a barrier to the advancement of standards and practices (ICAEW, 2010)

### **Culture**

Since cultural differences affect people's behaviors, faiths, attitudes, and values in addition to their languages, they are the most important and challenging obstacle to overcome. Numerous well-known authorities, including Hofstede and Trompenaars[7], have studied and categorized various cultural behaviors in the past. They emphasize that because of the many cultural influences on people, their behaviors and worldviews are simply different from one another. In light of ISA 220, which mandates protections to ensure auditor independence, it appears challenging to define the level of required independence. For instance, personal relationships are highly valued in Latin America, Asia, and southern Europe, while gift-giving is frequently utilized in professional settings (ICAEW, 2010)

Auditors are required to put professional interests ahead of intimate personal connections and to turn down presents from clients in North America and Northern Europe (Groeschl and Doherty, 2000). Additionally, different people have different values and ways of behaving, which affect how any international norm is applied (Bode, 2007)

On the other hand, 6000 or so languages are said to be spoken in total, according to (Parker, 1998). Since terms in other languages do not have the same meaning as those in English, it is extremely difficult to translate the true meaning of the English ISA into all other languages. Since the target language lacks exact professional term counterparts, translators may frequently run into issues. One of the primary causes of inconsistency between nations is also due to the various ways that standards and essential words are translated. In fact, poorly translated standards impede the harmonization of auditing practices by leading to major misunderstandings and confusions. Examples of important terms in auditing are the German phrase "Grundsätze ordnungsmäßiger Abschlussprüfung" (GoA, "principles of an orderly audit") and the English phrase "true and fair view". However, their literal translation frequently causes confusion. While the widely misunderstood English word "true and fair" does not appear to be consistent with the original meaning in any other languages, the translated German term "GoA" is frequently confused with the US GAAS. Additionally, it should be emphasized that variations can also be found within a single language. Several words in American English, for instance, have different meanings in British English. In this sense, the term "property" in accounting refers to more than just land and buildings in the US, where it also refers to tangible fixed assets (Bode, 2007).

Furthermore, because the ISA are not a result of firsthand experiences and do not reflect the necessary relevance of each nation, there may be a widespread resistance to international standards in some countries. The IFAC is still viewed, particularly in Africa and South America, as a Trojan horse that hides Anglo-Saxon auditing ideas inside of a more respectable international framework. In actuality, the IFAC is unable to dispel the charge that it is heavily biased toward the EU and the USA. The IFAC is situated between the devil and the deep blue sea, and that is a plain reality. In other words, if the two most powerful economies do not agree with their ideas, they are worthless (the EU and the USA). Although the ten board members represent eight different countries, the IAASB strives to be as globally diversified as possible (IFAC, 2007). Furthermore, since 13 of the 18 IAASB members are from large audit firms and the remaining member is made up of academics and public sector auditors, small and medium-sized businesses are overlooked in the process of setting international standards. Consequently, second-tier audit companies can be hesitant to implement the ISA (Jopson, 2006). Furthermore, the IFAC (2006) acknowledges that "challenges faced by small and medium practices (SMPs) in applying ISAs to the audits of small and medium companies (SMEs)" exist (Bode, 2007)

The study concludes that given the wide range of national differences; genuinely harmonized standards might not be possible. Achieving a minimal set of international auditing standards is more crucial because unitary standards provide numerous advantages. These advantages include, among other things, improved audit quality and acceptance, continued and increased cooperation amongst regulators, and a decrease in financial scandals (ICAEW, 2010)

### **Conceptual Framework**

The International Standard on Auditing (ISA) 315 (Revised) on risk identification and assessment requires auditors to obtain an understanding of industry, regulatory and other external factors that affect the audited entity. This includes the regulatory environment, but the standard limits its scope to the general considerations like culture, behavior, or the degree of corruption associated with countries. Literally, it means that in order to ensure consistency in auditing quality, auditors must be sensitive to the audit risks that arise as a result of national variations, reflecting on how these differences are currently addressed in international standards and in practice. The user of financial statements expects high-quality auditing to receive an audit report that provides assurance in reported data as well as the fairness in the presentation of the report.

The focus on this paper will be in political, economic, business environment, legal and culture. Hence, the conceptual framework depicted in figure 1 below is designed to clearly define the relationship on how the differences in national environments present a barrier in achieving auditing quality.



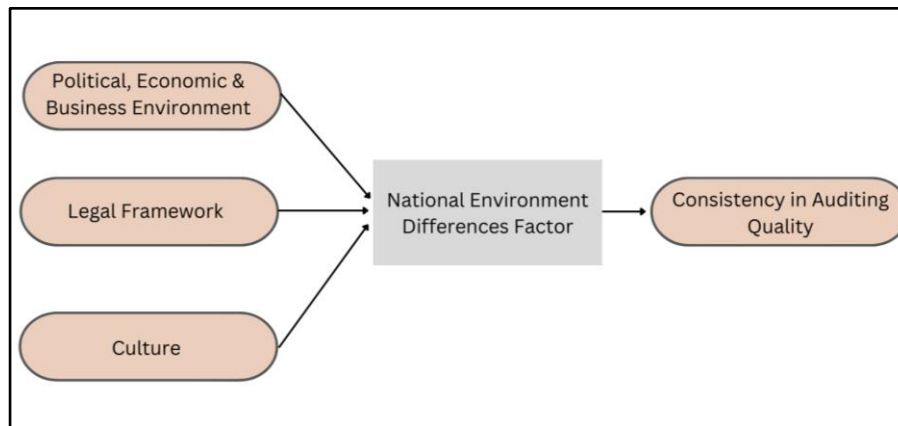


Figure 1: The Proposed Conceptual Framework

These factors give a challenge to auditors since they might result in bad outcomes if the auditor is unfamiliar and lacks expertise in the related issue. Furthermore, certain nations may have problems in implementing international audit and assurance standards due to cultural assumptions that differ from those inherent in the standards to be adopted. As a result, some practitioners may require assistance in interpreting the auditing standards. In contrast, if all these factors are handled properly in a recommended way, the objective of the auditing can be achieved despite the fact that it requires auditing across the national boundaries, hence contributing to the consistency in delivering quality auditing.

### Recommendations

According to the factors discussed earlier, legal framework, culture, political, economic & business environment have challenged the auditors in providing quality auditing. In order to respond to the difference of national environments, the national professional accounting bodies, regulators, standard-setters, governments, national and international institutions are responsible to expand the understanding and sharing practical experience and knowledge over audit firms. A clear understanding of national differences helps auditors to be aware of the challenges raised as well as their influences on the audit. For example, in several countries, locally organized networking groups together with audit firms from various sizes to discuss the current auditing problems. There is room to expand on these communication methods at the national level which is through professional accounting bodies whereby it allows members with different levels of international expertise to exchange ideas and concerns. This approach could enhance the auditor's knowledge and skills required in achieving audit quality internationally (ICAEW, 2010).

After establishing the sharing experience platform, auditors and standard-setters have to respond effectively to the audit problems that occur from national differences, considering how these differences are currently discussed in international standards and where improvements can be made. International standards should be more focused on how national differences impact the audit risk. The application and other explanatory information in ISAs should be expanded to increase awareness of obstacles that certain aspects of national environments may cause to auditors. It might involve revising the application and other explanatory information in ISA 315 to address the broader factors which are countries' culture and behavior that have not been discussed in the existing standard. It will help the auditors to react immediately to specific circumstances and enhance the audit quality (ICAEW, 2010).

## Conclusions

Our main purpose of the study is to highlight and spread awareness the problems arise from national difference and the recommendation solutions for auditors in providing consistent audit quality. It is based on a thorough detailed study. Based on ICAEW (2010), the existing standard has not discussed this issue broadly and more research is required for the audit firms to have a better understanding and face the challenges from multinational companies when performing transnational audit. We have discovered that most countries in the world have implemented the International Standards on Auditing (ISAs) however some have not done so, instead deciding to implement auditing rules established locally. Furthermore, several countries adopt ISAs that have been updated. Meaning that, a different auditing framework will be used in auditing some parts of group financial statements. As a result, the audit procedures within the group are inconsistent and there is a possibility the overall audit quality is lower. Thus, the study suggests the audit firms keep updating and improving the skills and knowledge of auditors.

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